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Dear Madam

Below is a brief follow up submission from the National Generators Forum to the Productivity Commission Inquiry into Energy Efficiency. Our principle contact is Dr Harry Schaap, NGF Policy Advisor.

Yours sincerely

A handwritten signature in black ink that reads "Harry A. Schaap". The signature is written in a cursive style and is located below the typed name "Yours sincerely".

Productivity Commission draft report
- Energy Efficiency, April 2005

Submission on Draft Report by the National Generators Forum

The National Generators Forum (NGF) welcomes the Productivity Commission's draft report into energy efficiency. The NGF acknowledges the use of selected parts of its submission (submission no. 65) in the report and agrees with the inferences drawn from them.

Overall, the NGF supports the PC draft report and draft findings as clearly reflecting economic reality in the national context in which energy is generally a small part of business expenditure and a declining part of consumer spending in percentage terms.

The draft report acknowledges the overall competitiveness and efficiency of energy supply at the wholesale level and the high level of competition and consumer choice at the retail level. It recognises the significant energy supply and use efficiency gains in terms of national economic output, while acknowledging Australia's lower energy efficiency improvements compared to many other OECD countries. In general, this reflects lower energy prices to consumers and the commodity nature of the Australian economy.

The report restates the common barriers to energy use efficiency and offers modest proposals for further addressing them, although some of these proposals could be strengthened through the use of enhanced regulatory and market-based mechanisms. In particular, market-based mechanisms for advancing energy efficiency are not well explored in the report.

The report provides comments on negative externalities, and in particular those related to greenhouse gas emissions and the potential for climate impact, but notes that *'pricing of environmental externalities is fraught with problems. In particular, the setting of an economic efficient price for carbon – whether through emissions trading or carbon taxes – are formidable.'*

The report has a chapter dealing with the role of energy market reform, with a comparatively cursory commentary of gas supply and use due to the paucity of gas supply and use data, which makes an effective assessment of competition reform in the gas industry difficult. With significantly more abundant data and market reform information, the report again focussing on electricity supplies and use.

The draft report comments that *'electricity prices still do not fully reflect the cost of supply because of the regulation of retail prices and network tariffs, imperfect competition among electricity generators, and, unaccounted environmental externalities associated with energy use'*.

The report's draft finding on these issues is:

'More cost-reflective pricing has the potential to improve energy efficiency by influencing both consumer and supplier behaviour, particularly in the longer term when consumers have both more information and opportunity to modify their behaviour, and producers have the opportunity to respond to changed market conditions.'

The report supports the reduction and ultimate removal of regulated retail prices (where they exist for domestic and small business consumers) and regulated network charges (generally implying distribution charges, which are unable at present to reflect network congestion). The NGF supports such proposals in the interest of economic efficiency. The NGF points out that network charges in Australia are higher than energy charges. The opposite is the case in most other countries.

The report focusses heavily on the use of smart (time-of-use) meters (but subject to comprehensive benefit-cost assessment if mandated) to deliver consumer benefits in a more deregulated retail (and network) market as a tool to 'incentivise' retailers and other parties to offer a more cost-reflective mix of tariffs. The NGF supports measures that deliver cost-reflective outcomes.

The report suggests that *'imperfect competition in the electricity industry may increase electricity pool prices and the volatility of spot prices. Improving competition will lower prices, which will tend to decrease incentives to invest in greater energy efficiency. But decreasing price volatility could decrease risk and uncertainty, thus enhancing the economic viability of a range of energy efficiency improvements.'*

There is little or no evidence in the report to support this assertion. There is no evidence that spot market volatility has much direct impact on consumers or impacts on energy efficiency.

Australia has one of the world's most competitive wholesale electricity markets and it is moving towards delivering an effective retail market for all consumers

- For more than a decade, the overarching objective of electricity market reform has been more competitive prices for consumers together with a secure and reliable quality supply of electricity

- Implied lower consumer prices, without other measures, are not necessarily consistent with improved energy efficiency, although clearly consistent with economic efficiency – a key determinant in improving overall efficiency in society
- Electricity generation is extremely competitive in Australia with more than 30 businesses competing in what by world standards is a small electricity market. There is little evidence that the removal of mostly unspecified so-called market impediments will further improve generator competition or that this will enhance energy efficiency
- The NGF supports the removal of retail price caps for domestic and small business consumers and the use of cost-reflective pricing on sound economic efficiency grounds, but again there is little evidence to support that these measures would lead to improved energy efficiency, although they can assist in providing more entrepreneurial and better demand side management tools.

The report should discuss more clearly the relationship, or lack of it, between demand side management, energy efficiency, competitive wholesale and retail energy markets, and the use of regulation.

Globally, there is little correlation between energy market reform and energy efficiency. Some of the most heavily regulated electricity markets in Europe and Japan also are the most energy use efficient (due to the higher price of energy and greater use of regulation) while some of the most deregulated markets, such as parts of the USA, Canada and Australia, are significantly less energy use efficient (due to the lower price of energy and less use of regulation).

In general, unless specifically regulated, electricity market reform has led to reduced emphasis on end-use efficiency, but improved supply efficiency, mainly because previously regulated retail businesses no longer have the obligation or incentive to deliver energy efficiency services, while suppliers have increased incentives to reduce cost.

However, a competitive energy market does provide opportunities to use innovative market-based tools, such as innovative tariffs, performance contracts and energy cost management processes, that deliver mutually beneficial energy efficiency outcomes for suppliers and consumers.

Harry Schaap
NGF Policy Advisor