



Hon. Paul Lucas MP

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Mr P Neville MP
Chair
Transport and Regional Services Committee
House of Representatives
Parliament House
Member for Hinkler
CANBERRA ACT 2600

Secretary: *J. Luff*

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HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON
TRANSPORT AND
REGIONAL SERVICES



Queensland
Government

Minister for
Innovation and Information
Economy

Dear Mr Neville

**Re: Inquiry into the Economic and Social Impacts of the Privatisation of Regional
Infrastructure and Government Business Enterprises**

I refer to the Background Paper "*Economic and Social Impacts of the Privatisation of Regional Infrastructure and Government Business Enterprises in Regional and Rural Australia*" (Paper), recently released for comment by the House of Representatives Standing Committee on Transport and Regional Services (Committee).

I ask that you accept this as a submission by the Queensland Office of Energy on the issues raised for consideration in the Paper and to assist the Committee with its deliberations on the impacts of privatisation on the delivery of electricity and associated services.

By way of preliminary comment, Queensland is of the view that:

- Government ownership of energy assets has not impeded the realisation of energy reform benefits in Queensland, where those benefits exist;
- Queensland will not support reform for reform's sake, particularly where this would result in inequity between customers in regional and rural Queensland and those in the south-east corner of the State;
- the real economic benefits of energy reform are in the wholesale market; and
- Governments need to focus their collective energy on ensuring the delivery of a robust and reliable transmission system to underpin the competitive wholesale market that has been created.

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Queensland Electricity Sector

The Paper's comments that it is not always possible to separate privatisation outcomes from the effects of other concurrent policy and regulatory changes is supported. This is particularly the case with electricity reform, where the cooperative establishment of the National Electricity Market (NEM) in 1998 coincided with decisions to privatise electricity assets in some NEM states (Victoria and South Australia), but not all (Queensland and New South Wales).

While the specific impacts of privatisation may not be identifiable in all instances, what can be said is that there is no evidence to suggest that full realisation of the benefits of energy market reform has in any way been impeded by the ownership arrangements in those States which did not proceed with privatisation.

As correctly identified in the Paper, the Queensland Government has retained ownership of a significant proportion of Queensland's electricity assets. Yet, Queensland has traditionally had the most efficient electricity sector in the nation. Our prices have always been among the lowest and the industry has never been burdened by excessive debt, unlike in other States.

Queensland does however face a number of unique challenges which drive our focus on the correct solution for meeting the future needs of Queensland customers.

One of Queensland's current outstanding economic features is the State's rate of load growth due to population and industrial demand. Queensland's load growth is the highest in Australia – averaging between 4% and 6% per year, compared with less than 3% for the other States. The outlook for the next three years is similar, with peak electricity demand expected to grow by 6% in south east Queensland.

The complexities associated with the management of this load growth are compounded by Queensland having Australia's largest and most diverse network, with 6,500 km of transmission line and 176,000 km of distribution line. To put this in context, the main power flows from central Queensland to Brisbane travel three times farther than the comparable flows from the Latrobe Valley to Melbourne. Clearly, more network investment is needed in Queensland to carry the same amount of power.

Despite these challenges, Queensland has seen significant new investment in the electricity sector. Since 1998, this has equated to:

- Over \$1 billion of investment in network infrastructure, representing approximately one-third of the network investment for the entire NEM.
- Over \$3 billion of investment in new generation assets – 70% from the private sector. This represents well over half the \$5 billion of investment in new generation in the NEM. Indeed, Queensland is the only NEM State where a 100% private merchant base-load generation project has been delivered (InterGen's Millmerran plant).
- A dramatically falling electricity pool price, this year averaging approximately \$23 megawatt hour (MWh), down from around \$60/MWh at market start. In fact, as shown in Table 1, this calendar year, Queensland's average pool price has been the lowest in the NEM:

Table 1: 2003 Average Pool Price

Region	2003 Average Pool Price (to 31 October)
Queensland	\$22.65
Victoria	\$23.08
South Australia	\$25.61
New South Wales	\$27.43

- Lower pool prices have translated directly into millions of dollars in savings for large Queensland electricity users, including those in regional areas. It has been estimated that since 1996, there has been a 22% reduction in electricity prices for large business users, who consume 70% of energy in Queensland. As correctly stated in the Paper, the benefits of “pricing reforms are not unique to the privatised players in the power industry”.

Reliable and competitively priced energy is important for investment and the delivery of price benefits to industry has played an important role in the attraction of major new investments in Queensland. Clearly, the Queensland Government has successfully delivered these outcomes without privatisation.

