

18 July 2007

Market Design Review Issues Paper Consultation
Electricity Commission
PO Box 10041
Wellington
Email: info@electricitycommission.govt.nz



SUBMISSION FROM THE CANTERBURY MANUFACTURERS' ASSOCIATION

FOR THE

Market Design Review Issues Paper Consultation

Canterbury Manufacturers' Association
P O Box 13152 Armagh
CHRISTCHURCH
Email: johnwalley@clear.net.nz

The Canterbury Manufacturers' Association is pleased to have this opportunity to provide feedback on this submission.

BACKGROUND

The Canterbury Manufacturers' Association represents manufacturers predominantly in Canterbury and Westland, with members throughout the rest of the South Island and Auckland. The numbers of staff employed by our members represent approximately 40% of those employed by the manufacturing sector in the Canterbury region. Locally the manufacturing sector is a significant contributor to the economy, representing about 13.2% of employment.

Elaborately transformed manufactures comprise over 30% of New Zealand tradable exports, sector sales total over \$30 billion and total national employment numbers around 170,000. New Zealand manufacturers face the ever-increasing onslaught of the cost of local regulation and global competition from low cost countries, without any significant support. The Canterbury region has a disproportionately high number of high value elaborately transformed manufacturers who have significant export sales when compared with all the other regions of New Zealand.

The historical reliance that New Zealand has placed in the primary sector and basic manufactured goods has seen the position that New Zealand has in the rankings of the Organisation of Economic Co-operation and Development fall from 5th in 1950 to 21st in 2005, between Spain and Greece, well into the lower middle bracket of global income per capita. New Zealand has grown more slowly than other countries due to the dependence on the primary sector. The manufactured goods sector of the internationally traded economy has grown much faster.

Without economic development, based on best cost, reliable and secure infrastructure, and elaborate transformation commanding high prices from global customers, we will increasingly see issues such as “health problems” correctly characterised as “wealth problems”, recent headlines on our inability to fund state-of-the-art cancer chemotherapy drugs demonstrate this limitation.

INTRODUCTION

We have looked at the report titled, "Market Design - Survey of Market Performance", and appreciate this opportunity to comment. Overall, the report does ask sufficiently fundamental questions, but before investigating, say the comparative costs of retail, we should be asking: is the market structure delivering what is required? Again, using the retail example, what real value does retail competition add to the electricity market? If the retailers were competing, it would be natural to see significant churn in the market - no churn, no competition, equals no market. In such a case, combining retailers and having them focus on cost of delivery, as opposed to competition, might be more sensible. From a competitive standpoint, there is no real benefit to be average, we have to be much more cost competitive than average.

In the past we have taken the view that the overall coordination to meet future growth is absent from the market. We do not accept the assertion that what we have is acceptable in terms of reserve capacity and capacity growth planning; saying things are fine to 2011, when lead-times for these assets are close to a decade and longer, when resource consents are factored in. This report echoes the complacency evident in the "*Powering Our Future: Towards a Sustainable Low Emissions Energy System - Draft New Zealand Energy Strategy to 2050*".

QUESTIONS THAT REMAIN UNANSWERED

We would have thought that the review would have looked deeper into some fundamental questions regarding the provision of electricity in New Zealand. For example:

- Is the system providing the right outcomes, lowest cost and higher reliability in comparison to our trading competitors? Is electricity a competitive advantage for New Zealand? If not what can be done to make it so?
- Is the market working? Are the components of the market working? Which market components are adding real value? Are any elements of the market only adding cost?

- Is the capacity planning mechanism that represents the aggregate from individual generating companies providing adequate capacity just in time or to late? Would other interventions be appropriate in the capacity planning methodology?
- How can the participants in the hedge markets have any real confidence that future contracts will be supplied without: secure fuel sources, confidence in the transmission availability, carbon costs, and environmental court associated with the Resource Management Act?

One key factor to demonstrate the supply side is adequately planning for demand growth is the reserve margin. What should this margin be? What is the acceptable tolerance or fluctuation in reserve margin, and will the Electricity Commission be explicit in this regard, and regularly publish where the supply system is operating in regard to this reserve parameter, and the expected performance projected forward to the full lead-time of the next generation/transmission asset implementation? Reserve capacity should be a key performance indicator of the demand/supply balance.

Fuel source availability and the inherent contradiction in the environmental desires seems to us to be unrealistic – certainly the projections on load and desired reduction in carbon output to the late 2020s suggest that it will be necessary to double all installed renewable generation. Given such a build programme is physically possible, the surrounding system problems (Environment Court, green activism, Not-in-my-backyard (NIMBY), RMA) make a mockery of that intent.

RETAIL MARKETS

In the analysis of the operation of the retail market, comparisons are made between New Zealand and other countries, but there is no absolute evaluation of the performance of the New Zealand retail market against the benchmarks that were established when the free market model was adopted. The report does not promote best practice, but the authors seem content that we are in the middle of the range of surveyed countries. Further analysis of the data reveals that New Zealand is not performing as well as it would first seem.

Whilst New Zealand's performance on reliability appears to be within the range of international experience, New Zealand failures have been in infrastructure rather than because of extreme weather, as is the case with many of the overseas statistics.

The free market model has certainly not delivered any benefits for residential customers. On average prices have increased by 33% over the last four years. While retail customers may choose their energy retailer, they are "price takers" and have no bargaining power when it comes to prices. Retail operating costs are \$170 per customer per year in New Zealand compared to Australian estimates of A\$60 - A\$80 per customer per year. The absence of competition will not drive efficiency, all prices are much the same and the consumer has no alternative but to stay and pay.

There is no competition at retail level. The low level of customer churn is a clear indicator of this. Retail adds no value and costs around one third of the total generation cost. A monolithic retailer system offering operational scale economies, with performance based KPIs may be a better solution.

DEMAND SIDE PARTICIPATION

In terms of the demand side, the market offers no or little incentive for any commercial or residential consumer to voluntarily partake in any load shedding or shifting. To the contrary, consumers in the South Island, in particular, are less likely to reduce demand during high periods of climatic demand as they struggle to keep warm in poorly insulated homes. The Government and the electricity industry would be better positioned to look at the cause of the problem and not seek to address the symptoms.

As the Electricity Commission seeks to reduce demand by subsidising low energy lights, the Government and the electricity industry could look for other incentives. This would enable all consumers to be able retro-fit existing homes with good insulation, under floor insulation and double glazing. The benefits would not only be permanent (compared to the temporary effect demand shedding or load shifting), but reduce the demand for more power.

In today's tight markets, industrial consumers balance the cost of higher prices of electricity against the inconvenience of reducing production, lost sales, etc, and trying to remain competitive. Our experience has been that the hedge market is for the larger players only.

For many users, the costs are too high and the feeling is that reliability is falling, and the industry is making huge profits under normal conditions, and windfall returns when demand is close to capacity. Higher prices and lower reliability follow the focus on returns to shareholders; an efficient electricity system does not equal an efficient economy, the associated incentives require more alignment.

CONCLUSION

Managed well, electricity can be a strategic advantage for New Zealand, leaving capacity planning to individual companies and arguing that low reserve margins are acceptable will delay decision-making past the point where it is prudent to act.

Currently, the electricity companies are operating to suit their own particular outcomes, and they are not incentivised or controlled to provide the best outcomes for New Zealand. A fundamental review is necessary, without it, we will simply see more of the same sub-optimal outcomes, from the New Zealand standpoint. How will the new strategy provide optimum outcomes for New Zealand?

We have to do better and make electricity a comparative advantage for New Zealand users.

John Walley