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At last, an energy policy that has Australia headed in right direction

HENRY ERGAS THE AUSTRALIAN 12:00AM October 20, 2017

If there is a lesson from Australian energy policy, it is that it is far easier to make a fish soup out of an aquarium than vice-versa. But even though Malcolm Turnbull and Josh Frydenberg have not worked a miracle, their National Energy Guarantee could be a first step to reversing the harm caused to what was once a relatively well-functioning electricity market.

That the market is on the verge of collapse is undeniable. According to the consumer price index, electricity prices for residential and small business users have increased 80 to 90 per cent in real terms over the past decade.

At the same time, the quality of the service, as measured by the reliability and security of the power network, has plunged: in addition to the highly publicised system failures affecting South Australia and NSW, there were, just in the final six months of last year, more than 25 instances in which breakdowns were narrowly averted.

Underpinning both trends is the dramatic rise in renewables' share of generation, with the renewable energy target lifting the proportion of their power that electricity retailers must source from renewables from 2.7 per cent in 2007-08 to 14.3 per cent this year.

That increase has added inherently unstable types of generation to the system, making prices ever more volatile while destroying the economic viability of baseload power, notably from coal-fired generating plant.

As a result, investment in dispatchable capacity — that is, power sources that can be run when needed — has almost entirely ceased. In the first decade of the 2000s, there was about $5 of investment in dispatchable capacity for every dollar of investment in renewables; since then, there has been about $10 of investment in renewables for every dollar of investment in dispatchable capacity, while the average annual investment in dispatchable capacity has fallen by 85 per cent. With investment in stable power - sources disappearing, it is only a matter of time before the system becomes unmanageable.

Left to its own devices, it is unlikely that the market would ever have found itself in this situation. But in their drive to achieve ambitious carbon abatement targets, successive governments distorted its workings, making investing in emissions reduction much more profitable than investing in secure and reliable power. Indeed, as subsidies to renewables reached $3 billion a year, generators had every interest in pursuing the first objective while entirely disregarding the second.

Correcting those distorted incentives is the central aim of the new policy. At its simplest, it seeks to do so by reshaping the obligation on retailers, requiring them to enter into contracts with generators that meet two criteria: that each retailer's portfolio of contracts balances dispatchable and intermittent sources of power, thus helping ensure the system is secure and reliable; and that the portfolio also meets an emissions target.

In that sense, the new policy could be viewed as combining a RET-like approach to emissions with a RET-like approach to - reliability, with both goals being pursued through mandates on electricity retailers. It is, however, much less prescriptive than the RET in how each target is to be met, encouraging retailers to find cost-effective ways of satisfying the criteria.

That is an improvement. And it is made even better by the fact the reliability criteria will be defined on a state-by-state basis. States that pursue absurd renewables targets will therefore bear the cost, as retailers serving those states will be required to buy the dispatchable capacity needed to offset the resulting system instability.

But it is important to also note the policy's very real limits. Even if it works as intended, the new approach will neither eliminate the cost pressures inherent in the pursuit of ever lower carbon intensity nor return our electricity prices to internationally competitive levels. Rather, with the RET still in place, the continued ramp-up in renewables will worsen the problems experienced to date.

Nor is that on a trivial scale. According to the most recent data from the Australian Energy Market Operator, the connection requests now in train in the National Electricity Market would increase large-scale wind and solar capacity by a factor of five.

Even if not all of those projects proceed, network costs will soar as new transmission lines are built to connect those that do. And to those costs must be added the costs of securing the dispatchable capacity required to preserve network stability and reliability once that mass of renewables comes on stream.

The new policy will not eliminate those costs; at best, it may help ensure they are minimised.

Unfortunately, whether it even does that is still highly uncertain. After all, almost nothing is known about precisely how it will operate. What is clear, however, is that the introduction of contracts for reliability involves a very substantial change in the way retailers contract with generators. But there is not the barest sketch available of the nature of those new contracts or of how they relate to the financial contracts retailers and generators use to manage risk. As for the interaction between the new contracts and the RET, that too remains undefined.

All that makes it difficult to understand how the policy's effects could have been modelled and so casts doubt on any estimate of the savings to consumers. The lack of transparency in the process leading up to the announcement only compounds the concerns.

But we beggars can hardly be choosers. So far, the main feature of our energy policy has been that every apparent nadir proved merely a step towards an even deeper form of madness. This, for once, looks like a move in the right direction — and for once, it faces up to the seriousness of the crisis. For that, hallelujah.