Queensland accepts however that separation of ownership and control of industry assets from regulation and market operations is important - Governments should not, and need not be, involved in the day-to-day operation of the market or its assets. In Queensland, this necessary separation has been achieved through corporatisation and vertical separation of Government-owned energy assets, each with their own governance structure and commercial charter.

Looking forward, the Queensland Government recognises that our high load growth and dispersed network will continue to place considerable pressure on our energy infrastructure and that positive steps are required to ensure that our future energy market framework delivers the level of investment required.

Our geography and economic climate mean that we have much at stake on this issue and Queensland is actively participating in inter-governmental processes involving the Commonwealth, States and Territories to develop energy market reforms which will ensure the continued delivery of reliable and competitively priced power to all Queenslanders.

Competition Reforms

A priority for the Queensland Government has been to ensure the reliable delivery of competitively priced power to customers, throughout the State. The Queensland Government currently ensures pricing equity between our rural and regional customers and those in our south-east corner through a uniform tariff policy. The uniform tariff provides that customers of the same class pay the same price for their electricity supply, regardless of their geographical location.

National Competition Policy (NCP) has provided considerable impetus to the issues of electricity industry reform, privatisation and price deregulation. Queensland supported the introduction of competition policy and acknowledges the many benefits it can and has brought to our economy.

The Queensland Government does not, however, support reform for reform's sake. Individual reforms must be considered in the context of a robust consideration of costs and benefits and assessed in terms of the goals that are sought to be achieved.

This approach has exposed Queensland to criticism from the National Competition Council (NCC) with respect to our position on the introduction of retail competition for residential and small business customers (full retail competition or 'FRC').

Retail contestability and price deregulation has been progressively introduced in Queensland for customers who use more than 200MWh (those with bills over \$20,000) of electricity per year. These customers have the choice of remaining on regulated electricity tariffs or choosing their electricity retailer and negotiating a market price for their electricity supply.

The Queensland Government has however deferred the introduction of FRC and price deregulation for residential and small business customers. This decision was made on the basis of a cost benefit analysis conducted in late 2001, which demonstrated that price deregulation in Queensland would result in significant price increases for the majority of Queensland's rural and regional customers. For example, while a customer in Brisbane might save \$90 on an annual bill of \$825 under price deregulation, a customer in Central or Far North Queensland would face an increase to more than \$2,000.

A copy of the Queensland Government's "Report on the Review of Costs and Benefits of Full Retail Competition in the Queensland Electricity Industry", 2001, is attached (Attachment 1) for the Committee's information. Also attached is an updated estimate of electricity price increases that regional customers in Queensland would face under deregulation (Attachment 2).

As the Queensland Government's analysis demonstrates, for smaller and regional customers there are limited benefits and substantial costs associated with the introduction of FRC, mostly due to the high network costs that arise from our dispersed electricity network. In some areas of the State, network costs can comprise up to 84% of total electricity costs.

As can be seen from Table 2 however, even without FRC, Queensland's residential consumers have among the lowest retail prices in Australia, closely behind New South Wales and the Australian Capital Territory. According to the Electricity Supply Association of Australia's annual publication "Electricity Prices in Australia", in 2003/04, Queensland domestic customers are paying around 11.61 cents per kilowatt hour (kWh). At fifth, Victoria's domestic customers pay 14.17 cents and at seventh, South Australia's domestic customers pay 17.84 cents.

**Table 2: Nominal Electricity Prices for Residential and Business Customers for 2003-04
(Capital Cities Only)**

State	Residential ¢ per kWh	Small Business ¢ per kWh	Large Business ¢ per kWh
Queensland	11.61 (3rd)	13.64 (4th)	6.38 (3rd)
New South Wales	10.43	10.81	5.46
Victoria	14.17	14.79	5.78
South Australia	17.84	16.40	8.29
Western Australia	13.77	16.17	8.89
Tasmania	12.21	12.40	6.90
Australian Capital Territory	11.41	12.57	7.71
Northern Territory	15.36	15.30	9.61

Source: *Electricity Prices in Australia – 2003/2004*, Electricity Supply Association of Australia Limited

In Queensland's view, FRC has been less than a success where it has been introduced, with few customers switching retailers – only 4% in New South Wales, 10% in Victoria and 0.9% in South Australia.

Clearly, customers will only embrace FRC if there are price savings to be had. South Australian consumers have been faced with approved increases of over 25% in their average retail prices since the introduction of FRC on 1 January of this year. This translates into average annual electricity bills for domestic customers rising by approximately \$240.

Although the remaining FRC states – New South Wales, Victoria and the Australian Capital Territory, have not experienced price increases of the same magnitude as those seen in South Australia, this in many instances is attributable to the regulators' refusal to approve the average price increases sought by retailers. That is, despite the introduction of FRC, the ability to regulate prices has been retained in an effort to insulate customers from price shocks.

