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Submission to Select Committee Inquiry into Privatisation of Public Services in South Australia

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Executive Summary

This submission focuses on the impact of privatisation on inequality, and in doing so distinguishes between privatisation which is an outsourcing (contracting out) of government services and one which is a full sale of a government assets and operations. The difference is important as they impact differently on inequality of income and wealth, although this submission does not take an a priori or ideological position for or against privatisation. Rather it puts forward 3 key propositions about how privatisation may increase inequality:

- That if, or to the extent that outsourcing of government services is based on cost savings due to lower labour costs outside of government, then that privatisation will increase income inequality;
- That, where privatisation results in returns to capital for the private corporation higher than the growth rate of the economy, then inequality will increase; and
- Where consumer expenditure patterns for a commodity are more regressive than the incidence of state taxes, then (if there is no decrease in prices) a privatisation of service provision will result in a more unequal outcome than direct government investment and service provision.

The extent to which one or more of these propositions apply to any particular privatisation will determine its impact on inequality. While this is an empirical question which will yield different outcomes for different examples of privatisation (or potential privatisation), the submission focuses on the privatisation of the electricity grid as a key exemplar of how this analysis can be done. And in that analysis, it clear that the privatisation of the electricity network (at least) has contributed to inequality.

However, the analysis also shows that the need for new investment and the re-shaping of the energy grid means that this question is not simply historical – an issue decided when the network was privatised. Nor is it simply an anachronistic call to re-nationalise energy production or distribution. Rather, it is a call to apply the methodology proposed here (along with broader analysis) to distinct parts of energy service provision and new capital investments to open up possibilities for government investment in discrete energy projects.

Again though, while there is a focus on electricity as a key case study, the situation is not the same for all government services.

Introduction

Thank you for the opportunity to provide a submission to the Select Committee's inquiry into the privatisation of public services in South Australia. SACOSS would be happy to provide further information or appear before the Committee to answer questions if requested.

The South Australian Council of Social Service (SACOSS) is the peak body for the non-government health and community services sector and we advocate for the interests of vulnerable and disadvantaged South Australians. In this capacity we seek to eliminate poverty, inequality and injustice. We bring these perspectives to the consideration of privatisation of public services in South Australia. The analysis in this submission also draws on the political economy research interests of the lead author, Dr Greg Ogle, and on the specific expertise of the SACOSS energy policy team whose research and advocacy is grant-funded by the Department of Energy and Mining.

This submission is limited solely to term of reference (d) "the effect on income and wealth inequality". This is not to suggest that inequality is the only or even the most important consideration in relation to privatisation of services, but focusing on it in isolation allows for a sharper focus on what is a key but often neglected issue.

This Inquiry's term of reference (d) also rightly refers to inequality of both income and wealth. The two are different, and ABS national data shows that only 35% of households in the lowest income quintile also have low wealth, while 23% have around average wealth. At the other end, 42% of the highest income households also have high wealth, meaning that the majority of households in the highest income quintile are not in the highest wealth quintile (ABS, 2019). However, the difference is also important in terms of this Committee's Inquiry because we will suggest that different dynamics associated with privatisation may impact differently on income inequality and wealth inequality.

The other issue around income and wealth inequality is time. While income inequality can generate significant wealth differentials over time (which then generates further income inequality), there are also broad questions of intergenerational inequality to be considered around privatisation of government services. When government assets are privatised, they are no longer available for future generations in the same way, although they may still benefit future generations (for instance, by government debt reduction, or by funding different investment). Further, in the privatisation of capital-intensive essential services like electricity, there are also issues around who bears the risks, costs or benefits of long-term capital investment. However, for the sake of simplicity, this submission focuses mainly on the more immediate impacts of privatisation on inequality.

In summary, this submission puts 3 propositions about the impact of privatisation on equality:

- That if, or to the extent that outsourcing of government services is based on cost savings due to lower labour costs outside of government, then that privatisation will increase income inequality;

- That, where privatisation results in returns to capital for the private corporation higher than the growth rate of the economy (in the case of electricity, a return largely mandated by regulation), then inequality will increase; and
- Where consumer expenditure patterns for a commodity are more regressive than the incidence of state taxes, then (if there is no decrease in prices) a privatisation of service provision will result in a more unequal outcome than direct government investment and service provision.

