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Former ACCC boss Sims calls for independent review of National Electricity Market

There is strong talk of a review of the National Electricity Market by the Productivity Commission.

If true this is to be widely welcomed, as the PC has the skills to take the widest possible view, and it sits outside the existing market institutions and arrangements so it can be truly independent. And of course, the PC did the foundational and very broad electricity market review in 1990 that laid out the platform for huge consumer benefits and productivity improvements for over a decade.

We need another dose of the same, though this time we are facing a different set of problems.

The cost of electricity to households breaks down like this. About 45 per cent is due to transmission and distribution (poles and wires), 33 per cent generation, 12 per cent retail costs and 10 per cent meeting green energy costs (which actually are outweighed by their contribution to reducing wholesale costs).

The way that electricity networks are regulated is, therefore, a critical issue. Has privatisation and the regulation of these monopoly assets worked? There is considerable evidence that there has been overinvestment and hurdles for high returns that may be too easily met, which all inflates consumer bills.

The distribution network is where most of the network costs are. But there are other regulatory issues involving distribution networks, particularly their role in connecting behind-the-meter supply which could be substantial and seriously challenge the traditional approach to generation. The issue is essentially one of how rooftop solar connects into the grid. Increasingly, behind-the-meter resources owned by households and businesses can also help ease congestion to avoid augmentation or replacement of network infrastructure.

Then there is the issue of where and when to build transmission and how to deal with congestion. Are the links between the decision to build generation and transmission strong enough? Does separate decision-making lead to higher costs?

The wholesale market faces particular challenges. To what extent do we want market-based versus centrally planned decision-making? The former was for a long time a complete success. Certainly, there are strong signals to build more storage, but the incentives to build more generation have been lacking. How do we fix this? There have been suggestions of a capacity market, which would pay generators simply for being available, but there is evidence this leads to the building of more generation than is needed, which increases costs for consumers.

Decisions on the wholesale market must, of course, link to the potential size of behind-the-meter supply, as discussed above, and to the extent of demand flexibility that can occur. The system needs a level playing field between building new stand-alone generation, behind-the-meter supply and the role of demand flexibility.

Then there are many issues associated with the retail market. Electricity users that will also be behind-the-meter suppliers. Some consumers have been exposed without their explicit consent to high prices at peak usage times. Consumers should be able to decide their level of engagement.

Finally, given the already mentioned independence of the PC, the review could also provide useful views on the current energy market institutional arrangements.

Our electricity system must be affordable, reliable and sustainable. As consumers know, our electricity prices have gone from being among the world's lowest to now being too high. The market operator has been expressing concerns over reliability. And in recent years the move to zero emissions appears to have slowed.

The three issues are closely linked. First, a poorly managed transition to sustainability could make electricity unacceptably expensive for consumers. Second, the good news is that the same policy levers can help achieve all three objectives. The costs of renewable generation and storage continue to decline at rates that keep surprising everyone.

As we transition to a grid dominated by renewable energy, the review needs to consider the entire interconnected energy system. Specifically, the role of transmission and congestion issues, the distribution network and behind-the-meter resources such as rooftop solar PV and batteries, the wholesale market, demand flexibility and the retail market. Increasingly policy and planning will also need to account for large-scale flexible demand and supply from industries such as exporting green iron and green transport fuel, as Australia is best placed to do this and contribute to reducing world emissions.