

## SUBMISSION TO PANEL ON DRAFT REPORT

### General Comments

1. The Panel, and the Secretariat, are to be congratulated on the preparation of a draft report that brings together much of the recent history of the electricity industry in Tasmania in an accurate and sensible way. In particular, the graphics are outstanding.
2. The effort by the Panel to gain community views and to try to consult with the community is considered to have been very good. It is to be hoped that the final report actually reflects the feedback received on the draft report.

### Comments related to dealing with the provided Terms of Reference

3. In relation to the terms of reference (tor), it is considered that insufficient attention has been given to tor 6. It is considered that more should be included in the final report about the impact of the carbon tax and why, according to figures presented, the Panel expects electricity prices to rise in Tasmania to a level not dissimilar to those on the mainland – despite the very high percentage of renewable energy (mainly hydro but also some wind) produced in Tasmania.
4. In relation to the terms of reference (tor), it is considered that insufficient attention has been given to tor 7. This tor focuses on a stated “Government primary objective” to “minimise the cost of living in Tasmania”. The Panel should indicate that the primary mechanism to do this is to ensure that the producer surplus available is as large as possible via pursuit of production efficiencies and that actions are taken that ensures that most of this surplus stays in Tasmania. It should also be clearly stated that any kind of hidden or indeed any explicit subsidy to actually “reduce the cost of living” can be, in the end, to the detriment of most Tasmanians.
5. Again, in relation to the terms of reference (tor), it is considered that insufficient attention has been given to tor 7. This tor requires attention to be given to Tasmania’s “long terms energy sustainability” – and not its electricity sustainability. The point should be made that there is no current threat to Tasmania’s energy sustainability due to it already having electricity energy supplies far greater than required by the domestic population and sustainable industries and also access to extensive amounts of gas in Bass Strait. There is also the possibility of more wind, wave and hot rocks energy. At the risk of disappointing some of the “peak oil” advocates, some common sense observations about the potential to substitute other energy forms for oil would also be very useful in informing the local community.
6. Still in relation to the terms of reference (tor), it is considered that insufficient attention has been given to tor 9. Already the Panel has added considerably to the stock of sensible knowledge by some minor diversions in relation to what might be described as “good public policy”. Given the expertise in the Panel, and the terrible state of public policy appreciation in Tasmania generally,

some more observations insofar as they relate to energy policy would be helpful. In particular, it is considered most desirable that the Panel make the point that increased “utility”<sup>1</sup> for Tasmanians should be the goal, and a description of the concept, would be useful – as against the pursuit of competition as an end in itself.

7. Otherwise, it is considered that the tor have been pretty well covered.

#### Comments on the Key Findings shown in the Draft Report

8. As a general observation, it is considered that the “key findings” identified are supported by analysis in the draft report. However, there are a few comments that it is considered should be made.
9. The third dot point (in the section on “competition”) purports to say that the mere lack of presence of major mainland retailers means that Tasmanians will be worse off – as “choice for households and small business will be stymied”. With great respect to the Panel, the evidence is far from clear, both theoretically and practically, that Tasmanians will be worse off simply because “major national retailers” are not present in Tasmania. In addition, it is submitted that it is, as also stated by the Panel in this dot point, far from clear or proven that “effective customer choice’ will “unlock” considerable extra surplus as postulated by the Panel. And if the modelling work commissioned is supposed to be the evidence for this, it is far from clear that the assumptions underlying this modelling can be relied upon. It is beyond doubt that there is considerable uncertainty about the amount of any such savings actually able to be “unlocked” for the “benefit” of Tasmanians.
10. It is correct, as is noted in the Panel’s dot point 4, that three options for increasing competition are identified. It is less clear as to whether they could be correctly termed, as the Panel does in the draft report, “reform paths”. It would be more useful for the Panel to specifically identify some “reform paths” as a group of reforms rather than just some options to increase what appears to be primarily increased wholesale level of competition in the Tasmanian electricity market.
11. It is perhaps also worth making a comment about retail competition at this juncture of the “key findings”. Elsewhere in the substance of the draft report, great stock is made of the benefits of introducing “full contestability” at the retail level. Whilst no comment is made by the Panel about this proposal in this “key findings” section, it is considered that the case is far from made out by the Panel for full contestability in the main part of the report – the conclusion is presented as basically being self evident. It is considered that it is far from self evident that a movement to full contestability is warranted in the Tasmanian market. It is also considered that the Panel should produce some kind of robust cost benefit justification in support of this contention. It is this observer’s view that such an assessment is unlikely to be able to demonstrate that the benefits of “full contestability” exceed the costs. Yes there are some benefits – but what about the costs – which are considered to be not only direct – but also indirect – and substantial in total - when