Definitions

Before addressing those issues though, it is necessary to distinguish between what we see as two different types of "privatisation":

- Outsourcing, where government services are provided under contract by a third party, but where government retains ownership of assets held prior to contracting of service (the service but not the assets are privatised); and
- Full privatisation, where a government business or service, including government assets, are sold to a third party which then operates the business as a private company (or organisation). [1]

Examples of outsourcing include contracting out a range of health and community services to charities and not-for-profit organisations, the outsourcing of the operation of Adelaide metro trains and of public housing maintenance in the recently announced tender. In many of these cases, the services were previously provided through government agencies, but those agencies have chosen to contract out the delivery of the same services, although government assets were not sold off. By contrast, the privatisation of electricity provision in South Australia saw the sale of previously owned government assets to private corporations. While this is perhaps the archetypal privatisation, every sale of government land to a private landowner/developer is also a privatisation of previously government-owned assets.

Whatever the rationale or service-delivery outcomes, the key difference between outsourcing and full privatisation is that the later leaves the government with fewer assets.[2] In this sense, outsourcing is a transfer of *income* from the public to the private sector, while full privatisation is a transfer of *wealth* from the public to the private sector.

This submission will discuss both of these privatisation "types" in turn before examining in fuller detail the third proposition above relating to consumer expenditure patterns.

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[1] There is probably a third type, which is a limited privatisation such as leasing of crown land or licencing of private operations on public land. These represent a temporary privatisation of certain usage rights, even if in some cases there may have been no previous government service or operation to outsource or privatise. However, for the sake of simplicity, this submission does not discuss these situations.

[2] Technically, in the first instance privatisation is simply a change in the form of assets (public assets are turned into cash), but it will be a net loss if the cash is used for operational expenditure or not invested into other assets whose values appreciates over time.

Outsourcing

As noted above, there are many examples of government outsourcing by contracting both private corporations and not-for-profit organisations to provide services on behalf of government. The key question in relation to inequality is the rationale and economic basis for this outsourcing. Beyond an a priori ideological position that private provision and/or market competition is more efficient, there are several reasons why service-delivery may be outsourced:

- Because private operators have better technology, processes, expertise or economies of scale which allow them to provide the same (or better) services for less money;
- Because there is a conflict of roles or interest in government providing a service – for instance, a government department with responsibility for coercive responses and support for people (e.g. if child protection authorities were also responsible for counselling);
- Because the private provider does not have the same levels of oversight and accountability as apply to government services or employees; or
- Because the private provider has fewer staff or staff on lower pay than equivalent public servants, meaning the service can be provided most cheaply.

The actual reasons for any privatisation can be mix of the above, but if, or to the extent that the decision to outsource rests on the first two, then there is a reasonable case for outsourcing and any negative impact on inequality will at least partially (if not entirely) offset by the benefits derived from these factors. (As we will see later, low-income earners may still be materially better off even if inequality increases).

The third issue above begs the question as to why there are different levels of accountability: either why is the public service tied up in layers of reporting/accountability which is not required of a private provider, and also, if the accountability is via a government contract, to what extent is the policing of quality and delivery undertaken by government contract managers – and is this time/resource factored into the cost of the outsourced contract? These are empirical questions which may vary from contract to contract, but they probably do not have significant or direct impact on inequality.

By contrast, if, or to the extent that the decision to outsource rests on lower labour costs in non-government employment, then any such outsourcing has a direct impact in increasing income inequality by suppressing wages for the workers concerned (often lower-paid workers with limited market power to demand higher wages). This leaves those workers (or workers in those jobs) further behind those on higher incomes. ABS data shows that on average full-time earnings in the private sector are around 15% lower than in the public sector.[3] While this is not necessarily a like-for-like comparison, there is certainly the possibility that outsourcing is cheaper for government simply because of lower pay rates in private or NGO sectors.

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[3] In February 2021, average Adult Full Time Ordinary Time Earnings in the private sector in South Australia was $1484.10 per week, by comparison with $1737.90 in the public sector (ABS, 2021, Table 14D).

This inequality in wages has certainly been an issue in human services outsourcing. While community sector organisations brought community connections, experience and other social capital to service provision, there is little doubt that historically part of the "better value" offered by the community sector was the cheaper labour costs that prevailed in the sector prior to the Fair Work Australia's Equal Remuneration Order (which brought community sector wages brought more in to line with public sector wages). Whether or to what degree an inequality in wages still contributes to government outsourcing decisions is an open question.

An inequality of wages in an outsourcing process represents an increase in income inequality in the first instance, but it may or may not translate into wealth inequality over time. The actual impact on wealth inequality will depend on tax levels and on individuals' investment and consumptions decisions.

Full Privatisation and Returns on Capital Investment

The publication of Thomas Piketty's ground-breaking *Capital in the Twenty-First Century* helped put questions of inequality on the political agenda around the world, but it also introduced new ways to think about inequality (Piketty, 2014). Of particular relevance to this inquiry is his foundational observation that where the rate of return on capital (r) is greater than the growth rate of the economy (g), then (all other things being equal) it will result in greater inequality. As Piketty notes, this relationship of $r > g$ is simply an accounting equation (not an immutable "law" of capitalism). Indeed, it is really just common sense in that if a part of anything grows quicker than the whole, then the other part(s) must grow less quickly and the faster-growing part becomes relatively bigger.

