CEDA Speech by John Pierce – 3rd June 2014

Thank you Simon and CEDA for putting on today's event.

A few weeks ago I was across the Ditch in Wellington, killing a little time in a coffee shop before an appointment. There were two people sitting next to me having a very engaged and animated conversation……………………about house insurance. They were comparing notes on the different policies they were on and of other policies from different companies they had received quotes from.

Two things struck me about their conversation. The first was the level of emotion…….. there was none. Their tone was very 'matter of fact' without a hint of angst or frustration borne of confusion. They had the demeanour of people who were confident they knew what they were talking about.

The second was the range of things they were comparing……premiums of course, but also the level of excess, exclusions and how pleasant and informative the voice on the other end of the phone was when they rang this company or that.

And I thought, “that’s it!”

How can we get to a world where people are as comfortable shopping for energy as they are house insurance…….or car insurance or bank loans or a myriad of other services where we take choice and competition for granted.

Now I often hear people say that energy is complicated. Well guess what so are the financial services or telecommunications sectors or even groceries, if you try and explain the retail offerings to people by describing the processes and technology that make up the supply chain.

Of course it wasn’t long before John Pierce the human being, eavesdropping in a coffee shop reverted to Pierce the econocrat who thought

“confident, well informed consumers”….. notice how that term de-personalises our thought processes…..” is one thing, but if their choices are going to result in efficient operation, investment and innovation along the supply chain and hence make a positive contribution to productivity growth in the economy more generally, the prices and other characteristics of the services being offered to these ***individual*** consumers need to reflect the costs to the system of supplying them. The supply chain then needs to be flexible enough to respond to these consumer choices. Generally this requires price levels AND structures to be capable of communicating the consequences of these choices on underlying demand and supply at each link in the supply chain."

Pierce of the AEMC recognised that these two New Zealanders were unknowingly living the *consumer* priority in the Australian Energy Market Commission's Strategic Priorities for energy market development. The econocrat was thinking about the *market* priority and both are needed.

Pierce the human being thought it best not to burden the house insurance shoppers with this revelation and left for his appointment without disturbing their search for Pareto Optimality.

The *Consumer* Priority

aims to allow consumers to participate confidently in the energy market and that they can see a benefit to themselves from doing so.

Participate in the competitive generation and retail markets, through their consumption and contract choices and in the network sector, through the impact of these choices and through participation in the regulatory processes.

Underpinning this is a view as to who you want to be driving the way the sector operates and develops in response to changing technologies, costs and relative prices.

Importantly, and in common with the *market* priority, it also requires reflection on how risks of various types are allocated, primarily between consumers and equity investors, but also in this game, taxpayers.

In the old world of state-based utilities, the sector's development – perhaps quite appropriately for the times – was largely driven by planners employed in what was often labelled the "Power Development Division" where the focus was on building generation capacity. When energy demand was growing at 6 per cent *plus* per annum some would argue that this focus was fair enough.

A consequence of this type of industry structure however is that investment risks fall on consumers. When demand growth slowed to around 3 per cent per annum but generation plant was still being built as if it was 6 per cent, prices rose to recover the costs of the excess capacity.

With the start of the wholesale NEM more than 15 years ago, it was recognised that the drivers of the way the sector developed would shift from generation to retailers and the way networks were regulated.

It was also recognised, indeed intended, that investment risk would shift to the owners of generation capacity. If too much capacity was built wholesale prices would fall. Competing generators need not be any better at forecasting the future than the planners, but the consequences would sure be different.

What we are experiencing now is….. admittedly what can at times be in an untidy manner……. a transition to the next phase of that trend where consumers, doing what they do best – making consumption decisions – drive the way the sector develops.

Consumer representatives, governments, the businesses operating in the sector, and market institutions such as the AEMC and the Australian Energy Regulator all have a role in facilitating this transition. For the Commission's part perhaps the two most important or at least visible pieces of work are the Rule changes flowing from the Power of Choice Review and our reviews of retail competition.

Power of Choice was a package with numerous elements. Each element to varying degrees depends on the others. Three fundamental building blocks though are the Rule changes dealing with (i) the way network charges are structured, (ii) the development of a market for the data that new metering technologies can provide consumers, retailers and distribution network operators, and (iii) arrangements that allow for multiple trading relationships at the consumer's connection point.

All are a bit "techy" and looked at individually each in isolation might not seem world shattering. Taken together however they create the opportunity for consumer choice about how they use this stuff to drive efficient delivery of energy services.

The work we have done as part of the Retail Competition reviews identified four things energy consumers need for there to be coffee shop conversations like the house insurance conversation I overheard in New Zealand.

1. A trusted source of advice that allows them to compare "apples with apples",
2. Knowing that consumer protections were in place and that the reliability of their physical supply was unaffected by shopping around,
3. That the potential savings made shopping around worthwhile, and
4. That doing so would be relatively easy to do and not overly time consuming.

Energy of course is an all-pervasive input to economic activity. There is a strong link between the productivity of this sector and that of the broader economy. This is why the energy sector was a particular focus of the microeconomic and competition policy reforms of the 1990's and the resulting wholesale market arrangements have been an enduring reform success.

Creating the conditions that allow consumer choice to drive the way the sector and the market for energy services develops will help open the next chapter of what is a productivity improvement story.

Governments naturally tend to have objectives that go beyond these *consumer* and *market* priorities for energy market development. Concerns for vulnerable customers and the environmental impacts of the sector are obvious examples. That is quite appropriate of course because after all they are elected to govern and I am not.

How these objectives are pursed,…… whether the instruments used to implement them are compatible with the way energy is bought and sold and the risk allocation that allows the market to operate……. however has important implications for how effectively the energy market can work in the long term interests of consumers.

Like the market arrangements themselves, policy instruments that depend on a particular view of the future, on predictions of relative prices and technology costs are likely to result in inferior outcomes to those that can achieve their objectives whatever the future may bring.

Thank you.