compared to the minor amount of identified benefits ! It is also considered that the benefits identified are NOT “conservative” as characterised by the Panel. Having said that, some further movement towards contestability may well be warranted.

12. In relation to “key findings” under the sub heading of “price setting framework”, it is agreed that “the arrangements” should reflect “current and prospective supply-demand balances” – provided this just means that demand and supply forces should operate BUT it is of concern that the “finding” only relates to “non contestable customers”. Is the Panel assuming that if there is contestability, there is automatic interaction or some kind of equilibrium of supply and demand ? If so, the question must be raised as to the “supply and demand balances” in which market(s) ? If the market is Tasmania, then there MUST be consideration of the fact that if (when) one large major industrial customer leaves Tasmania, the supply demand balance will change dramatically ! This should be carefully and robustly examined and assessed by the Panel – as it is almost the “elephant in the room” issue when considering the future energy demand in Tasmania.
13. Further, in relation to “key findings” under the sub heading of “price setting framework”, it is considered that a point or two should be made about the extensive regulatory processes in place for price setting certain elements. In particular, it should be made clear that the price setting framework – such as for transmission – is NOT simply at present a free for all by the private sector or monopoly gouging by the government.
14. It is also considered that the actions of the Parliament, the Treasurer and the Tasmanian Electricity Regulator (TER) should be examined in more detail – both in the main report and in this “key findings” section. For instance, this author considers that not many in the general population (and perhaps even many politicians) understand the power that has been granted to the Government of the day, via the Treasurer of the day, to influence the way that the TER does its job in relation to the setting electricity prices. Secondly, many people would be unaware of the financial consequences of the Government of the day instructing a wholly owned company to enter into financial obligations of over \$300M (to buy the Tamar Valley Power Station) – without any reference to Parliament whatsoever. The ability of the Government of the day to do this without ANY examination by the Parliament or public scrutiny is considered to be a serious governance problem. This is so – especially when contrasted with the fact that small capital works projects proposed by the Government of the day are required to be examined by a special Public Works Committee of the Tasmanian Parliament before they can receive funding or proceed.
15. In relation to “key findings” about “Basslink”, it is considered that the statement that “customers are not paying for Basslink through their electricity prices” is a bit broad and not exactly correct. It is considered that there was certainly some influence on the net position of regulated customers during the drought of the late 1990s – especially via the general taxpayer - if not regulated customers as a group. The other “key findings’ relating to Basslink

are considered to accurate and informative. In addition, a considerable public service has been done by the Panel in pointing out that the existence of Basslink effectively stopped the lights going out in Tasmania and/or avoided a very large increase in generation costs – during the latter stages of the extensive drought in the last decade.