This inequality arising out of $r > g$ refers initially to the balance between capital and labour (and forms part of Piketty's broader analysis of macroeconomic relationships), but of itself it says nothing about the distributional outcomes across households. However, as all the data provided by Piketty shows, the ownership of capital is disproportionately owned by the top 10 percent, and in particularly by the top 1% and 0.5% of households – so an increase in capital's share of the economy translates to income and wealth accumulation at the top end and greater inequality across the economy.

There are some debates about Australian "exceptionalism" (Quiggan, 2018), and there is also evidence that Australian households have a relatively greater mix of capital and wage incomes with the importance of income from capital going much further down the income spectrum than in most other countries (Ranaldi and Milanovic, 2020). That said, much of the wealth of "middle Australia" is in home-ownership, whereas the wealth arising from privatisation (the private ownership of previously publicly-owned assets) shows up in the data as financial assets (which includes superannuation). In 2017-18 some 70% of all financial assets (i.e. non-property assets) in Australia were owned by the highest net worth quintile, while the bottom 40% of the wealth spectrum owned just 6% of all financial assets (author's calculation from (ABS, 2019 Table 7.4)).

What this massive inequality of ownership of financial assets means in terms of privatisation is that any privatised entity is almost certainly going to be acquired by those in the top wealth quintile. Further, while much of Piketty's analysis is at the macroeconomic level, he

notes that it can also be applied to individual corporations where r > g leads to increased capital intensity (Piketty, 2014, p 54). There may be various labour market outcomes arising from this increase in capital intensity in privatised services. In some instances it may lead to fewer jobs and potentially greater inequality between those in work and those without work, or even higher wages for remaining employees increasing inequality between those workers and lower paid workers in the economy. Again this is an empirical question, but the primary focus here is on the broader macroeconomic inequality noted above.

In terms of the privatisation of public services in South Australia, by virtue of the privatisation of the electricity network and its management as a regulated monopoly, we have very direct evidence of returns to capital being greater than the growth rate of the economy. For entities like the South Australian Power Networks (SAPN), the Australian Energy Regulator determines what constitutes the recognised capital base of the company (the RAB, the Regulated Asset Base) and then determines an average annual return on that capital base through a weighted average capital cost (WACC; also called the allowed rate of return). The WACC estimates the cost of funds that a network's financiers can expect to justify investment and takes into account a range of factors including the return on debt, the return on equity, and the value of imputation credits. Overall the return on capital makes up 30-50% of network revenue across all networks (AER, 2021).

For the SAPN regulatory determination period 2015-2020 the rate of return was set initially at 6.17% (varying slightly over the period), although this is the "nominal vanilla" WACC, which is not adjusted for inflation or taxation. These adjustments are necessary to discount for inflation and because, as Piketty notes, r > g is a driver, but the impact on inequality can be mediated by institutional arrangements - including taxation. The AER models estimated the post-tax real WACC return as varying between 2.96% and 3.02% over the five-year determination (AER, 2015). As evident in Table 2 below, this is still above both real revenue and real economic growth rates.

However, the system for setting the WACC has now changed. In an effort to avoid adversarial regulation and challenges to determinations, in 2018 new legislation was introduced so that the AER could establish a "binding rate of return" instrument setting out a single approach for calculating rate of return for all network businesses. The instrument is set every four years with the next iteration currently under consideration (AER, 2021). For SAPN, the result was that for the 2020-2025 regulatory determination, the WACC rate has been reduced and begins at 4.75%, (with an expected inflation rate at 2.27% reducing its real value) (AER, 2020). Despite the reduction, this is still likely to be greater than the 2.25% per year economic growth rates forecast in the state budget up to 2025, and as Piketty points out, even small differences in r > g are important as the differences accumulate to lead to great increases in inequality over time.

It is important to note though that the WACC is an allowable rate of return, but the actual rate of return may be different depending on a number of factors including incentive schemes, forecasting errors, or unexpected revenue fluctuations. In this sense the WACC represents a benchmark or idealised rate of return on capital. But this is itself important because it means that in this case the regulator is setting an ideal which is inadvertently promoting inequality.

