

No end in sight to electricity consumers paying for poor policy

Judith Sloan, Contributing Economics Editor, 11:00PM October 26, 2018

We were staying in a Queensland country town a few weeks ago. I got talking to the owner of the local bakery. He was looking at his latest financial statement that the accountant had sent through. And there it was in black and white. His annual power bill last financial year was \$114,000. It had been a tad over \$30,000 two years before. He employs 30 people, some on a part-time basis. Business seemed to be brisk but it's hard to put up the price of pies and buns too much without demand dropping.

It's easy to concentrate on the impact of rising electricity prices on households. And let's be clear on that score. In real terms, the average retail price of electricity over the 10 years ending in 2017-18 rose by 51 per cent and the average retail bill rose by 35 per cent (people have used less electricity, in part because of the higher prices).

But for many small and medium-sized businesses, the increase in their electricity bills has been higher again. Many are exposed to the full variations in wholesale prices, which have risen from less than \$40 a megawatt hour to more than \$100/MWh before settling around the \$70 to \$80/MWh mark. This threatens the viability of a number of businesses.

It's hardly surprising the federal government has decided to focus on getting electricity bills down. Let's be clear about reduced emissions and the commitment the government has made to the Paris climate agreement — the target in respect of electricity will be met by the early 2020s. Every participant in the industry acknowledges this.

It's one of the reasons why the emissions reduction target that was part and parcel of the now defunct national energy guarantee was superfluous. Note also there was considerable manipulation going on of the precise details of this target to suit the activist ambitions of those promoting the NEG. The only part of the NEG now worth saving relates to the reliability obligation, which is likely to become binding much sooner than generally expected.

For those who complain about a decade of energy policy paralysis, the truth is there has been a constant and active government policy position over that time. Renewable energy sources have been massively promoted, favoured and subsidised. The renewable energy target, which remains in force until 2030,

has spun off subsidies to renewable energy generators to the tune of about \$80/MWh (the value has been higher in the past) through large-scale generation certificates. The value of these LGCs is expected to drop but not for several years.

In addition, there have been the interventions of reverse auctions run by state governments and the ACT that provide guaranteed cash flow for renewable energy projects. There are also the rules in the National Energy Market that give preferential dispatch to renewable energy generators. And there are the mountains of subsidies available through bodies such as the Clean Energy Finance Corporation and the Australian Renewable Energy Agency.

Estimates put the value of the subsidies paid to the renewable energy sector at between \$2 billion and \$3bn a year, paid by consumers and taxpayers. That's not policy paralysis; that's policy promotion of a particular sector. If we ignore the decimation of the business models of dispatchable power generators and the much higher electricity prices we have had to pay, arguably the policy has worked. It is estimated that \$2bn was invested last year in renewable energy generation — a record amount. And this year the boom has been even bigger.

The Clean Energy Regulator has released information that 34 renewable energy power stations with a combined capacity of 667MW were accredited last month, which was the largest single month of solar and wind capacity since April 2001. Nearly 2800MW has been accredited so far this year, compared with the previous annual record set last year of 1088MW.

The CER also notes about 1600MW of rooftop solar will be installed this year — the six panels every minute scenario mentioned by Audrey Zibelman of the Australian Energy Market Operator — which is up 44 per cent on last year. There are now more than three million small-scale installations. Note there are also about 40,000 commercial solar systems.

Now, if renewable energy could provide reliable electricity at affordable prices, these trends would be great. But even on the most optimistic estimates of the boosters of renewable energy, wind can produce at most 50 per cent of the time and solar at 30 per cent. This produces a very large shortfall that has to be covered by firming capacity. Batteries and pumped hydro don't come close to filling the gap and are unlikely to do so for many years.

And here's another thing that needs to be considered when observing the boom in renewable energy investment: 10 coal-fired power stations with a total capacity of more than 5000MW have left the grid since 2012. None of these stations has been replaced.

What is beginning to emerge is a crisis affecting the grid that makes up the National Electricity Market, which covers South Australia, Victoria, NSW, Queensland, Tasmania and the ACT. This is being recognised by AEMO, which worries about the reliability of the grid in general and the possible shortfall of power in South Australia and Victoria at certain times during the coming summer.

The NEM electricity grid has always been long and skinny. It is now longer and skinnier, with far too much unreliable renewable energy and far too little firming capacity. This is the principal reason why federal Energy Minister Angus Taylor is so focused on getting more firming capacity into the system to back up the runaway investment in renewable energy.

It is also why he has decided to take a resolute line with the large "gentailers" — think AGL, Origin and Energy Australia — whose behaviour has contributed to the growing fragility of the system as well as to rising prices. The companies are quite capable of manipulating the market while promising to invest in firming capacity but never quite following through with their plans.

Of course, in a normal competitive market government should always refrain from intervening to force down prices. But the electricity market is not a normal market. Apart from the fact electricity is an essential service, the high degree of market concentration almost certainly means prices are higher than they should be. The egregious behaviour of the retail divisions of the gentailers, by dudding loyal customers in particular, indicates they cannot be trusted. Just ignore their howls of complaints about the downsides of regulation. By setting a reference price for standing offers, this will force down prices more generally, and the companies know it.

By bringing more dispatchable power into the system as quickly as possible — another focus of Taylor — wholesale prices will hopefully fall, bringing further price relief for customers. The truth is the gentailers have been feasting on high wholesale prices. Surely no one will complain if the government offers the same cost of capital to new dispatchable power plants that is available to - intermittent renewable energy plants?

With all this new renewable energy coming into the market, there is a real question mark over the commercial viability of some of the projects. When the wind is blowing and the sun is shining, wholesale prices can be driven to low levels. Clearly, the backers of these projects are basically betting on the election of a Labor government to impose a higher emissions reduction target and a reinstated RET. In this scenario, we would expect electricity prices to resume their upward trajectory.

The NEM is in disarray, but let's not kid ourselves that this is because of policy paralysis. This is because of incredibly poor policy where the consequences in terms of price and reliability were completely foreseeable. The challenge for the federal government is how to pull us back from this abyss.