16. In relation to “key findings” about the “TVPS”, it is considered that the commentary in the summary and the substance of the draft report underestimates the cost of the folly. In fact the purchase price was way over the market price – and the consultants responsible should not be saddled with the whole blame. There should also be some clearer recognition of the fact that this purchase was NOT necessary for so called drought risk mitigation - as there was already in place back up arrangements IN ADDITION to Basslink. These were the old Bell Bay Power Station and the then recently purchased gas turbines and load shedding agreements. The effective cost of this folly must also include the costs of scrapping the old Bell Bay Power Station and the new gas turbines. What happened to them ??? It is considered that the Panel could examine in even more detail how and why such a folly occurred – notwithstanding the detail currently provided in the supplementary report on the TVPS. And some starker comment of the governance and public policy shortcomings of being able to commit so much taxpayer funds without any external public review of the financial consequences would be useful.
17. In relation to “key findings” about “governance”, the Panel’s views are insightful and consequently valuable. It is relevant to note that it is not expected that an Auditor General (AG) investigation would shed much light on efficiency or risk management problems with a SOC – as its charter is more one of discovering defalcation and accounting convention anomalies rather than an examination of “good practice principles”. It is not a criticism – just a fact – that the Tasmanian AG simply does not have the experience necessary to offer robust observations on efficiencies or managerial decision making or debt to equity relationships in a changing and dynamic energy sector. There is also an opportunity for the Panel’s observations on this issue to be much more forthright and clear – as the ones made tend to be “holding back” from well justified criticism.
18. It is considered that at least two issues should be expanded upon. The first is the need for more regular disclosure, the need for more complete disclosure, the inability for the Parliament to enquire, (as representative of the owner) given the “commercial in confidence “ argument and the limited descriptive detail and KPIs presented. The Panel notes a number of submissions were made on these issues yet it virtually dismisses them without a rational justification. The second is the virtual non existence of the expertise to sensibly examine any such material provided – and act on it. It is mistake to assume that the Treasury or another government agency in a small State such as Tasmania, has or can maintain the expertise to assess the information for the “shareholder” who is each and every Tasmanian. It is however noted that the Panel has identified the fact the Government of the day (in Tasmania and elsewhere) normally has a vested interest in NOT disclosing shortcomings rather than highlighting them. In fact there is no “shareholder s association”

for the taxpayer owner – for this or most other government owned entities. Notwithstanding this, it is a fact that more disclosure is generally better than less – a bit like the threat of competition is better than none.

It is interesting to record that a Tasmanian Legislative Council specialist Committee dedicated to finding the truth and with an independent perspective (as distinct from a political party perspective), has been more successful and effective (but was still not able to get the whole truth) in getting to the bottom of the financial performance and business activities of a Government owned business operating in the Tasmanian forestry industry than any Auditor General, other public servant, Minister of the Crown, Lower House Parliamentary Committee, observer, employee or consultant. Accordingly, the Panel could do far worse than recommend the enacting of special legislation that would:

- (a) require a written report from each of the State Owned Companies operating in the electricity industry in Tasmania, the Auditor General, the Electricity Regulator and the chief public servant involved in providing policy advice on the electricity industry in Tasmania - not less than two yearly - to both Houses of the Tasmanian Parliament on the recent past and their approach to the near future; and
- (b) require a joint committee of the Parliament to be formed to consider the reports – and receive comment from relevant observers – and call witnesses.

Whilst the Panel might, at first glance consider this proposal overkill, it is relevant to note that there exists a great deficit in understanding of electricity matters in the general Tasmanian population – notwithstanding its critical role in the past, present, and more than likely in the future, of the State. Furthermore, when one considers how the Treasurer of Tasmania can instruct the TER and how the Government can contract to spend hundreds of millions of dollars on taxpayers funds on new electricity assets without any reference to the Parliament, it is considered that there is justification for a much closer review of activities in the electricity industry by the Parliament of Tasmania. And the success of an “independent” Senate review process known as “Estimates Hearings” further demonstrates the value that can be derived and the “light that can be let in” from Parliamentary enquiry processes with significant numbers of intelligent Parliamentarians and a few good independents asking questions. (It is however specifically advised that the existing few hours of so called GBE hearings in Tasmania is largely a “side show” and is NOT an adequate mechanism for either “getting to the truth” or a detailed assessment of policy issues and financial performance.)

19. In relation to “key findings” about “electricity price trends”, the Panel’s views are generally factual and hence supported. However, there is great concern about the fourth dot point dealing with MI pricing. It is considered to be both unwise and a cop out for the Panel to say it “has seen no evidence” that retail electricity customers “are subsidising” MI customers. Firstly, “seen no evidence” tends to suggest that, as no-one provided any, the Panel could not

make a finding. Secondly, the word “subsidising” can mean many different things to different people. For instance to one person, it may mean simply (and legitimately), a pricing mechanism that only deals with marginal or avoidable costs for one customer and total costs for the other customer. To another it might mean a lesser purchase price even though the product is different. To still another, it might mean a hidden grant. (Unless further explanation is provided, the Panel’s “conclusion” can continue to be “abused” (these words in the draft report have already been misused) – which is not helpful to anyone - except perhaps the MI customers.)

