

FINANCIAL REVIEW

NSW a crucial test of reform future

Mike Baird is a young, personable and principled but pragmatic politician – a contrast to the pugnaciousness of the ousted Campbell Newman in Queensland or the overt social conservatism of Tony Abbott. But the NSW Premier is taking on the same opposition to leasing out the state-owned electricity distribution networks on which Mr Newman's first-term government crashed and burned. That has made the looming NSW election a test of whether the nation can make the adjustments necessary to secure our high point of prosperity.

If Mr Baird wins on March 28, it will trigger the biggest infrastructure spending program in the country's history, able to do some of the economic heavy lifting for the nation as a whole, as he told *The Australian Financial Review* on Thursday in the most substantial media interview of the state election campaign. If he loses, the state will take a step back along with Victoria and debt-burdened Queensland, both of which are unwinding their growth plans.

Few outside the Labor Party and its union backers still argue that the state's poles and wires are best owned by government, or that selling them would increase voters' electricity bills. But Mr Baird has to persuade a public that is still sceptical of big changes, and which is being bombarded with a union-funded campaign that will stoop to crude dog-whistling on Chinese power investment. As reporting by the *Financial Review* has stressed, the Labor opposition and union claims that power prices will surely rise under this form of privatisation are nonsense. The network's are subject to price regulation. And the Australian Energy Regulator has ruled that the NSW networks must cut their prices by 20 to 30 per cent over the next five years, whoever owns or operates them.

But Mr Baird is not helped by banana skins, such as a hastily withdrawn UBS research note this week which examined only the negatives for the state budget in lost dividends from state-owned network companies while overlooking the positives in new underlying growth and reinvestment. Or by his Nationals

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coalition partners, who are happy to take the gains of the sale but have undercut the logic by keeping regional networks out of it. Yet the Premier argues – as UBS now acknowledges – that a \$30 billion boost to NSW gross state product over the next 20 years, identified by Deloitte Access Economics from the recycling of the privatisation proceeds into road and rail infrastructure, would more than compensate for the loss of half the dividends from the power networks and their loss to the state budget.

In the end, multiple studies have shown that the government-owned power networks are feather-bedded. Private operators are better placed than governments to drive efficiencies and innovation. So private operators are prepared to pay more for the right to operate the networks than bureaucrats can return in ongoing dividends. The state government economy and, one way or another, the state budget would benefit from this. And improving road and rail infrastructure is one of the keys to helping young Sydneysiders break into Australia's most expensive housing market.

Mr Baird goes to the polls with more than a state at stake. Tony Abbott is in trouble after less than two years in office. First-term Coalition governments have been rejected in both Victoria and Queensland.

Across the Tasman, two-time conservative election winner John Key provides a model for continuous policy reform that does not scare voters but which delivers results – with economic growth higher and a budget deficit and jobless rate lower than in Australia.

The NSW poll is a referendum on whether Australia's political process, under the right leadership, can still deliver the sort of policy changes that helped generate our modern prosperity.

From the Gallery

David Rowe



What governments should own

Asset sales The government might pay for many activities, but does it have to own them as well? It is possible to make an argument in some cases – but none apply to electricity poles and wires.



Richard Holden

In the wake of the Queensland state election, and in the run-up to the election in NSW privatisation is, again, a hot topic.

Predictably, Labor is running a scare campaign that makes Henny Penny look like an optimist. If we privatise electricity distribution in NSW then not only will the sky fall in but the ground on which we walk will be in trouble, too. We will rue the day we deemed to discuss it. The Liberal party is no slouch in the scare stakes either: privatisation is so obviously right that we'll tie building roads and basic infrastructure to it. No sell the poles and wires, no good stuff. I'm not so sure.

There are sensible arguments on both sides of the privatisation debate. We just haven't heard them yet. So here goes.

Most people would agree with the following statement: there are some things that government should pay for – national defence, primary and secondary education, and basic healthcare.

But what should government own? After all, we could give students (or their parents) a voucher for education primary and secondary education. The same goes for healthcare. Just because government should pay for some stuff doesn't mean they should own it. Yet sometimes government should not just pay for things, it should own them, too. Not often, but sometimes. And it's useful to understand when and why. The most insightful example is prisons – as Harvard economists Oliver Hart and Andrei Shleifer pointed out in 1997, along with Robert Vishny of the University of Chicago, in a now classic academic paper in the world's oldest and most highly regarded economics journal: *The Quarterly Journal of Economics*.

Imagine privatising a prison. The downside of public ownership is that the warden who runs the prison has terribly weak incentives to cut costs and find efficiencies. In contrast, private ownership will provide strong incentives for cost reduction because the private provider gets all the benefit of cost reductions. But if quality – such as how prisoners are treated and what rehabilitation services are provided – is hard to describe in a contract then these incentives might be too strong. Private prisons could cut costs by providing substandard treatment and insufficient rehabilitation services.

This is hard to dismiss as ivory-tower academic waffle. There's plenty of evidence about how privatised prisons treat prisoners. And it ain't pretty.

In a world of perfect foresight and perfect

contracts none of this would matter. But in the real world there is a trade-off. Private ownership provides big incentives for cost cutting, but it typically comes at the expense of quality. Public ownership provides weak incentives across the board. The key question is how hard it is to contract on what the government wants from a private provider.

The public debate that I listen to right now involves pretty silly arguments on both sides. On the left: "These are essential services" – subtext: "I wish the government could run everything, but we've lost that fight, and this is the last asset standing." On the right: "Business is more efficient than government" – subtext: "I don't trust public-sector-types to run a bath, let alone a \$20 billion business."

The key in all of this is that privatised entities will respond to incentives – they will

Privatising these assets is neither right nor wrong. It's just efficient and sensible.

cut costs. But experience teaches us that they will cut costs across the board, and there are some things we, as a society, want more rather than less of. "Quality" and "innovation" are chief among those things.

So what about poles and wires in NSW? To make a serious case against privatisation requires pointing to big issues that the government cannot contract on in the process. It's hard to see what those might be. This is a simple business with easily measurable outputs. We all know what quality electricity provision means and the technology is well understood. Privatisation would provide incentives for cost reduction and free up much-needed capital for the state government.

Government should own things when, and only when, it is hard to describe what "quality provision" means and hence residual rights of control are important. Poles and wires in NSW is not such a case. Both sides of politics would do well to drop the ideological pronouncements and get pragmatic.

The NSW government has no business being in the electricity business.

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