

Business
Council of
Australia



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**Submission to the
Owen Inquiry into Electricity Supply in NSW**

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1 INTRODUCTION

The Business Council of Australia (BCA) welcomes the establishment of the Owen Inquiry into Electricity Supply in NSW.

The work of the review is timely as the BCA considers there is an urgent need for Australia to re-establish forward-looking and coherent strategic directions for national energy market development and each state should make the necessary changes to ensure this outcome.

The BCA will contain its comments to matters related to operation of a national market and ensuring an environment to support investment in energy infrastructure.

This submission is made by the BCA, an organisation representing the Chief Executive Officers of Australia's leading 100 companies. Collectively, these companies employ around one million people and are responsible for a significant share of Australia's interaction in global markets through trade and investment flows.

A key focus of the BCA's work is developing and advocating a policy reform agenda aimed at locking in Australia's economic prosperity. The BCA's policy agenda focuses strongly on building the foundations for sustained economic growth as the basis for achieving prosperity more broadly defined. Business clearly has a vested interest in such reform – strong economic growth is obviously good for business. But a vibrant, competitive and profitable business sector is also good for Australia, delivering jobs and income growth, higher tax revenues and better investment returns for shareholders and superannuation funds.

The BCA policy reform agenda has been developed on the basis of independent research and highlights the need for reform in four key areas of the economy to lock-in current levels of prosperity for the long-term. They are workplace relations, taxation, regulation and infrastructure renewal.

Specifically, the BCA assessed the current state of a selection of Australia's economic infrastructure sectors, including energy related infrastructure, with the release of its *Infrastructure Action Plan* in March 2005 (available at www.bca.com.au). It found that as a result of poor institutional arrangements and policy choices, Australia's infrastructure is in urgent need of expansion, reform and repair. It found serious bottlenecks in key areas of the economy that, unless addressed, would pose major constraints on future growth. In



particular the *Action Plan* noted that energy demand will exceed current supply levels by 50 per cent by 2020.

The *Infrastructure Action Plan* concluded that the development of quality infrastructure is essential to alleviate capacity constraints within the economy and ensure Australia's continued international competitiveness. However, the *Action Plan* noted that funding was not the primary issue. Rather, the major barrier to better infrastructure to support future growth has been a lack of proper strategic policy and planning by and between governments. The *Action Plan* stated that a sustainable system of infrastructure cannot be achieved without structural and systematic change in the governance and planning of infrastructure policy in Australia particularly given our federal system of government. To achieve a sustainable basis for Australia's economic infrastructure, the *Infrastructure Action Plan* called on COAG ie federal, state and territory governments, to lead a national and integrated infrastructure reform program.

In examining energy infrastructure constraints the BCA noted:

- the negative impact of retail price caps;
- limitations to the effective operation of and investment in the developing national electricity market through different ownership models;
- limitations on market operation and transmission investment decisions as a result of the current regional market structure;
- the negative impact of the regulation test on new transmission investment;
- poorly developed regulatory frameworks for distribution which do not support service standards;
- greenhouse policies which differ across States, favour different technologies and create investment uncertainty; and
- poor price signals to inform consumer behaviour.

The decisions made by COAG in February 2006 and again in April 2007 following consideration of the report of the Energy Reform Implementation Group provide the basis for moving forward and addressing key aspects of these constraints.

Each state must now play its part in delivering a truly effective national energy market and facilitating ongoing investment in the necessary energy infrastructure.



2 THE BENEFITS OF PAST REFORM

The programme of economic reform – of which energy reform is a significant component – has underpinned the transformation of Australia's economy during the 1990s and helped Australia avoid the setbacks experienced by other overseas countries.

Changes to the National Electricity and Gas Markets over the past fifteen years have brought about improvements such as enhanced efficiency and productivity in energy supply and some customer and industry segments have also achieved benefits such as price reductions and improved supply reliability. However the reform process is incomplete and not all customer and industry segments have realised the benefits of energy reform.

An efficient energy sector is vital for all economies, but particularly for Australia. Electricity and gas are critical inputs to all businesses and consumers in Australia. The relative lower cost of Australia's supplies of energy resources has also encouraged the growth of a number of energy-intensive industries including aluminium smelting, non-ferrous metals, chemicals, paper and steel manufacturing where electricity and gas costs are a major input cost (from 15 to 30 percent).

Further energy reform is essential to ensure our current competitive advantages are not eroded through inaction – delays in progress towards a more efficient national electricity market could put at risk the newly found strength of our domestic industries and economy.