The Panel has presented an assessment in the body of the draft report that explains why there should be a significant difference between the prices that “normal” residential customers pay and the price paid by a MI customer. And there is substance to the arguments presented. But the Panel has NOT presented any evidence, despite asserting that it has seen the actual contracts, that the full difference between approx 10 cents/kwh paid by some MIs and the close to 30 cents/kwh paid by residential customers can be explained by the different “product” being purchased plus some load shedding agreement which is basically in place in any “emergency” situation in any State and in most supply contracts with “act of God” provisions. Indeed, by way of evidence to the contrary, on page 6 of the separate Basslink report, the Panel appears to conclude that one of the benefits of Basslink was to “transition major industrial pricing to market related levels”. This means, for most people, that the then existing MI prices were not at market related levels – and to most people, this is evidence that there was a “subsidy” – meaning an effective transfer of funds from non MI customers to MI customers.

In addition, it is considered not only unusual but obnoxious, for electricity contracts for some MIs to be negotiated some 5 years in advance of expiry of the current contract and for a period of 10 years. Such behaviour certainly gives the MI concerned confidence about its future energy cost – but at what cost to the owner – ie the Tasmanian taxpayer ?

For instance, Rio Tinto – one of the MIs signed a contract with Hydro Tasmania in 2010 to purchase over 300MW of electricity – with the contract to start in 2015 and last for 11 years. This means that the contract is likely to have no incorporation of the “premium” for green energy post the carbon tax or be reflective of other dramatic pressures on electricity prices. Against this evidence, it flies in the face of reality for the Panel to maintain a view that residential and business taxpayers and/or the Tasmanian taxpayer are not “subsidising” at least one MI in the State.

There is absolutely no doubt that if large blocks of “green” electricity were auctioned, the Tasmanian taxpayer would receive a much higher net return than it currently receives from some of the large MI customers – and certainly what will be received from one of those over the next 10 years. It is also the case that locking up large blocks of power for some MIs in Tasmania at relatively low prices for long time periods is impeding structural reform and efficiency improvements in certain industries which are no longer large labour employers. In addition, the sale of electricity at substantially less than could be

derived from other customers is potentially impeding the development of new structural reform in the energy industry which might have large efficiency improvements – such as from the installation of a new Bass Strait interconnector or more high tech/labour intensive/electricity using industries in Tasmania. Put simply, there is an urgent need for the Panel to revisit this part of its analysis and to consider the counterfactual more broadly. For instance, considering there are only about 500 Tasmanians employed by Rio Tinto, (a very profitable multi national company), it is valid to ask the question: why is the electricity contract to operate between 2015 and 2025 very substantially supporting those 500 jobs and leading to a very substantial financial transfer out of Tasmania – particularly when the remaining Tasmanian taxpayers are required to “subsidise” the electricity costs of so many thousands of Tasmanians via “concessional” assistance ?

20. In relation to “key findings” about “electricity price trends”, the last dot point deals with future electricity prices for non-contestable customers. Part of the wording says that in future, regulated prices “will not be linked to changes in the wholesale market” but “will still reflect” the introduction of a carbon tax in Australia. This statement is far from obvious to the average reader – and the argument behind it is not well developed in the body of the draft report. It is suggested that both these perceived deficiencies be dealt with in the final report. In particular, it is far from clear why Tasmanian customers, who by and large will be purchasing renewable energy generated in Tasmania, should be paying for carbon emissions in their electricity prices at a quantum or percentage similar to mainland customers !
21. In relation to “key findings” about “the performance of the TESI”, the dot points made are generally considered to be factual and a useful summary. It is also considered appropriate to make the point that the consulting work done by consultants Wilson Cook is excellent – but far beyond what the AG could be expected to do - or indeed the average Treasury officer or energy policy analyst.
22. The observations by the Panel in the associated report are also excellent. In this regard, it is considered important that the Panel bring forward into the “key findings” some words similar to the following extracts from page 6 of the associated report. – “Overall, taking previous detailed regulatory determinations as the benchmark for efficiency, the Panel has not been able to conclude that regulated aspects of the SOEBs have been operating efficiently over the review period. The financial consequences of this have primarily been borne by taxpayers as owners of the businesses through lower returns, rather than by electricity customers through higher prices.” A statement that would be even more informative would be something like “there is still a considerable way to go before the arrangements on the ground could be said to be as efficient as broadly equivalent mainland organizations”. In this regard, it is postulated that a hydro based electricity system should be able to be significantly more efficient at the generating activity than a coal fired one.

