

National electricity guarantee an exercise in politics



There's a simple way to bring down energy prices, but the Coalition's policy isn't it.

Judith Sloan, *The Australian*, 12:00AM October 21, 2017

The National Electricity Guarantee announced this week is an exercise in political economy. If you simply were interested in ensuring cheap, reliable electricity on demand, the NEG would not figure among the policy options.

But the challenges of the government are many, including paying heed to the ill-judged commitment to the Paris climate agreement and the need to get states on board. An endorsement from Labor also would be helpful in providing confidence for investors, in the renewable and synchronous energy space.

Of course, the NEG still sticks in my craw. After all, when did central planning ever work? Has Malcolm Turnbull decided those experts in Gosplan, the Soviet Union's state planning committee, and five-year plans were actually incredibly clever and we should be importing their ideas?

To be fair, electricity may be a special case. It is an essential service and there was always planning at the state level in years gone by, although it was undertaken chiefly by engineers rather than by people who think they know something about economics and business with nary any attention paid to the

physics of the system. You may say the only worthwhile part of the NEG is the reliability component — the requirement that retailers offset their purchase of intermittent energy with solid synchronous sources. By all means, purchase wind power, but the retailers will need to make sure there is available backup to deal with its intermittent nature.

Mind you, it's important that this requirement is not fiddled by the retailers, which always would be a temptation. The detail will be particularly important.

So why bother with the emissions reduction part? Why would we not rely on market forces to achieve this outcome by believing the renewable energy sector that it will be able to out-compete all other sources of electricity generation? The answer is twofold. First, we should not necessarily believe the claims of the renewable energy sector. There is a high fudge factor in the assertion, including the failure to account for additional costs of transmission and distribution; the uncertain lifetime of some of the installations; and their actual load factors (the energy delivered as a percentage of their nominal capacity).

The second issue relates to what may be termed carbon uncertainty. In the absence of the government having a specific intervention to drive down emissions from the electricity sector, businesses will factor in a shadow price of carbon.

The expectation is a Labor government, with its pledge to double our Paris commitment and to have 50 per cent renewables by 2030, inevitably will introduce a form of carbon pricing, notwithstanding that such action has been political poison in the past. (Note that, in any case, the renewable energy target is a form of carbon pricing, at present sitting at about \$80 a megawatt tonne.)

Banks and financiers also will be including carbon risk in their calculations, in turn affecting their willingness to provide finance for new electricity projects. Long-living coal-fired plants, even ultracritical ones with low-emissions intensity, will struggle to get up unless the funders can see a clear path into the future in terms of the handling of emissions reductions. (A new high-efficiency, low-emissions coal-fired plant also will likely require government guarantees, but that's fine. It's what the renewable energy sector is being given by state governments with their expensive reverse auctions funded by taxpayers.)

One of the upsides of the emissions reduction component of the NEG is that the price impact of high penetrations of renewable energy in particular states — for example, South Australia — will be sheeted home directly to consumers. Vote for a government that promotes high renewable energy penetration and pay the price. Not only is this fair but it is sending an efficient price signal in terms of the consequences of particular government policy stances.

That retailers will be able to meet the emissions reduction obligations by purchasing local or international carbon credits (rather than sourcing high-cost renewable energy) is probably the best economic feature of the NEG. With the price of international carbon credits so low at the moment — a few euros per tonne of carbon dioxide — this will be the way to go for many retailers. The option of buying credits should cap the cost of domestic abatement via the purchase of renewable energy.

Don't forget climate change is a global issue and it doesn't matter the source or location of the emissions reduction. Note also the government's own Climate Change Authority has recommended this action as part of least-cost policy.

To be sure, there are some important issues raised by the parallel operation of a reliability obligation and the requirement to meet emissions standards on the part of retailers. Arguably, the gentailers — companies that operate in both the generation and retail space (think AGL, Origin, EnergyAustralia) — will have a serious competitive advantage under the NEG, particularly in terms of - accessing hedged contracts.

The worst case scenario would be the withdrawal from the market of some retailers, reducing the limited competition in this space. The option of forcing the gentailers to break up should be considered by the government.

Is the NEG just a form of carbon price in disguise? Is it really true that there will be no further subsidies for renewable energy?

For anyone who understands economics, whenever a constraint is imposed on an activity, an explicit or implicit price emerges. As noted, the RET throws off a carbon price of \$80 a tonne of CO₂, which is excessive by any standard. And recall that Labor's carbon price started off at a tad over \$23 a tonne. The way to judge the NEG is to ask the question: is the cost of abatement under the NEG lower than the adoption of the Finkel clean energy target? The answer is a

clear yes. But this doesn't mean there will be no further subsidisation of - renewable energy. That's what the emissions reduction guarantee does. It's just that the degree of subsidisation will be considerably less than it is now, which again is a good outcome.

So should we believe that electricity bills will be \$115 a year lower under the NEG? The short answer is that there can be no definitive prediction of this outcome. The Finkel proposition that bills would be lower by \$90 a year clearly was manipulated and had no credibility. The \$115-a-year figure is more simply derived: it is just the price response you would expect from getting more supply, particularly of reliable energy. The one missing piece of the jigsaw that the government should consider is the scope to change the bidding rules under the National Electricity Market. Under the existing arrangement, the highest bidder sets the price, which is paid to all the intra-marginal suppliers. The aim is to create an incentive to invest.

But it is clear the arrangement has failed to spur investment in reliable electricity while the RET has overwhelmingly driven investment in renewable energy.

The alternative is simply to pay all the bidders needed to meet market demand the actual price they bid. If this were to happen, then there would be significant scope for wholesale prices to fall.

To be sure, the renewable energy sector would complain. And the regulator would need to watch for strategic bidding. But this simple rule change offers the government the best chance to do something quickly rather than wait until after 2020. If I were them, I would be giving this option serious consideration.