That said, there is a further caveat in that what Piketty means by "capital" is not reducible to the RAB and in reality the WACC is only part of a much more complex system of regulated and unregulated financial flows, and not all returns to capital find their way to shareholders (where they will impact on inequality in society). Given this complexity, an alternative method of calculating returns to capital is simply to focus on those end-of-line returns to shareholders. This is a narrow measure as it ignores the returns to capital from debt financing (which do not accrue to shareholders), but in practice it is also difficult to identify the market capitalisation (the value of the company) that the return is on. Market valuations of companies change by the minute with share market fluctuations, and in any case SAPN is not publicly traded so there is no stand-alone market value.[4] However, the share-dividend approach does provide a different window on returns to capital and in the case of a regulated monopoly like SAPN, the RAB could be used as a measure of the company's capital value (at least according to the regulator, if not the market).

The table below compares the return on capital (based on the distribution to shareholders as a proportion of RAB) with the revenue growth of SAPN and the growth rate of the South Australian economy over the period of the last regulatory determination. In all years the return to capital (column 2) was greater than the growth rate for the economy generally, and greater than SAPN revenue growth in all but one year – again, a situation which will lead to greater inequality.

Table 1: SAPN - Comparative Growth Rates

Year	Share Dividend as % of RAB	Real Revenue Growth %	SA Economic Growth (Real % of GSP)
2016	6.16	-7.8	1.9
2017	6.00	-3.4	2.2
2018	5.59	3.7	2.0
2019	5.46	9.2	1.4
2020	4.95	-0.5	-1.4

Source: Author calculations from SA Budget Papers (Govt of SA, 2020 and other years) and (Spark Infastructure, 2020).

Obviously this is only a short term analysis and a longer time series would be useful, but it is also worth noting that the stated market capitalisation of one of SAPN's parent companies is around half their regulated asset base (across their range of entities)(Spark Infastructure, 2020). If a similar ratio held for SAPN itself, the returns to shareholders as a percentage of market capital would be much greater - and significantly higher than the rates of growth of both SAPN and the South Australian economy.

[4] SAPN is 51% owned by Hong Kong based CK Group, and the remaining 49% by Spark Infrastructure.

The r > g analysis here is a new and should be an important consideration in relation to privatised services, although it does not form part of energy regulation in Australia. However there are a range of further caveats that need to be added. The data is not designed for the type of calculations being attempted here and it is acknowledged that there is room for debate as to data and methodology. In that sense the data should be treated as indicative rather than absolute. Nonetheless, what the data shows is that:

- at the idealised level, that is, for what the regulator determines is the capital base and allowable rate of return, then r> g,
- r > g for the company itself, meaning it is likely becoming more capital intensive; and
- the return to shareholders has also been higher than the growth in the rest of economy.

All of which suggests that there is further reason to believe that in this instance we have a privatised, regulated monopoly which by definition will increase inequality – at least on the evidence from the 2015-2020 regulatory period.

However, another important caveat arises where there is foreign ownership of shares in the privatised entity, noting that almost two-thirds of SAPN is foreign-owned.[5] Such foreign ownership may lead to income and the accumulation of wealth overseas (and inequality between nations), but it may decrease income inequality within Australia or South Australia. This is simply because within the local economy there is a return to labour but not to capital which would, with local ownership, normally accumulate at the top end of the wealth spectrum. This is a quirk of statistics rather than a desirable outcome, but there may also still be some impact on inequality if the ability to tax foreign income is lost and that restricts the redistributive spending of government.

It is also important to point out that the SAPN example above is just one example of a privatisation. Other privatisations, even in the regulated energy field, may have different results as the energy generation, transmission and distribution, and retail markets are significantly different. Again, the question of whether r > g is an empirical one, but part of the point of this submission is that the methodology and analysis could and should be applied more broadly in the discussion of privatisation. But in arguing for this approach, it is recognised that in many cases the post-privatisation return on capital may not be publicly known – although in the current era of low economic growth it is likely that the rate of return on capital for many corporations delivering former government services would be greater than the growth rate.

Another example of regulated monopoly service further highlights the issues at play in privatisation where r > g. SA Water is a monopoly with a regulation of assets and revenue

[5] As noted, the CK group is foreign-owned. In 2017 Spark Infrastructure was approximately 75% owned by Australian professional, superannuation and retail investors, with the remaining 25% representing foreign investors (Francis, 2017). Accordingly, about one-third of SAPN shares are owned by Australian investors, and given the ABS data noted earlier, we can assume around 70% of those would be owned by those in the top wealth quintile. Almost no SAPN shares would be owned by the lowest wealth quintile (on the average, around 2% [being 6% of Australian-owned shares]).

similar to that in energy, although of course SA Water remains publicly owned. The regulatory rate of return for SA Water for the period 2016-17 to 2019-20 ranged between 3.81% and 4.53% (real, post-tax)(ESCOSA, 2016). Again, this was higher than the economic growth rate, but as a public corporation the equation is very different. Even if r > g, the capital-labour inequality does not translate in the same way into inequality *in the community*. For a publicly-owned corporation the returns to capital go to the government (which then spends on a range of community services), rather than going to private owners who are mostly in the highest wealth quintiles. If returns to capital lead to an increase in wealth for a public corporation, it is an increase in public wealth, not private wealth accumulation that would increase inequality.

