COVER STORY

Energy prices: Reliable supplies come at a price

There have been stories in recent months about rising electricity prices. There have been claims that power prices are set to skyrocket across the country. What is really going on?

AROUND AUSTRALIA, retail energy prices have been rising due to higher supply costs. A typical Australian household spends about three per cent of its weekly goods and services budget on electricity and gas. This increases to four per cent for low-income families.

Consumers buy electricity from retailers such as AGL, Origin, EnergyAustralia, Country Energy, Integral, TRUenergy and Simply Energy. The prices that consumers pay are determined in different ways. In Victoria retail prices are determined in a competitive market but with government oversight. Most other jurisdictions also have competitive arrangements but with 'safety net' prices set by government or a local regulator.

Whether retail prices are determined through competition or by a regulator, they reflect the underlying costs the retailer must pay to supply energy. More than 40 per cent of a typical household electricity bill covers wholesale electricity costs, and almost 50 per cent covers the costs of using networks (power lines for electricity, pipelines for gas) to deliver energy to homes.

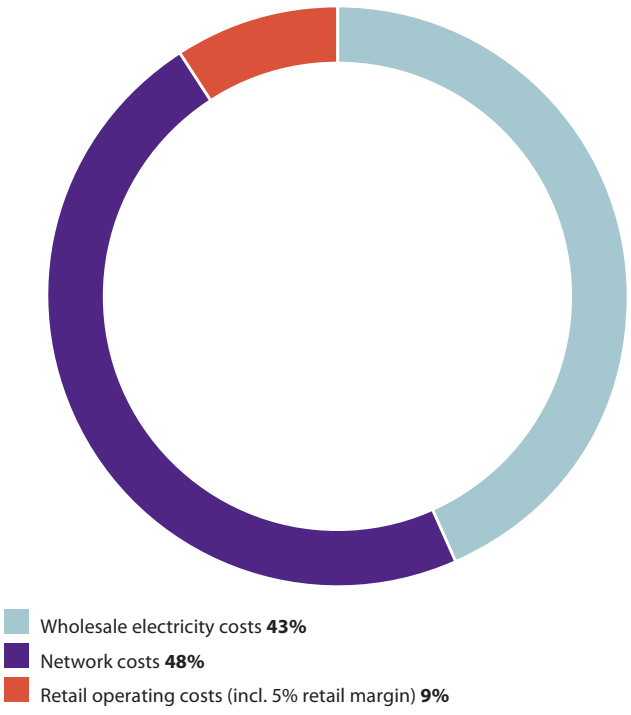
The balance covers retailers' operating costs and profit. Figure 1 shows an approximate breakdown for Queensland. The numbers are similar for other states.

The two largest components of retail prices are: (1) the wholesale costs of energy and (2) network charges.

Wholesale electricity prices have been fairly stable over the past 18 months.

South Australia has been an exception to this pattern, with unusually high summer prices. There has been a general shift

Figure1
Composition of electricity retail prices—Queensland 2009



Note: Figures represent the composition of estimated costs for an electricity retailer.

to more volatile conditions, with prices shifting between $40 a megawatt hour and $10 000 a megawatt hour in the space of a single day. Retailers take out insurance to protect themselves and their customers from these fluctuations.

Network charges have had the biggest impact on retail prices. The Australian Energy Regulator approves the revenues or prices the networks can charge to deliver energy to customers. This prevents the businesses from setting unfair prices. But network costs are on the rise across Australia for quite legitimate reasons. The main reasons are:

- Some networks have deteriorated over time (many were built more than 40 years ago) and new investment is needed to avoid serious power outages for customers.
- State governments are setting stricter laws for networks to provide reliable services. Some networks need new investment to be able to meet these laws.
- The growing appetite of consumers for air conditioners—which are energy hungry—puts a huge strain on the networks and requires new investment to keep up with demand.

These costs are starting to flow through to retail prices. The New South Wales regulator (IPART) announced in 2009 that retail electricity prices would rise by around 20 per cent.

About half of this increase was due to higher network charges. The Queensland regulator (QCA) recently proposed that retail prices increase by nearly 14 per cent from July 2010. The biggest single factor was higher network charges. The benefit to consumers of these price increases should be more reliable energy supplies and fewer power outages.

Governments are looking at other ways to make energy networks more effective.

Several states are introducing or trialling smart meters that would allow consumers to better manage their energy use. While smart meters cost more than traditional meters, they will allow for better service, for example, through more accurate billing and faster detection and correction of faults.

Eventually, they will benefit consumers by providing them with information to better manage electricity use, for example by running appliances such as washing machines at off-peak times when prices are lower.

In summary, while retail prices are rising—caused mainly by increasing network costs to deliver energy to homes—there are benefits for consumers.

Higher retail prices will pay for new investment in energy networks. This will make power supplies more reliable and help transport more electricity on peak summer days for air conditioning. The new smart meters will also provide consumers with more information and help them use energy more efficiently.

These improvements will place consumers in a better position to manage their electricity consumption into the future.