

**REVIEW OF NATIONAL COMPETITION POLICY
ARRANGEMENTS**

SUBMISSION BY ORIGIN ENERGY

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Introduction

Origin concurs with the Productivity Commission (PC) that National Competition Policy (NCP) has been an ambitious and historic undertaking and that much has been achieved since it was introduced eight years ago. NCP has had a significant impact on the energy sector and therefore every aspect of Origin's business directly and indirectly (via other linkages across the economy and the community).

Origin is a leading Australian energy company that supplies natural gas, electricity and liquid petroleum gas (LPG) to more than 2 million business and residential customers in Australia, New Zealand and the Pacific. Listed on the Australian Stock Exchange in February 2000, Origin Energy is a participant in virtually all segments of the energy supply chain including natural gas and oil exploration and production, power generation, energy retailing and trading (natural gas, electricity and LPG); and asset management services. Origin employs almost 3,000 employees and has more than 140 years experience meeting the energy needs of Australians. Origin sold about 201 PJ of energy to customers in 2002/3.

Origin supports the stated scope and approach of this review of NCP arrangements, specifically to:

- assess the initial and ongoing impacts of NCP and related reforms undertaken to date; and
- report on areas offering further opportunities for significant gains to the economy from removing impediments to efficiency and enhancing competition.

This review is particularly timely for the energy sector, which has recently undergone a major review by the Council of Australian Governments (COAG) and commencement of implementation of a second wave of reform. In Origin's view, it is vital that these reforms continue along the path envisaged under the NCP eight years ago (consistent with and in the context of Australia's further microeconomic). Inter-jurisdictional cooperation is essential to this end, without which a truly national and efficient energy market cannot evolve fully.

Origin's comments in the remainder of this submission relate to the energy sector unless specifically stated otherwise.

Impact of NCP and related reforms

Would the strong economic outcomes evident in recent years have been possible without micro-economic reform in general, and NCP in particular.

Strong economic performance over the last decade is unlikely to have occurred to the extent that it has, in the absence of the substantial micro-economic reform to Australia's economy. NCP has played a central role in this reform agenda in recent years, particularly in the energy sector. The NCP provided the framework for the jurisdictional cooperation and coordination required to move from an industry structure characterised by state-based, government-owned energy monopolies, to a competitive and nationally integrated energy market with private and government ownership. Energy market competition, spurred by this transition, has undoubtedly contributed to the substantial decline in real energy prices, consistent levels of energy system reliability and service quality, and greater innovation in energy product offerings. The inherently monopolistic structure of the energy industry prior to NCP was not capable of producing such outcomes (at least not beyond the level a natural rate of technological change would produce).

How important have NCP initiatives been relative to other factors (for example, technological change and education and training) in contributing to Australia's recent economic performance?

A precise quantitative attribution of the multiple factors potentially driving economic performance over the period is difficult (if not impossible). However the dramatic effect of competition on energy market outcomes since NCP was introduced, in terms of improved labour and capital productivity in generation, lower wholesale prices and substantial new investment in transmission and generation, is irrefutable. Other factors, such as technological change and general improvements in education and training across the economy, undoubtedly played a role in these outcomes, but to a far lesser extent. NCP is likely to have enhanced the effect of these other factors on the energy sector because of the stronger incentive competition creates to develop and adopt new technologies and upgrade to human capital etc.

Have NCP outcomes been consistent with their stated objectives (that is, to raise the competitiveness and flexibility of the economy and improve living standards)?

Energy market outcomes over the period are consistent with NCP objectives. Most business energy users can choose their energy supplier and from a range of energy product and service offerings (which better suit their needs). Investment in a more integrated transmission and distribution infrastructure for gas and electricity has enabled a greater degree of inter-fuel competition and substitution across fuel types, particularly gas and coal but also for renewable energy sources. Because virtually every industry in the economy uses energy as an input, greater choice in the energy market enhances the international competitiveness of the Australian economy and in particular, its ability to respond export opportunities and external threats (such as commodity price shocks).

Many residential energy users have also gained from having choice of energy supplier and a greater product and service range (including environmentally sensitive offerings). Residential energy users also benefit indirectly to the extent that business users pass on lower energy prices through other final product and service market generally.

