CELESTE Funds Management

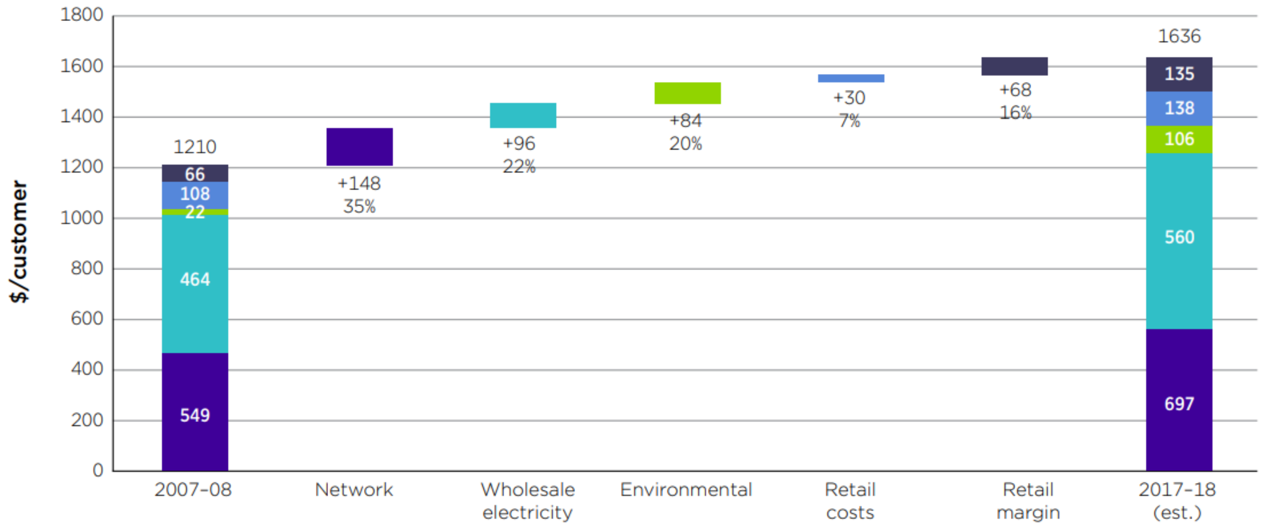
Quarterly Thought Commentary – October 2019

What is driving our high electricity prices?

A story that you may have never heard

Electricity price increases have only recently moderated having been spiralling upwards for the last decade. The average residential customer bill from 2007-08 to 2017-18 increased 35% adjusted for inflation and noting that electricity usage declined by 13.3% over that time period. Put simply, the large, well above inflation increases have hurt the consumer and damaged our industries competitiveness. High prices have also ensured that consumer spending has been constrained. Despite economising the bills consumers actually pay have risen substantially.

Figure A: Change in average residential customer bill from 2007–08 to 2017–18, NEM-wide, real $2016–17, excluding GST



Note: The percentages show each components' contribution to the total increase between 2007–08 and 2017–18.

Source: ACCC Retail Electricity Pricing Inquiry—Final Report

While consumers are well aware of high electricity prices what is perhaps more poorly understood is the causes behind them. As the figure above[1] shows the largest contributor to your bill is not the costs of generation, environmental costs, carbon taxes or the oligopoly of retailers price gouging (although none of these have helped relieve the consumers plight!). The largest contributor to the rises in your bills has been the network costs; the transmission towers, sub stations, poles and wires that deliver your electricity. These costs accounted for 35% of the rise in your bills in the decade to 2017-18.

To understand how this little discussed element of the rise in electricity prices came to be it must be understood how this highly regulated industry gets paid. The various network monopolies get paid based on their expenses to run the business and on their assets. They earn a fixed, and often very generous, return on any asset they own.

Essentially the more a network company spends the more it gets paid.

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[1] ACCC Retail Electricity Pricing Inquiry – Final Report, page v (Restoring Electricity Affordability and Australia's Competitive Advantage)

This leads to the perverse incentive to spend more than is necessary. Overspending on the network is termed gold plating. In this highly regulated industry the Australian Energy Regulator reviews the spending plans of the networks for approval in five year intervals. In the 2009-14 regulatory period the network companies were allowed to spend up. On an existing asset base of $46 billion the distribution companies were allowed to invest a further $37 billion[2]. This 80% increase in their asset base fed directly into electricity bills.

The massive spending approved by the Regulator was allowed principally to cater for a forecast increase in demand. The increase in demand never materialised, in fact the price rises implemented to pay to gold plate the network, saw demand fall.

In the current regulatory period the network companies have been more moderate in their spending plans and the Regulator more diligent. The rules have changed in favour of the regulator. This does not help the electricity consumer who still has to pay for the over spending that has occurred in the past. What is worse is that much of this spending was done to cater for an outdated model of the electricity industry. Traditionally the electricity industry has been run on a centralised model. Generation of electricity has been centralised principally in big coal fired power stations. This model has changed to one of decentralised renewable generation. Considerable generation now occurs nearer the point of consumption. Large new renewable plants are generally not located where the coal fired generators they replace existed. This leads to redundancy in the network where the coal plants were located and the need for more spending and upgrading to cater for the new generation plants.
The electricity network is in a bind, it needs to spend to cater for a new model while still charging the consumer for assets that are quite simply useless.

In any other industry the solution is simple, a write down of the assets that are unproductive would occur. This is staunchly resisted in the cosy, regulated, highly profitable electricity industry.

To move forward a write down in the value of the networks must occur. It was one of the principal recommendations of the ACCC Retail Electricity Pricing Inquiry[3] and could save consumers up to $200 on their bills. Unfortunately, this material recommendation, that could save consumers substantial sums of money, has somehow been lost in the culture wars that are the debate on Energy.

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[2] Page 63 – State of the Energy Market 2013 – The Australian Energy Regulator
[3] ACCC Restoring Electricity Affordability and Australia's Competitive Advantage – Retail Electricity Pricing Inquiry – Final Report, page ix and x

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Important information: