Electricity Re-Regulation

Very few commodities are as essential to our daily lives as electricity. The reliable flow of cheap electricity powers our economy and underpins our wealth. Increasing electricity prices constrains economic growth in much the same way the oil crisis of the seventies hurt global economies.

No doubt many economists have determined a critical 'cost' for electricity beyond which there is serious economic decline. Hence the need to get the deregulated electricity market working as effectively and efficiently as possible. Prior to deregulation, governments had the ability to deal with local economic concerns by adjusting electricity prices. Most of us can remember state governments instructing their energy utilities to reduce the cost of supplying electricity to a special project that was deemed to have a local net economic benefit.

Deregulation and privatisation are making this type of government intervention much more difficult. The free market must set electricity prices and deal with reliability issues such as adequate growth of generating capacity.

This, in itself creates a level of uncertainty or business risk that needs to be managed and costed. In parallel with this are the additional burdens of an uncertain environmental policy and the administrative difficulties of dealing with a plethora of energy regulatory bodies over each of the states. Unfortunately, these risks are borne by both sides of the electricity market.

Large electricity consumers need some degree of price certainty if they are to commit to new developments or major projects. Similarly, electricity producers need some degree of price certainty before they can commit to any major projects. This is particularly true of generators who are comparing the merits of relatively greenhouse friendly but relatively expensive gas against coal, especially brown coal. The increasing imposition of greenhouse compliance requirements swings the balance towards gas. In fact, economic modelling has been done to determine a carbon tax that would make coal fired generation more expensive than gas fired generation and there are numerous advocates for the imposition of such a tax.

Leaving aside all arguments about the environmental consequences of the greenhouse issue and arguments about the societal cost of carbon, this uncertainty imposes its own set of costs. Against this background it is pleasing to note the acceptance of recommendations to extend the existing MRET[1] scheme through to 2035. This time frame effectively deals with any short, medium and quite possibly long-term uncertainty.

The existing target of 9,500 GWh pa of new renewable electricity by 2010 is to be retained along with the existing penalty of $40/MWh. Between 2010 and 2020 the target will be increased to 20,000 GWh per annum and the penalty is to be increased by CPI. Compliance costs have been estimated at between $415M per annum in 2010 to $900M in 2020. The 20,000 GWh pa target is then to be retained through to 2035

[1] The Mandatory Renewable Energy Target (MRET) scheme initially aimed to increase Australia's annual consumption of renewable energy by 9,500 GWh. When proposed the objective was to lift Australia's usage of renewable electricity from 10% to 12%, however natural load growth has seriously eroded this figure. The MRET target is proportioned over all energy retailers and any retailer who fails to meet their obligation faces a non tax deductible penalty of $40/MWh.

and it is assumed that the annual compliance cost from 2020 to 2035 will remain at $900M.

Given that the total value of electricity sales in Australia is probably close to $20B, (or more) and rising with increased consumption, the compliance costs are not overly significant. In round terms, the 2010 compliance cost will probably be between 1.5% and 1.75% of total sales. Hopefully, most of the compliance costs are used to fund renewable energy projects that contain a high proportion of locally sourced materials and equipment, hence there should be a beneficial flow on effect to the economy. (specially to the rural centres that host renewable projects).

In parallel with this, it is hoped that some more certainty will be built into Australia's wider response to the greenhouse issue. Although the Prime Minister has ruled out ratification of the Koyoto Protocol there is still some thought that Australia will implement further greenhouse abatement measures. (Interestingly, Russia is also holding back on implementation of the Koyoto Protocol and the EU Minister for Transport and Energy has called for consideration of alternative climate change mechanisms). Within this context the ESAA has called for a federal target and greenhouse policy through to 2050. Again, this will give some much-needed certainty to industry

In the absence of a national approach, NSW, Victoria and SA are jointly examining an emission-trading scheme. Unfortunately this has the potential to further clutter what is already a disjointed approach to greenhouse issues. At the moment there are a number of state based schemes that are applied in addition to the national MRET program. Notably, Queensland have their GEC[2], NSW has their NGAP[3] and Victoria is considering introducing a state based scheme. Hence the title of this article; lets 're-regulate' so that there is one national environmental constraint on the electricity industry, and lets make sure that the regulations are stable (i.e. not continually under discussion and review) with a long shelf life.

We also need to review the scope of the regulatory bodies that affect the National Electricity Market (NEM). In that context, moves toward a national Australian Energy Regulator (AER) and a national Australian Energy Market Commission (AEMC) should be applauded. There are currently seventeen separate electricity regulatory institutions and fourteen separate gas regulatory institutions and it is understood that regulatory costs are in the order of $100M per annum. As with the MRET compliance cost, this is not a significant proportion of the market, but it is a large number. More importantly, 'new entrants' are faced with the need to deal with these regulatory issues and costs.

Anything that simplifies the regulatory and approvals process has got to be good for the economy and the industry.

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[2] Queensland Gas Abatement Program, aims to source at leat 13% of electricity used in Queensland from gas fired generation

[3] New South Wales Greenhouse Abatement Program (NGAP) aims to reduce per capita emissions of carbon dioxide to 5% below the 1989/90 level by 2006/7.