To what extent have NCP and related reforms contributed to the achievement of other policy goals (for example, social, regional and environmental objectives)?

Lower greenhouse intensity of electricity generation was an anticipated benefit of the NEM. However the average greenhouse intensity of electricity generation has actually increased since establishment of the NEM as the most cost efficient sources of fuel, typically black and brown coal, are utilised for base load generation. Environmental objectives related to climate change have been pursued via a fragmented array of jurisdiction-based greenhouse gas abatement schemes which are not part of NCP. Arguably, if environmental objectives were an explicit part of NCP, a least-cost, nationally consistent approach to greenhouse gas abatement might have been adopted.

How large have the benefits and costs of individual NCP and related reforms been? In what form have they been manifest? Which community groups and regions have been affected most? What have been the social benefits and costs?

The COAG Energy Market Review (2002) quoted estimates of an additional \$1.5b in benefits to the wider economy (per year) as a result of energy market reforms undertaken up to 2001. Final consumers in most market have benefited, to some extent, because of substantially lower real energy input cost across the economy. Producers in energy intensive industries are also likely to have benefited to a greater extent than those employed in less energy intensive industries.

Some residential consumers have experienced real energy cost increases, particularly those in some rural areas in some jurisdictions. Although this undoubtedly represents an additional cost to these consumer segments, it largely reflects the unwinding of cross-subsidies embedded in energy pricing structures prior to the implementation of NCP (in jurisdictions where this has been allowed to occur). Transfers of this kind are necessary for improvements in allocative efficiency to occur and can be compensated for using less distortionary means.

Are there perspectives that have not been sufficiently considered in implementing the reform program (for example, have distributional impacts and adjustment costs been adequately taken into account)?

Have significant adjustment problems been widespread or limited to a subset of NCP reforms? What are the distinguishing characteristics of those reforms where significant adjustment problems have arisen?

Two key aspects of energy sector reform appeared to have been underestimated (or poorly anticipated) in the implementation phase of NCP:

- the role of the demand side in the NEM; and
- the distributional consequences of full retail contestability (FRC).

The structure of the NEM is conducive to maximum supply side responsiveness (evidenced by substantial levels of investment in generation and transmission capacity since its inception). However the inherited metering and related communications infrastructure for small users in the NEM is not conducive to maximum demand side responsiveness (evidenced to some extent by severe price spikes over summer in some jurisdictions). The optimal level of expenditure on new generation and transmission capacity is based on a balance of supply and demand that reflects (as accurately as possible) the actual cost and value of energy at a point in time. The lack of accurate demand side signals fundamentally impacts the efficiency, reliability and security of supply in the NEM.

Significant regulatory disruption and uncertainty has occurred as a result of attempting to address this issue several years after the establishment of the NEM.

Deregulation of wholesale and retail energy markets, and the competition results, inevitably exposes purchasers of energy to price volatility, and ultimately, the true cost of energy. As a result of FRC some customer segments will experience price reductions while others will experience price increases (exacerbated by cross subsidies embedded tariff structures prior to NCP). Retail price regulation that attempts to cap prices arising out of the wholesale market will thwart the development of effective retail market competition. Transparent community service obligations are a more effective and efficient means of addressing adjustment issue and can be used, if deemed appropriate by the community, to compensate adversely affected customers segments.

The development of effective retail market competition has been significantly inhibited by the unwillingness of jurisdictions to allow competition to function as intended under a deregulated approach.

Have some NCP reforms been more successful than others in meeting their objectives and delivering benefits? If so, why?

What could have been done better and what lessons does this provide for future reform initiatives? For example, are there areas where reviews of NCP impacts have been deficient and, if so, why? Was adequate information collected on the benefits and costs prior to the implementation of reforms? Can any lessons be drawn from overseas experience in assessing the impacts of NCP?

NCP reforms have literally transformed the structure and operation of the energy sector over the past eight years, delivering substantial benefits to the sector and broader economy as a result. However the reform has not been equally successful in all jurisdictions and various factors have caused the reform process to stall, before its completion (as envisaged under NCP) and before the full benefits have been realised. In particular FRC does not yet apply to all small energy users and significant regulatory impediments remain in the retail, network and wholesale segments of the energy market (reported in COAG Energy Market Review, 2002).