In Queensland's view the real economic benefits of competition reform are in the wholesale market and we are yet to be convinced that giving households a choice of electricity supplier adds to economic growth, particularly for those customers in rural and regional areas. We do however acknowledge that this situation may change as the market develops and have undertaken to again examine the introduction of FRC in 2004.

Even at the risk of incurring financial penalties for our decision to defer the introduction of FRC, the Queensland Government remains committed to ensuring a reliable supply of electricity at prices that are consistent with the long-term interests of all Queensland customers.

Emerging Issues

The Committee is concerned as to whether commercial incentives alone are sufficient to ensure continuity in supply during periods of peak demand, particularly in light of recent supply failures overseas.

The United States' (US) energy crisis resulted from a lack of national coordination and substantial underinvestment in the network. In the US, the electricity market is operated by a series of State based independent system operators (ISOs) – with each State at a different stage of reform. There are no national network standards and there is a lack of regional coordination. At the time of the US crisis, at least five ISOs were required to manage their systems without a full understanding of the overall network implications.

In contrast, in Australia, the NEM States have established this function in a single independent operator, the National Electricity Market Management Company (NEMMCO), which operates the entire NEM. The Reliability Panel (also established under NEM rules) determines reliability standards and the power system security for the entire NEM is based on advice from NEMMCO.

The US industry has also suffered from chronic underinvestment in transmission and generation. In contrast, Queensland has been vigilant in ensuring adequate supply and a reliable network is maintained and as stated above, since the NEM began in 1998, Queensland has had the greatest level of investment in generation, equal to more than 2,500 mega watt (MW) of capacity.

In terms of opportunities for future investment in electricity infrastructure to meet projected growth in demand, the NEM system operator, NEMMCO, has released its 10 year forecast for the demand and supply of electricity across the regions of the NEM. While the report did not foreshadow imminent blackouts due to a lack of available generating capacity, it did highlight strong growth in electricity demand, and identified the scope for new investment in the medium-term, so that Australia's existing high levels of electricity supply reliability can be maintained.

The level of investment in the Queensland energy sector places the State in a very favourable position. According to NEMMCO, Queensland has sufficient electricity reserves over the next few years and, based on current forecast demand, would have sufficient reserves until 2007-08. Queensland experienced record demand levels over January 2003, exceeding 7,100 MW, without experiencing supply disruptions - this is clearly a sign of the strength of the Queensland electricity system.

Queensland is well placed to meet the forecast higher demand with projects such as the Kogan Creek coal power plant licensed to begin construction when demand warrants. It is Queensland's ready access to cheap coal, and the low cost electricity that it produces, that has underpinned much of the State's economic development to date.

What is more, the average age of Queensland power plants is among the lowest in the country – at around 16 years, compared with more than 21 years in NSW and 23 years in VIC. This means that Queensland has the latest generation technology available to underpin the continuation of competitively priced energy.

The level of network investment in Queensland has been such that the levels of supply reliability are first-rate in the context of record load growth in Queensland. Powerlink Queensland, the State's transmission entity, assigns approximately \$160M per year to capital expenditure to maintain reliability of the existing Queensland network. This accounts for approximately 40% of the capital expenditure on network assets in the NEM.

Queensland is not only addressing the issue of meeting future demand at a State level, but, as part of the national reform process and sees transmission reform as the key. Queensland recognises the need for improvements to the transmission framework and is at the forefront in developing and proposing solutions to address these concerns. Queensland's key proposals for improving the transmission system in the NEM are:


- Changing the regulatory test for transmission investment to take into account the benefit that transmission investment brings in reducing wholesale energy prices by enhancing generator competition.
- A new national transmission planning process.
- A power to direct interconnector investments if the market does not bring forward these investments in a suitable timeframe.

Queensland is also working to change the transmission regulatory arrangements to ensure that investment in the transmission system occurs in order to deliver timely and reliable energy supplies to underpin Queensland's economic and social development and that of the NEM as a whole.

Queensland's enviable position is a direct result of the Government's priority to engender a robust and reliable network to underpin Queensland's competitive wholesale electricity market. It is this environment which will provide real benefits to Queenslanders and an important stimulus for investment and service delivery to rural and regional Queensland.

My Department would be happy to provide any additional or more detailed information the Committee may require to assist it with its considerations. If you do require any further information, please contact Ms Loretta Boman, Manager – Electricity & Markets, Office of Energy on telephone number (07) 3224 6927.

Yours sincerely



PAUL LUCAS MP

Minister for Innovation

and Information Economy

Minister with responsibility for Energy