

Reconciling Energy Prices and Social Policy

The regulation of retail electricity prices has been a highly contentious energy policy issue in Australia, with industry arguing for its removal on the one hand and welfare groups arguing for its retention on the other. Yet rarely is the most basic question asked: are 'market contracts' delivering benefits to customers? The authors contrast regulated standing supply offers in NSW, which are set at long-run economic levels, with market contracts across households of differing consumption levels.

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I. Introduction

The Australian National Competition Policy (NCP) reforms of the 1990s were aimed at introducing competition in various Australian industries to improve productivity and economic output (Hilmer et al., 1993). In the case of electricity, it was recommended that a National Electricity Market (NEM) be created and competition introduced at both the wholesale and retail level. This has largely

occurred, albeit with some criticism (Chester, 2006).

Wholesale market reforms have been estimated to have delivered around \$2 billion in annual productivity benefits to the Australian economy (Parer, 2002). As reforms were adopted, significant excess supply-side capacity became utilized and unit prices declined for consumers. However, since 2008 there has been a rapid run-up in electricity prices. There has been significant debate within Australia about

why prices have increased so rapidly following real declines in tariffs experienced throughout the 1990s and early 2000s. Views range from lack of demand-side participation, gold-plating of electricity networks, poor regulatory oversight of natural monopolies, and overlapping support for small-scale solar photovoltaics (PV). The Australian Energy Market Commission (AEMC, 2011, p. 2) for example concluded that prices have increased because of “peak demand, higher commodity prices, replacing aging assets and higher costs of capital due to the global financial crisis.”

Whilst prices have been increasing over the period 2008–2013, two NEM jurisdictions removed retail price regulations and shifted to price monitoring regimes. Victoria removed retail price regulation in 2008 and South Australia removed retail price regulation in early 2013. As a consequence of the removal of regulated pricing and the increased focus on electricity bills by households because of rising prices, customer switching rates in Victoria are the highest of any market in the world (VaasaETT, 2012). However, ongoing discussion of the role of price regulation in other jurisdictions persists.

Public policy advocacy in relation to the merits of retail price regulation relates to consumer protection from market power of energy retailers, and in particular, the protection of low-income consumers. Yet

there is scant evidence of market power in the NEM retail market, and somewhat surprisingly, even less quantitative evidence presented in the Australian context to determine whether regulated prices or competitive market contracts (with varying terms and conditions) are a better outcome for low-income consumers. The purpose of this article is therefore to sequentially determine whether competitive

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market contracts provide a better deal for consumers in a range of scenarios against an economic regulated price cap benchmark, and to identify if customers in hardship are being adequately advised and supported in making the right decision for their circumstances.

Section II of this article provides a brief literature review and documents the lack of existing literature related to the suitability of competitive market contracts for low-income customers deemed to be financially vulnerable. Section III presents our analysis of household electricity bills for customers on

competitive market contracts and regulated tariffs across varying consumption levels. In Section IV, we provide an overview of the results of a survey of financial assistance providers¹ on their perceptions of the suitability of market contracts and regulated tariffs for hardship customers. Policy recommendations are discussed in Section V with concluding remarks following in Section VI.

II. Brief Literature Review

There is rich academic and public policy literature devoted to the theoretical and empirical understanding of the introduction of competition in retail electricity markets. Many of these studies and inquiries recommend that retail price regulation be discontinued where competition is effective (Parer, 2002; Abbott, 2002; Yarrow, 2008; AEMC, 2008; Simshauser and Downer, 2012; Commonwealth Government, 2012; Simshauser, 2012). The studies view the market as a superior instrument for allocating capital and pricing electricity efficiently, when compared with regulatory intervention. This is perhaps best articulated by Yarrow (2008, p. 15) who noted that “price regulation in competitive market situations generally harms economic efficiency. . . .” However, there have also been significant criticisms of the deregulation of the electricity industry.

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