3 POLICY OUTCOMES AND STEPS FOR ENERGY REFORM

The BCA has previously highlighted the desired policy outcomes from reform of the electricity and gas sectors. These are:

- sustainable and effective market mechanisms;
- competitive neutrality;
- Government policies that do not influence investment in and the operation of the energy market adversely;
- transparent and accountable regulatory institutions;
- efficient and consistent regulation where regulation is required; and
- improved electricity interconnection.



Steps to achieve these outcomes for electricity include:

- the establishment of competitive (generation and retail) and monopoly network components;
- access to monopoly networks with the terms and conditions of open access established under a system of informed national economic regulation; and
- the creation of a national market (ie East and South Australia) linked by strong interconnectors, and with many producers and sellers able to compete in the market place.

Whilst for gas the steps include:

- competition amongst producers within and between gas basins;
- access to monopoly networks under a system of informed economic regulation to determine terms and conditions of access to producers, retailers and consumers; and
- removal of legislated barriers to the inter-State trade in gas.

Whilst aspects of these reforms are underway they have not yet been concluded with the end result that there still remain inefficient costs in the energy sector at all points: generation, production, supply and transmission and impediments to investment.

4 THE BCA RESPONSE TO THE OWEN INQUIRY

One of the key benefits of the move to a National Electricity Market was the promise of a single, national market, with separate regional markets connected by a strong national grid to ensure the capture of the benefits of robust competition by generators in one State selling excess capacity to offset excess demand in another State. This has occurred to a limited extent. Competition and lower prices require improved transmission and interconnectedness. Examples of particular concerns in NSW are outlined below.

The NSW Experience

In parts of NSW “bottlenecks” are occurring as demand increases and on occasion large users have to reduce electricity use or cease particular operations during peak electricity demand periods. Such situations have impacts on production planning and meeting demand



but in the longer term lead to questions about where to locate future capital investment in plant and production facilities.

When energy intensive businesses are deciding on major investment in their future plant and facilities they need to take into consideration the capacity/availability of both generation and transmission to support these long term investments. There is insufficient information on such investments, particularly in transmission in NSW.

Where there are major long term investment decisions and the business requires significant energy (electricity or gas) and the energy price and supply cannot be forecast with a reasonable level of confidence there is an inflated risk to be factored into the cost structure for the venture and therefore a higher hurdle rate to be achieved in the business case for the investment. This is increasingly the case in NSW. In effect the lack of reliable energy supply and an inadequate transmission grid act as an impediment to business investment.

The varying approaches to greenhouse gas emissions being implemented in each state, including NSW, are contributing to a much higher risk premium on investment and uncertainty about the availability of future generation.

Some governments in Australia have continued to intervene in the market place by introducing schemes that insulate certain segments from price signals or protecting them by placing retail price caps. The Electricity Tariff Equalisation Fund (ETEF) operating in NSW, for example, not only places caps on retail prices charged to households, but its operations significantly distorts the wholesale market. It clearly reduces the amount of peaking capacity in the market.

5 RECOMMENDATIONS TO IMPROVE CURRENT ARRANGEMENTS

National planning for and coordination of energy infrastructure is critical to Australia's economic growth. Bottlenecks and inadequate provision will lead to decreased productivity and competition.

An essential part of ensuring a fully effective national market is NSW commitment to and support of recent Council of Australian Government deliberations.



Consideration should be given to the ownership structure in the NSW electricity sector. Where the State has only one owner of all their significant electricity generation assets and robust competition is limited (as is the case in NSW) there are both constraints on investment in infrastructure but also little opportunity to benefit on pricing. At a minimum outsourcing of the trading functions of the State owned entities should be considered if privatisation is not an option. Provided sufficient competitors can be attracted and the opportunity for exercising market power lessened through a more robust re-allocation of generating units in each trading entity, a more competitive market structure could be engendered by pursuing the outsourcing option. However it is likely that privatisation will provide a more robust long term market structure.

The policy frameworks put in place to address greenhouse gas emissions will have a major impact on energy investment decisions. The BCA has endorsed the need for a national emissions trading scheme as the key market mechanism to cut emissions (as part of a multifaceted response which includes greater research and development and other policies) and highlighted the need to review and rationalise state-based policies and programs. Copies of the two BCA publications related to greenhouse gas emissions – *Strategic Framework for emissions reduction* and *Setting Achievable Emission Targets for Australia* are available at www.bca.com.au. The array of NSW programs and the decision to pursue a state-based emissions trading scheme should now be reviewed by the NSW Government in light of the federal government's endorsement of the national emissions trading scheme proposed by the Prime Minister's Task Group on Emissions Trading.

6 CONCLUSION

The discussion above highlights a number of areas where business is not achieving the benefits inherent in a fully functioning national energy market. Benefits such as increased efficiency and cost reductions would occur with the advent of increased competition and better functioning financial markets to support energy markets.