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High cost of fairy floss policies

HENRY ERGAS THE AUSTRALIAN JULY 29, 2013 12:00AM



Illustration: Eric Lobbecke Source: TheAustralian

ALWAYS keen to play the blame game, Kevin Rudd claims Labor's climate change policies are not "the primary reason for the hike in electricity prices"; rather, the hike is due to "excessive rates of return for publicly owned transmission and distribution utilities which have become cash cows for various state and territory governments". That is not just incorrect; it misleads the public about the cost of Rudd's policies.

It is true that allowed rates of return for both publicly and privately owned electricity utilities increased after the global financial crisis made investors more risk averse. But it was not state governments that were to blame. Rather, independent regulators decided higher returns were needed to attract investment. Painful though those increases have been, they are temporary: as financial market conditions improve, regulated returns will fall, and electricity prices with them.

That is not the case for climate change policies, for it is impossible to slash carbon emissions without substantial, steadily rising costs. Yet Rudd has never flinched from the "far-reaching" emissions cuts he called for in 2007. Treasury's carbon tax modelling spells out the price of those cuts: even on its optimistic assumptions, cutting domestic emissions reduces gross domestic product by \$115 per tonne from now to 2020, with costs as high as \$158 per tonne this year.

Little wonder then that in Queensland, Labor's climate change policies already account for 20 per cent of the average household's power bill.

When the Newman government was elected in March last year, those costs were projected to increase to an annual \$621 per household by 2015-16, thanks not only to the carbon tax but to the renewable energy target (which will transfer \$300 over the next three years from each household to the rent-seekers in the renewable energy industry) and also to contracts Anna Bligh entered into which pay five times more for power from solar panels than it is worth.

Rudd's proposed changes to the carbon tax will do nothing to stop those increases in the longer run. Sure, their immediate effect may be that carbon prices will fall to EU levels; but at those low prices there will be virtually no reductions in Australia's emissions. If Rudd genuinely wants to make the domestic emissions reductions Treasury modelled, the lower carbon prices will have to be very short-lived.

In fact, Treasury's modelling implies that after falling to \$7, permit prices will need to rise to \$50 per tonne (in 2010 dollars) by 2030, almost doubling wholesale electricity costs compared to their levels without a carbon price.

So Rudd faces a choice, and voters do too: low electricity prices or deep cuts in Australian emissions. Yet Rudd pretends he can have his cake, eat it and give it to his green-minded friends.

Where that refusal to recognise costs leads is all too clear. The stringent electricity reliability standards the NSW and Queensland Labor governments mandated in 2004 are a case in point. A political fix in response to increased brown-outs, those standards' impacts were scarcely assessed, much less adequately disclosed; but they ultimately required \$2.75 billion in capital expenditure in NSW, while capital expenditure on electricity networks in Queensland has had to double.

Yes, reliability has improved, but studies show the benefits to consumers are worth barely 30 per cent of the costs incurred to achieve them.

The Newman government has now shifted to more cost-effective ways of ensuring network reliability, with an expert panel concluding that the measures could save more than \$3bn in the next three years. Unfortunately, however, the bulk of the investments have already been made and their costs will weigh on consumers for decades, with the average household's annual power bill \$200 higher than it would need to be.

Exactly the same outcome seems likely from Labor's National Broadband Network.

Decided by Rudd and Stephen Conroy on a flight between Melbourne and Brisbane, the NBN helps ensure that Australia, along with Japan, is the only advanced economy that the McKinsey Global Institute recently concluded spends more than it should on infrastructure.

With costs exceeding benefits by more than \$20bn, productivity in the economy as a whole must drop as the NBN absorbs resources that could be more efficiently used elsewhere.

Indeed, each \$10bn wastefully invested in the NBN makes us some \$14bn worse off. And who will pay for the inefficiencies is no mystery. As Conroy himself insisted just days before resigning, "it's going to be paid for by users", with Telstra estimating that network charges, after falling for two decades in real terms, will have to rise fourfold over the next 15 years.

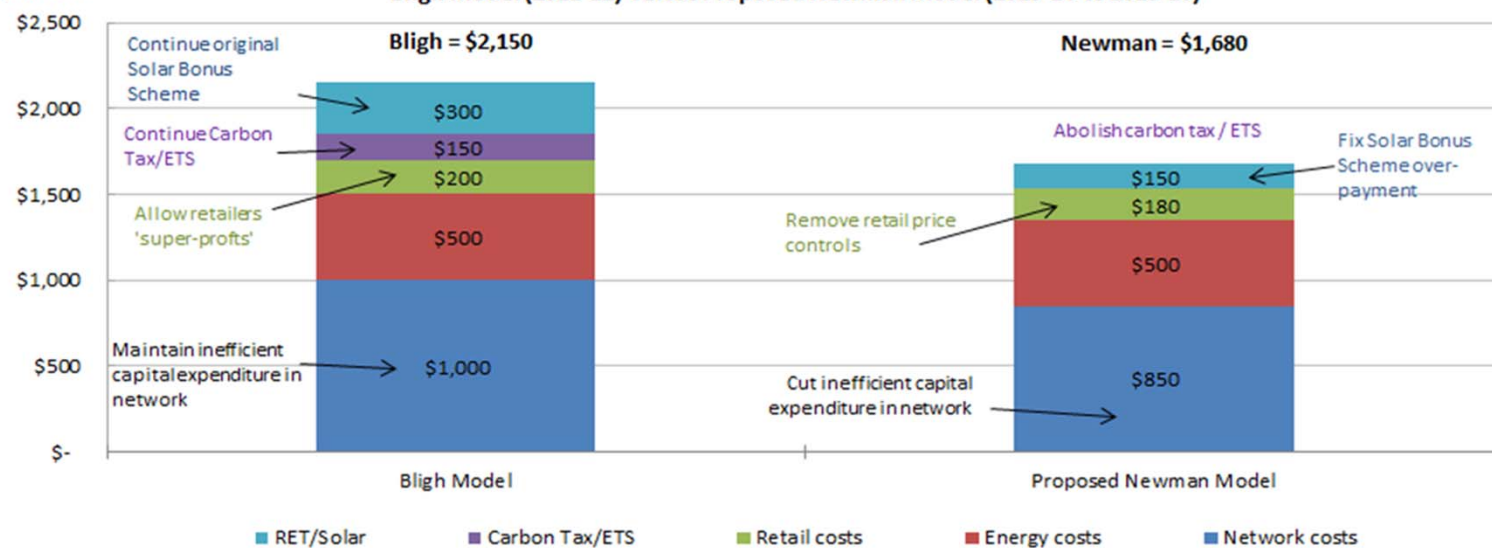
But Rudd continues to claim that broadband bills won't go up. Just as he claims he can deliver both cheap power and tough action on climate change. And just as he claimed school halls could be built, and pink batts installed, without enduring costs.