In this case, there is a clear difference in public and private ownership of a corporate entity where r > g, but it is important to note that this analysis deals only with the unequal distribution of income and wealth derived from privatised entities. It says nothing of energy prices or consumption and it is acknowledged that it is possible for inequality to increase through r > g, but for consumers (even those on low incomes) to be better off due to price decreases. Again, this is an empirical question and in cases where it exists, policy-makers may need to weigh the relative importance of inequality and affordability.

However, in considering affordability, there is another set of impacts on inequality which arise from consumer expenditure patterns and prices where changes may impact unequally on consumption costs (and therefore the relative real value of income). It is to these issues we now turn.

Regressive Consumption Patterns and Privatisation

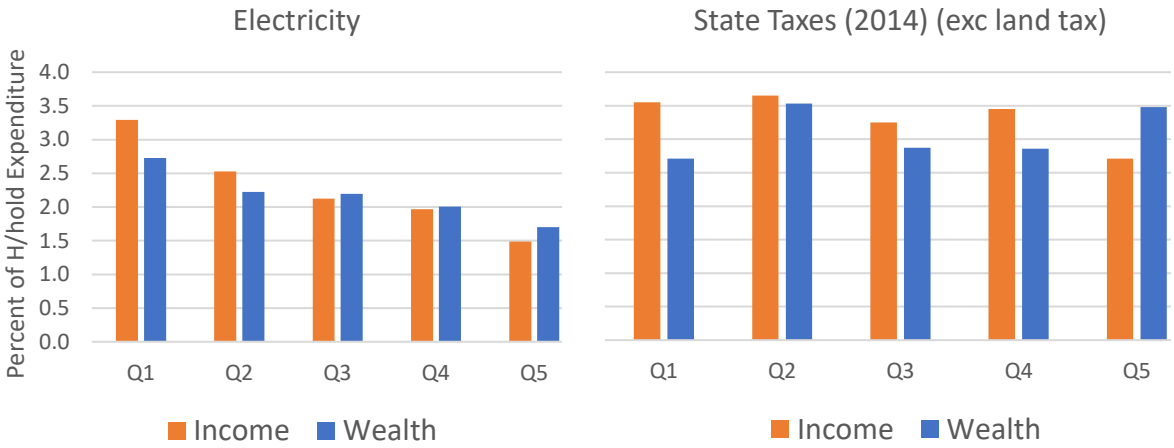
There is a special instance of privatisation where payment for services can be obtained from customers, and where basically everyone is a customer and regularly uses the services. This largely applies to essential service commodities like energy, water and telecommunications.

In these instances, the equality question is whether such services are more equitably paid for by people as tax payers or people as consumers. The answer initially turns on whether consumer expenditure patterns on the privatised services are more or less regressive than the state tax base. A regressive expenditure here is where the particular costs account for a greater proportion of household expenditure for low income/wealth households then for those higher up the income/wealth spectrum. In theory, if consumer expenditure patterns for a service are more regressive than government taxes, then recovering costs from customers will impact disproportionately more on low-income households by comparison with direct investment from government.

This can be seen most clearly in practice in the case of electricity and who bears the costs of new investment. As noted above, the revenue able to be collected by entities like South Australian Power Networks is limited by the regulator based on an assessment of legitimate operating costs, capital costs and returns on capital. Put somewhat over-simply, what this means is that once the regulator is convinced of the necessity of an expenditure, that money is added to the revenue able to be recovered from customers. That is, once the expenditure is approved, the costs are passed on in their entirety to customers and from there we can assess the differential impacts on households.

The graphs below show, for both income and wealth quintiles, the consumption expenditure on electricity as a proportion of household expenditure, by comparison with the incidence of state taxes – although the tax data is somewhat dated and limited in that it only deals with a selected range of taxes (most crucially, not including land tax)(Govt of SA, 2015). Nonetheless, the graph on the left shows that expenditure on electricity is regressive in that it accounts for a greater proportion of the budget for households in the lowest income and lowest wealth quintiles than for households higher up the income and wealth spectrums. Crucially, the graphs also show that electricity expenditure is far more regressive than the expenditure on state taxes which is much flatter (and arguably, if land tax was included, state taxes would likely be more progressive).[6]

Figure 1: Proportion of Household Expenditure on Electricity and State Taxes



Source: Electricity expenditure from(ABS, 2017) and tax data from the (Govt of SA, 2015)

In practice what this means is that when the cost of electricity services is borne by households as customers (as it is with approved network costs) it will impact disproportionately on lower income households. By comparison, if the cost of electricity provision is borne by taxpayers, the impact on household budgets is likely to be more evenly shared across income quintiles and wealth quintiles.