The following conclusion from page 8 of the associated report is also considered worth restating in this “key findings” section; - “ it is important that these frameworks are regularly independently (of management) reviewed by either Boards or Shareholders to ensure that there remains strong alignment between the incentives faced by individual employees, management and the Board in driving outcomes that are consistent with regulatory requirements and Shareholder expectations.”

23. It is considered factually incorrect for the Panel to conclude that “poor returns” have been largely due to investments in “non-core business activities” (As an aside, the evidence presented in the draft report could justify a conclusion of financial returns as being “pretty awful” or “way below similar entities interstate” or “abysmal in comparison with other business averages”.) There is no cogent case developed in the draft report that supports this contention/conclusion. In fact, it is probably more accurate for the Panel to conclude that the “poor financial performance has been primarily due to the initial expense of implementing reforms and the effects of the drought which increased the average cost of production substantially. Remaining inefficiencies and investments in non-core business activities have also reduced the financial performance”.
  
24. It is considered there is an implicit “ key finding” that is not canvassed in the current summary in the draft report - and it should have its own dot point. This relates to the effective recommendation (No. 5) to sell the primarily retail business Aurora. It is submitted that there is virtually NO argument in the draft report that presents a robust case for the sale of the electricity retail business – or a large part of it – yet this conclusion is presented. It is one thing for the Panel to argue for greater competition at the retail level - it is quite another to promote the sale of a government owned business. If the purity of the current argument of the Panel that threats of competition or removing barriers to access to existing retailers on the mainland to the Tasmanian market are to be accepted, (which this writer does NOT), then there is no need for the sale of the existing business. In addition, as argued elsewhere in this submission, the sale of all or part of the existing retail business will just aid and abet the movement of profits (and more of the small amount of producer surplus – as well as jobs) out of Tasmania – to the overall detriment of Tasmania and Tasmanians. Electricity in Tasmania is NOT just another asset to be “cashed in” to provide a short term one off cash flow boost for the consolidated fund. There are a number of potentially strategic advantages to the State from it having a large position in the Tasmanian retail electricity industry. These include the comparative advantage of the State in renewable energy, the capacity for the market in Tasmania to be “gamed” by other retailers, the very large percentage of concessional customers in the State, the very geographical dispersed population in the State and the relative overall smallness of the market and the need for economies of scale in administration. It is submitted that there is no coherent argument stated at this stage by the Panel for the sale of Aurora in the draft report – and accordingly, reference to this direction should be removed in the final Report.