In the real world, however, there are no free lunches. Bob Hawke and Paul Keating knew that, as did John Howard; and they even had the courage to face voters with tough decisions.

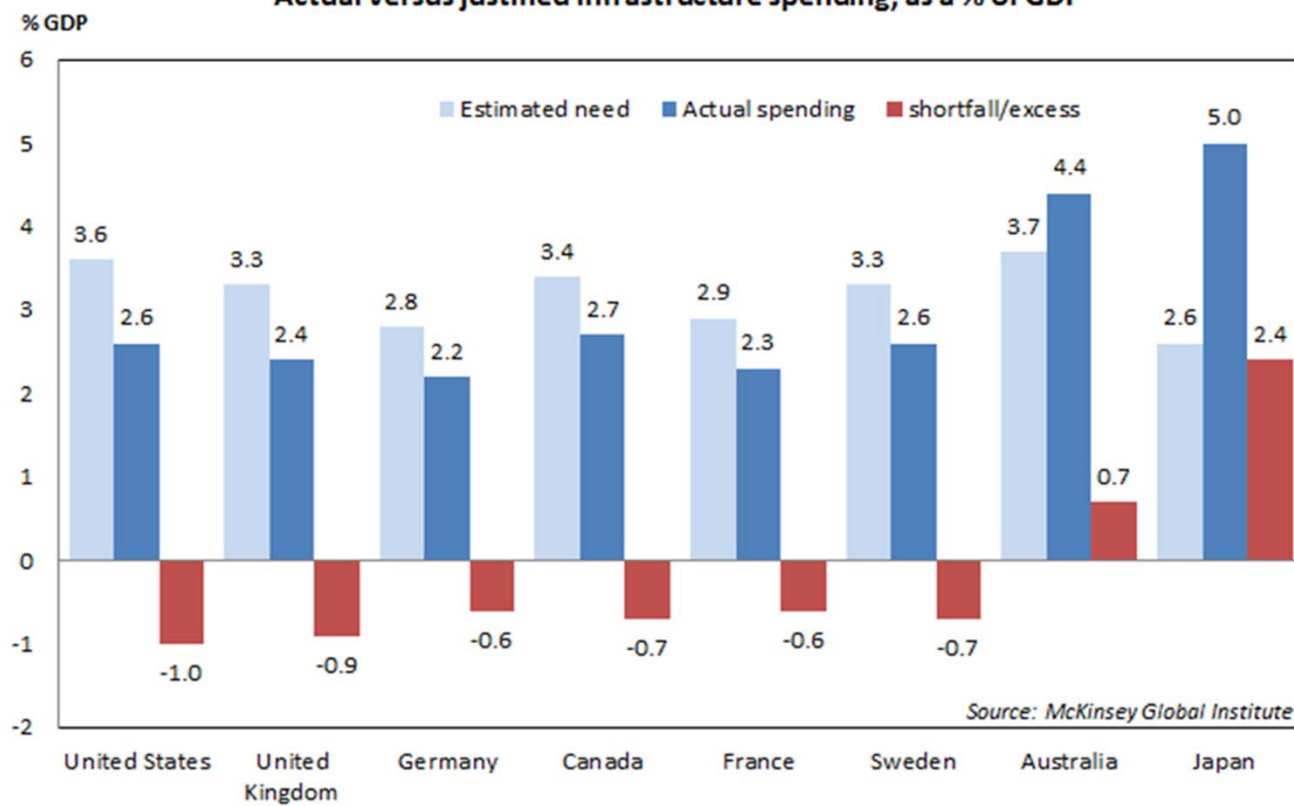
But the magus of Nambour is made of different stuff: he offers not choice and consequence but fantasy and fairy floss. Yet when the party is over, it is consumers and taxpayers who will be left with a toothache that just won't go away; and no amount of blame-shifting will make it any less painful.

Annual bill
\$2013-14

Retail Electricity Annual Household Bill, Queensland, Bligh Model (2011-12) versus Proposed Newman Model (2013-14 to 2015-16)



Actual versus justified infrastructure spending, as a % of GDP



\$2013

Rudd's Domestic Carbon Price Path (\$2013)

