

Box E: Electricity Prices

The electricity industry in Australia has changed substantially over the past decade. A range of administrative reforms and the introduction of competition to parts of the industry have been associated with significant productivity gains and, for much of the period, declining real electricity prices. However, in recent months there has been upward pressure on electricity prices, with some customers experiencing particularly large price increases.

Reforms implemented over the past decade have resulted in the separation of the components of electricity supply – generation, transmission, distribution, and retail supply. Competition was introduced into the generation of electricity by dividing the power stations into separate corporate entities, initially in Victoria and NSW and later in other states. Competition has also been introduced to parts of the retail electricity market. At this stage, large and some medium-sized users of electricity in most states have the choice of retail supplier – that is, in the parlance of the industry, users are deemed to be ‘contestable’. All users in NSW and Victoria are expected to be able to choose their electricity retailer next year. South Australia plans to adopt full retail contestability later than in these states, while Queensland has decided not to proceed.

Another key development was the establishment in December 1998 of the National Electricity Market (NEM), which connected the individual electricity grids of NSW, Victoria, Queensland, South Australia and the ACT.¹ It allows the transmission of electricity across these regions’ borders.

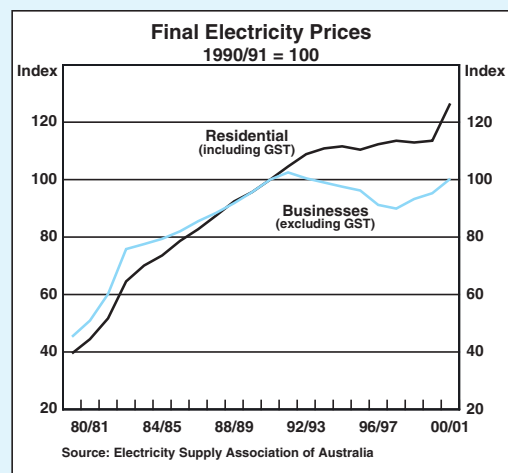
Electricity price developments

Movements in final electricity prices can largely be traced to two components: an

energy charge which mainly reflects movements in wholesale electricity prices, and *network* charges levied on electricity retailers by electricity distributors, reflecting the costs of building and maintaining the electricity distribution and transmission network. As a rough guide, for medium-sized businesses the energy charge comprises at least 50 per cent of the final electricity price.

The reforms in the electricity industry were associated with a decline in electricity prices faced by businesses and a slowing in the growth of electricity prices faced by households (Graph E1). Large and medium-sized businesses in Victoria and NSW who were contestable benefited from falls in electricity prices during 1996–1998, underpinned by the low wholesale price of electricity as generators competed for market share (Table E1) and, more recently, falling network charges. Businesses in South Australia also experienced lower prices in this period. However, over the past few years, wholesale prices have risen which, along with expected smaller future reductions in

Graph E1



1. Tasmania is scheduled to join the NEM in the near future. Although distance may preclude Western Australia and the Northern Territory from joining the NEM, they are also implementing electricity reforms.

Table E1: Average Wholesale Spot Electricity Prices^(a)
Dollars per megawatt hour

State	1994	1995	1996	1997	1998	1999	2000	2001 ^(b)
NSW	–	–	24.1 ^(c)	17.5	19.4	22.7	35.7	34.7
Victoria	46.7 ^(d)	42.2	19.9	18.8	18.3	22.6	38.3	38.3
Queensland	–	–	–	–	–	41.6	50.3	37.2
SA	–	–	–	–	–	54.5	57.2	46.2

(a) Prices only available since the commencement of each state's wholesale spot market

(b) Until 31 October

(c) May 1996 to December 1996

(d) July 1994 to December 1994

Source: NEMMCO

network charges, have been feeding through to higher final electricity prices as businesses in these states renegotiate their electricity contracts.

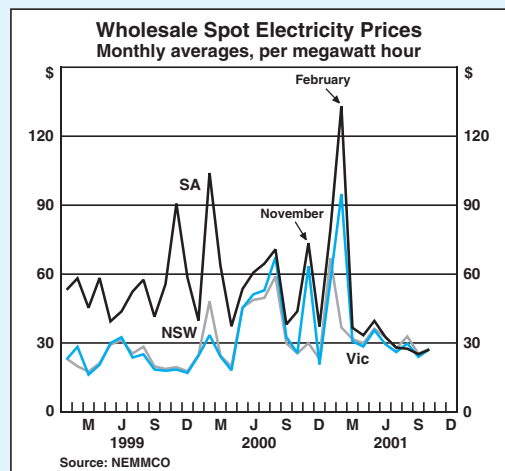
In South Australia, where many additional business users have just become contestable, electricity prices are increasing substantially. This partly reflects the artificially low prices contained in their previously regulated contracts, but also a perceived increased risk that tighter supply of electricity in the summer months may cause large spikes in wholesale electricity prices, as occurred last summer (Graph E2).

In contrast to larger businesses, the supply of electricity to households and smaller businesses is only now becoming contestable in NSW and Victoria. In Victoria, the government has reserved the right to oversee the setting of electricity prices in that state. In NSW, households have the option until mid 2004 of remaining on (or returning to) a regulated contract which limits the price rise to that of the total CPI. In South Australia and Queensland, price rises of around 3 per cent have been determined for 2001/02.

Effects on the CPI

Electricity prices affect the CPI directly through households' consumption of electricity, and indirectly as changes in input costs faced by businesses are passed on to

Graph E2



prices of other goods and services. Electricity has a weight of 1.8 per cent in the CPI and, in the near term, as the majority of households will be covered by regulated contracts containing subdued price increases, the direct effect on inflation will be fairly small. Although electricity comprises less than 2 per cent of total intermediate inputs used in production, it accounts for much more in selected industries – electricity comprises up to 8 per cent of intermediate inputs in parts of the manufacturing industry. The size of recent price increases for some businesses will have a significant effect on their overall costs and may feed through to consumer prices. ✎