25. It is also considered very important to include a new section in the “key findings” section called something like “recent progress”. It is a fact that there has been very large efficiency and other improvements in the electricity industry in Tasmania in the last decade. At the retail consumer level, there is a belief by many Tasmanians that the only result of the last decade of so called “reform” has been a big increase in electricity prices – and they have therefore concluded that if that is what “reform” brings to Tasmania, “we don’t want any more”. Many people, particularly elderly Tasmanians, believe that the split up of the old HEC has just meant 3 organisations rather than one with added overheads, extra board member fees and duplication – and higher levels of unemployment. And accordingly, to their way of thinking, any more bodies or companies in the electricity industry in Tasmania MUST mean greater inefficiencies and higher charges at a retail level. The facts are that IF the old HEC had remained with the old staff structures (and no separation into 3 bodies and the introduction of structural competition and greater transparency), the level of increases in electricity prices would have had to have been much higher and/or the level of dividends paid to the State Government to assist in the provision of other services by the consolidated fund would have been much lower. Some evidence to demonstrate this situation would be very useful in educating some in the Tasmanian public – and others. – about what has been achieved as a result of “reform” over the last 15 years.
26. In relation to “key recommendation” 1, it is submitted that it is not clear what is being recommended. Firstly, is it being proposed that the existing special legislation to have the Treasurer direct the way the Electricity Regulator performs its task be expanded further or used to further restrict some price signal ? Secondly what does “the prevailing and prospective supply- demand balance” actually mean ?. For instance, one interpretation is that future price settings should “reflect” the fact that there will a shutdown of a major MI in the next few years and a transition strategy should be considered – such as setting aside funding for a new Bass Strait interconnector ! Further clarification is required and needs to be supported by coherent argument.
27. In relation to “key recommendation” 2, there is little guidance provided by the Panel about what they consider is an appropriate way of achieving the recommendation. It is submitted that there are many way of achieving this recommendation – some with potential very serious consequences – and some less so. Unless there is an expression of what the Panel perceives as a sensible approach, there could well be great difficulty in supporting this recommendation. In particular, as outlined by some at the discussion session on 2 February 2012, it would be extremely helpful if the Panel would articulate its view as to the main options and its preferred one and why, in relation to achieving a fair and equitable allocation of drought risk premium across the customer base.
28. In relation to “key recommendation” 3 in the draft report, as currently drafted there is broad scope for a stakeholder to say that the Panel proposes this “reform” or that “reform” – because none is specifically stated at this point. As stated earlier, this author believes that competition is not and should not be an

end in itself. Accordingly, this author asserts that particular reforms that are specifically identified by the Panel be implemented to increase competitive pressures ONLY IF the Panel can confidently demonstrate via a cost benefit analysis that the benefits significantly exceed the costs -with reasonable levels of confidence.

29. There is strong opposition to “key recommendation” 4 by this author. This opposition is for a number of reasons – some of which have already been canvassed above. The first is that it is considered that the benefits of so doing will not exceed the costs. Secondly, it is considered that astute retailers from the mainland will “cherry pick” the Tasmanian market and leave the State Government with an even higher burden of social welfare in lowering the costs of electricity to the large numbers of less fortunate in the State. Thirdly, it is submitted that full contestability will just accelerate the profits from the electricity industry leaving the State – with consequential detriment to those Tasmanians left in the State. Accordingly, it is believed that this recommendation should not be in the final report.
30. In relation to “key recommendation” 5, as stated above, it is considered that there is no justification thus far presented for the sale of all or part of the existing primary retailer. Indeed. It is considered that in the current state of flux as to the effect of the carbon tax and the future pricing of renewables in Australia, there is a strong likelihood, given the extensive expertise elsewhere in the world for negotiating such acquisitions and the relative inexperience of the Tasmanian Government operatives and advisers, there is a high risk that the State will be worse off from any such transaction – rather than better off. Accordingly, it is believed that this recommendation should be deleted from the final report.
31. “Key recommendations ” 6 and 7 are strongly supported. As previously stated in this submission, the Panel has done public policy debate a great service by articulating its views on this very under considered area.
32. As the Panel was given latitude in its terms of reference to reflect on other matters “relevant”, it is submitted that the Panel could make some suggestions/conclusions/ recommendations on the following:
  - (a) the opportunity for gas to supplement /complement the energy industry in Tasmania . The relative poor performance thus far in retail gas penetration (and the reasons for this) should also be commented on – and hopefully explained. This is especially important when the gas market in Tasmania has the capacity for competition at the retail level but the “invisible hand” seems to have concluded that it is not worthwhile to do so !;
  - (b) the opportunities currently going begging in terms of potential green energy users who would be prepared to pay much higher prices than the MIs currently pay but find it difficult to survive on the existing and projected Tasmanian retail price of electricity;

- (c) the opportunities to rejig the current arrangements which have an inbuilt detrimental bias against Tasmania with its very high proportion of renewable energy. (These biases include the way the NEM was set up and operates and the rebate arrangements under the carbon tax.)
- (d) the opportunities for expansion of major or minor hydro generation in Tasmania – including new energy storage technologies;
- (e) the quantum of the extra electricity coming from a decision to proceed with construction of the Musselroe wind farm – and the impact of this as a new and independent generator in the State;
- (f) the likely quantum of new electricity generation from the construction of a Bell Bay pulp mill (should it be built) – and the strategic impact of this as a new and independent generator in the State;
- (g) the opportunities for wave energy generation and other renewable energy generation in the State and the likely relative costs of their production at current technology levels;
- (h) the opportunities, if any and the practicalities of using electricity powered vehicles rather than petroleum products – when the electricity primarily comes from a hydro system such as in Tasmania.