While this is evident in the graphs, the situation is not as straightforward because government investment and ownership of services may be done through government business enterprises. These public corporations may operate analogously to a private corporation and pass on all costs to consumers so that the regressive impact is the same regardless of ownership. That said, while it may not be as progressive as direct tax-payer funded investment, even if a public company passes on costs to consumers, there is a difference because as McAuley and Lyons point out, state government services disproportionately advantage those on lower incomes (McAuley and Lyons, 2015). By

[6] If land taxes followed the same pattern as the Emergency Services Levy (which is also a form of land tax) the tax impact would be progressive through the first three income quintiles and across all wealth quintiles – and probably even more progressive given the more progressive rate structure of land tax.

contrast, as we have seen, the revenue from privatised corporations goes predominantly to high wealth households and increases inequality, although this relates more to the issues in the previous section than to the impact of regressive consumption patterns.

Putting public corporations to the side, the comparison of the impact on inequality of privatised costs passed on to consumers against direct government investment in service provision is important. The following section discusses two examples which highlight these policy issues.

Two Examples

The first example is a hypothetical expenditure on new capital investment in the electricity network. While hypothetical, the issues are very real as we struggle to build a grid to accommodate dispersed production of renewable energy and two-way electricity flows. As a thought experiment, let's assume that it becomes apparent that a new large-scale piece of capital equipment (PoCE) is required to improve network stability and performance (analogous to ElectraNet's synchronous condenser expenditure in 2019, or the new Interconnector, but also applicable at much smaller scales). In the normal course of events, SAPN or ElectraNet would cost the PoCE and if the regulator determined it was needed and the cost was right, the investment would be made and the cost recovered from customers via the process noted above. But what would happen if at the point that the regulator deemed the PoCE to be necessary, the state government purchased the PoCE and allowed it to be used by the network free of charge?

This government action is not, as it may first appear, simply a massive gift to a private corporation. If the government retained ownership of the PoCE, it would not form part of the ElectraNet/SAPN Regulated Asset Base and there would be no return to them on that capital. They would not have to spend money on capital, but they would get no money in return – indeed, they may be worse off as they would not get any potential profit from the return on capital (if regulated rate of return was higher than their actual financing costs).

In this instance, what it would mean is that the cost of the PoCE would be borne by the public as taxpayers rather than as energy consumers – which, as we have seen, results in a far more equitable impact on households. Of course, in practice there would be a range of other considerations to take into account in deciding who should fund the PoCE, including efficiency, liability, licencing and practicality. But simply viewed in terms of the impact on equality, the capital investment would be better made by government.

A different, and perhaps less hypothetical example, may be found in relation to a program like the Residential Energy Productivity Scheme (REPS) – a scheme to provide incentives for South Australian households and businesses to save energy. By including REPS as an operational requirement of private energy retailers operating in the state, we not only have the contradiction of an energy-saving scheme being run by retailers whose purpose is to sell energy, but the costs for the scheme are spread across the customer base and therefore impact disproportionately on low-income households. That said, the nature of this impact is not as straight-forward as it is in the case of the regulated monopoly network provider because in the retail market the extent to which costs are passed on to consumers will

depend on market competitiveness, elasticity of demand and a range of other considerations.

Nonetheless, the costs that are passed on to consumers will impact in the same regressive pattern, which is particularly problematic given that the scheme is not limited to or even necessarily targeted to low-income households. In practice, this could lead to low-income households bearing the cost for energy saving initiatives for higher income households. By contrast, if the scheme was funded directly by government, it would be paid from the more progressive tax base and the scheme would not be adding to inequality.

It is important to note though that in these examples, and more generally in the discussion above around the impact on customers where there is regressive consumption expenditure, it has been assumed that everything else remains unchanged. In a sense, that was to establish the theoretical model. In practice though, other things do change and it may be that a privatised service, if it was more efficient and delivered a cheaper service, could be a net benefit to those on the lowest income. The amount they pay for the service may decrease, leaving them absolutely better off in terms of their household budget.

Further, given regressive expenditure patterns (and assuming price reductions were spread evenly across the board), the arguments above would be reversed because the gains would disproportionately be enjoyed by those in the lowest quintiles – precisely because they spend proportionately more. Those on higher incomes [who tend to have higher expenditures on the commodity] would save more in absolute terms, but as a proportion of the household budget those on low-incomes would benefit more – in that sense, reducing inequality in consumption (and therefore real income).