These impediments are diametrically opposed to the design and intention of NCP and have occurred largely as a result of unilateral intervention by jurisdictions where, presumably, market outcomes were considered politically unacceptable, regardless of the impact on national market outcomes. For example, the Electricity Tariff Equalisation Fund (ETEF) was implemented to smooth wholesale price volatility for generation and retail businesses in New South Wales despite its detrimental effect on hedge contract market liquidity in the NEM.

Opportunities for further reform

How important are the remaining NCP reforms compared to those already undertaken? How significant are the potential gains from completing the agenda?

The potential gains from completing the reform agenda are likely to be substantial. The recent COAG Energy Market Review (2002) commissioned economic modelling that projected an additional \$2b in 2010 based on the full implementation of recommended reforms.

Are there specific impediments to completing aspects of the current NCP agenda and how could they best be addressed? Have aspects of NCP processes (for example, the requirement for separate State and Territory legislation reviews of common issues) been inefficient and/or contributed to the time taken to complete the agenda?

Is the current NCP framework (its legal underpinnings, processes, institutions and incentive payments) the most effective way of progressing and extending competition reform and of 'locking in' the worthwhile changes that have already been made? What modifications to the present framework would improve its operation?

The following modifications to the present NCP framework would improve its operation:

- amendments that serve to prohibit, or at least minimise, unilateral interventions by jurisdictions which are inimical to the underlying objectives of NCP – which may involve an adjustment to the structure of competition payments to reflect the external cost on the national market of actions by a particular jurisdiction;
- greater consistency (and commonality where possible) in the processes used by jurisdictions to assess the costs and benefits of reform initiatives including a clear separation of economic and political considerations in the assessment – which may involve granting greater control of this process to the National Competition Council (or equivalent advisory body); and
- a greater reliance on the Trade Practices Act (TPA) and the Australian Consumer and Competition Commission (ACCC) and a diminishing scope for jurisdictional Regulators to intervene in market structure and competition related issues.

Are the underlying objectives of NCP still appropriate? If not, how could they be modified?

The underlying rationale (and objectives) of NCP, to use competition to strengthen incentives for better economic, social and environmental outcomes, remains appropriate.

Are there procedural issues that need to be resolved for the future? For example, do current processes take appropriate account of adjustment issues? Is the current public interest test (see box 4) facilitating socially beneficial reform? Has it provided a means to avoid worthwhile reform in some areas? Have differences in the approach to legislation review and reform across jurisdictions had any significant impacts or outcomes? How effective have competition payment arrangements been in facilitating reform?

The 'public interest' test is appropriate in its intent and design and, on the whole, appears to be facilitating socially beneficial reform outcomes (that is, those which are inclusive of private and social costs). The test could be used to avoid socially beneficial reform if and where political considerations are misidentified as legitimate social, environmental or economic considerations (as listed in Box 4 of the Issues Paper). For example, the fact that implementing FRC in Queensland would result in the unwinding of cross-subsidies between small urban and rural electricity user (causing price shocks for rural users), is not in itself, justification for not proceeding with FRC for small customers. The distributional consequences of FRC can be addressed transparently via community service obligation, if deemed appropriate by the community, without forgoing the efficiency benefits of enabling contestability and competition.

Are current CoAG energy and water initiatives appropriate ways of extending reform in these areas? Are there other reform opportunities in these areas which need to be explored? What benefits and costs would they involve and what procedural arrangements would be required to implement them? What impediments are there to the timely implementation of additional reforms in the energy and water sectors?

Origin is broadly supportive of the findings and recommendations arising from the COAG Energy market Review (2002) and considers them perfectly consistent with the underlying rationale and objective of NCP. One impediment to the timely implementation of additional reforms in energy is the reluctance of the jurisdictions (and Regulators) to cede regulatory control over their retail energy markets. The full benefits of a national energy market will be heavily compromised if retail regulation is not ultimately phased out (or at least reduced to 'light handed' monitoring of retail markets).