33. Lastly, by way of comments on the draft report, it is considered important to draw to the attention of the Panel a few other matters:

- (a) Hindsight is a wonderful thing. The Panel, like other observers, is looking backwards - as well as forwards. It is always easier to be confident about observations in hindsight ! It is very probable that many who made decisions in the past, which have proven to be less than ideal or wrong – actually made those decisions believing that they were doing the best thing for Tasmania.
- (b) The Panel has placed some significant reliance on the regional modelling work done by the Centre of Policy Studies at Monash University. With great respect to the constructors of those regional models, experience has shown those models to be notoriously unreliable predictors of resource flows and GSP changes when the model is applied to a small regional area and particular one such as Tasmania that has some peculiar characteristics. Accordingly, it is submitted that the “results” of the modelling work done by Monash cannot be relied upon and to do so would mean the taking on of some very high risks – where the risk premium is simply not sufficient.
- (c) The extent of the producer surplus from the Tasmanian electricity industry is very small – particularly if the “pensioner concession” is deducted from the surplus. Accordingly, it is submitted that the emphasis on pursuing competition initiatives that are expensive to implement when the surplus is so small cannot be justified on either

traditional cost benefit analysis or more detailed behavioural economic utility analysis;

- (d) “Normal” competition principles simply do not work when there is a very distorted market as exists in electricity in Tasmania. Some of these “distortions” are:
- (i) the existence of a single constrained interconnector;
  - (ii) the existence of a non independently owned interconnector;
  - (iii) about 50% of supply tied up MI contracts;
  - (iv) the dominance of renewable energy in the market;
  - (v) the dominance of hydro renewables and the interconnectedness of the supporting dams;
  - (vi) the additional objectives of most hydro schemes in terms of wilderness “protection” or irrigation facilitation;
  - (vii) the problems caused by a very dispersed customer base;
  - (viii) the constraints imposed by low voltage interconnections across the State which limit the capacity of electron movement (and will deliver problems akin to being experienced by new solar generators on the mainland) etc.
- (e) The modelling work done by Frontier Economics also suffers from assumptions problems – which render the results with a degree of inaccuracy and risk which needs to be more explicitly recognised. Again the assumptions about free movement of resources to increase overall Australian efficiency are considered to be inappropriate when applied to the unique Tasmanian situation – and do not have the “Tasmanian economy” as the ring-fenced “economy” being assessed.
- (f) Whilst the attraction of the virtues of the “invisible hand” by the Chairman of the Panel at the 2 February discussion are understood, as is the simplicity of the assessment in neo classical theory, the fact is that many markets do not perform as the theory would suggest – particularly in small and isolated markets – like what is the case in Tasmania. The Panel is reminded that “unintended consequences” are regularly identified in ex post facto assessments – and Tasmania should NOT be made to suffer from unbridled pursuit of an increasingly proven deficient ideology.
- (g) The “unintended consequences” of some electricity disaggregations in the name of “competition” are now apparent in other States – leading to current serious consideration of re-aggregating electricity entities in Queensland, Western Australia and NSW.

## Conclusion

The substance of the draft report has some very good elements – however, a number of the recommendations do not easily or factually flow from the analysis presented and in some cases, the assumptions or modelling on which they are based are not valid.

Accordingly, the final report should reflect careful and thoughtful consideration of the matters and issues identified above.

Prepared by Peter Brownscombe  
Senior Consultant

JND Pty Ltd

Hobart February 2012

<sup>1</sup> In this context, utility is to be interpreted as per the broader concept used by behavioural economists. See “An Introduction to Behavioral Economics” by Nick Wilkinson published by Palgrave Macmillan, Great Britain 2008.

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