That said, even if lower income households did gain proportionately more from lower prices, it may not be a straightforward gain in equality. We would need to go back to the questions asked around outsourcing as to why the private operator can deliver the service more cheaply. If it is simply because of lower labour costs by paying less, then a gain in equality one area (consumption) might be offset by a decrease in equality in another area (income). Again, the extent of the offset or where the final benefit fell would be an empirical question, but in the case of the REPS example, shifting the cost to government would see a decrease in costs to consumers (disproportionately benefiting low income households) and payment from the tax base which is more evenly spread across quintiles.

Clearly from the above, there is no simple answer in looking at the impact on inequality of privatisation of services with different consumption patterns. Yet while inconclusive in a general sense, this is precisely the analysis that needs to be made (alongside the other analyses discussed here) to determine the impact of privatisation on inequality.

Policy Issues and Inequality

Beyond the conclusion above that in instances with regressive consumption expenditures, privatisation results (all other things being equal) in more unequal outcomes than direct public investment in services, there are two policy considerations which can also be drawn from these examples. The first is that privatisation should not necessarily be thought of on a "whole of service" basis, where the service is either publicly owned or privatised. Some

parts or requirements of service are severable from the existing privatised service, meaning that there is the possibility of public provision of service even within a privatised market and that this could contribute to greater equality in the community.

This is not a particularly radical idea. The government has already shown this is possible in some aspects of energy provision (for instance, investment in generating plants, or batteries to store energy and stabilise the grid). Further, in a general sense, both government and private businesses already disaggregate their production processes when they buy raw materials from other companies, or contract cleaning or accounting companies rather than hiring cleaners or accountants directly as staff. The model of a corporation with all subsidiary production processes in-house is very dated.

Governments re-entering markets where service provision has been privatised is possible, if it is desired, and it need not be about acquiring or nationalising privatised services. But it is about asking for each new investment or project, whether the project is severable and can operate separately from the privatised entity – and if that is so, then is that project best undertaken by direct public funding/investment or by the customer-funded company. Unfortunately, this is not common practice. In the hypothetical example above, there would be extensive consumer consultation and the ability to comment at multiple points on whether a PoCE is needed, the cost of the PoCE and whether the expenditure is justified, but these consultations would be confined to technical questions within the regulated market model. The question is never asked about the most equitable way of paying for the PoCE (or the REPS) and such issues and commentary would largely be beyond the regulatory process.

The arguments and examples above are also important, not just because of an economic model of where the incidence of costs rests, but also because they show how privatisation can limit the options for fairly addressing social challenges. For instance, faced with the challenge of climate change (which will also disproportionately impact on low-income households) and the need for investment and programs to increase renewable energy production and to re-engineer the grid to cope with renewables, consumer advocates are often faced with a choice of either advocating for change – the cost of which will be felt disproportionately by low-income households, or opposing the expenditure and therefore failing to address climate change

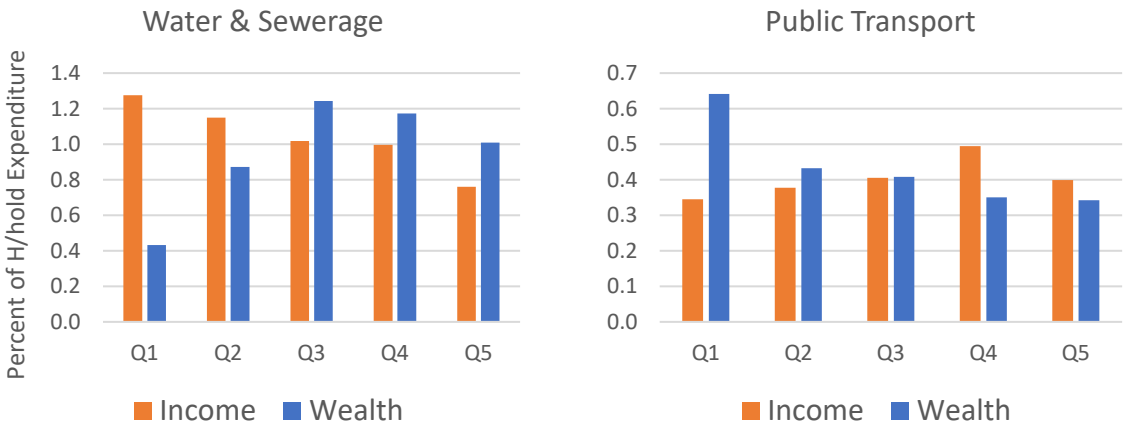
Obviously this does not apply to all issues or to all consumer advocates, but it is a pressure from the logic of market rules for privatised energy and it is only likely to increase inequitable outcomes in energy policy. This is because advocates often have limited or no good options to argue for, and have to weigh up the least inequitable outcomes within the allowable paradigm. But it also because once energy is privatised, the market logic forces advocates to focus on the interests of people as consumers rather than as multi-dimensional humans or citizens. An example would be a focus on perceived solar subsidies because they add to costs for customers in the energy market (which impact disproportionately on low income households), while ignoring fossil fuel subsidies (which are paid by taxpayers outside of the energy market). Both are costs of energy provision, and without accounting for both it is impossible to see who is subsidising what, and to see what the full energy costs are to households. But a focus on (and funding for) energy *consumer*

advocacy hides this complexity and is a dis-service to the vulnerable and disadvantaged people both in principle and in practice. People are more than simply customers, and the energy security, affordability and climate conversation could be very different if not framed by a privatised market with necessities of cost-recovery for private businesses.

Transport and Water

It should be noted that the factors evident in the consideration of electricity above do not necessarily apply to all privatisations. As is clear, the arguments rests on the particular pattern of consumption expenditure. The graph below shows the quite different water and public transport consumer expenditure patterns.

Figure 2: Proportion of Household Expenditure on Water and Public Transport



Source: (ABS, 2017)

Clearly water and sewerage expenditure is regressive across all *income* quintiles (a pattern similar to electricity), but it is progressive through the first three *wealth* quintiles. This pattern is presumably because sewerage rates are based on land values, and paid by landlords, not renters (who almost by definition will be in the lowest wealth quintiles). However, it does mean that when water service costs are recovered from customers rather than taxpayers those on the lowest *income* are being disproportionately impacted by new expenditure. This applies to SA Water as a public corporation (with the offset being government expenditure back to those on lower incomes), and would apply without the offset if SA Water was privatised. That said, such a recovery of expenditure from customers would have the least proportionate impact on those with low wealth (but higher incomes), while those with middle wealth would see the biggest proportionate impact on their household budget.

By contrast, public transport is progressive across the lowest three income quintiles, but heavily regressive in relation to wealth where the lowest net wealth quintiles spend a much higher proportion of the household budget on public transport than those households with more wealth. Thus, the impact of privatisation (or recovery of costs from customers rather than taxpayers) is quite different to water or electricity – although public transport is also not an expenditure spread across all households, so the analysis is not as straightforward.

Again, the argument here is a matter of evidence rather than ideology, but the broader point is that the impact on equality caused by the potential shifting of costs from taxpayers to customers should be a key part of any consideration of privatisation. Of course, this is only part of the consideration of equality required in relation to privatisation, because as argued above, both the rationale for privatisation and the returns on capital also have an impact on equality, and again, the impact on equality is only one issue to be considered in relation to any privatisation. Nonetheless, it is an important consideration and one that is often over-looked.

Conclusion and Recommendations

The three different approaches taken to analysing the impact of privatisation of public services on inequality confirm that there is a real possibility that privatisation could lead to increased inequality.

While the issues raised in relation to outsourcing are not new or complex, they still require empirical analysis of the economic rationale and drivers behind each decision to outsource services.

By contrast, the arguments around returns to capital are complex and relatively new. While Thomas Piketty's analysis is well-known, we are not aware of these tools being used to look at the impacts of privatisation. While the outcomes may be different in regulated monopolies to privatisations into more competitive markets, the tentative analysis here of the privatisation of South Australia's power network suggests that the rate of return on capital was greater than the rate of growth and that this would lead to an increase in inequality.

Finally, the comparison of the impact on inequality of the privatisation of public services (as against direct public investment in services) where there is a regressive expenditure pattern is more complex in that there are a range of variables. The results may be different for inequality based on income and on wealth, price changes can reverse the impact and a government business enterprise may mimic private corporations. Nonetheless, in the straightforward case where there is a regressive expenditure pattern for an essential service where basically all people are consumers, there is a choice between people paying as citizens (through taxes) or as customers of a privatised service providers, and in that case the public option will have more equitable outcomes.

These issues are crucial in relation to electricity provision, but the analysis showed not just the potential for privatised electricity to increase inequality, but also the limitations imposed on social outcomes and consumer advocacy. However, the analysis also pointed to a potential way forward in that, if government wants to limit inequality arising from the previous privatisation of electricity, it could look to provide new capital and programs by direct government investment.

Overall though, the primary focus of this submission has been to propose methodologies for considering the impact of privatisation of public services on inequality. In that sense, it is also the primary recommendation that the impact on inequality and methodologies used here be included in any consideration of privatisation.

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