Article published in the *Dominion* Post newspaper, Wellington, 4 April 2018, under the title 'A protection-racket line straight out of The Godfather'.

[A response on 16 April 2018 from Eric Crampton of the New Zealand Initiative thinktank, and a letter in reply from me on 18 April, are reproduced below the original story in scanned form.]

The oligarchs of the electricity industry have moved quickly to capture the new Government's Minister of Energy, Megan Woods. In her speech to the industry's Downstream conference on 13 March, as reported by *Businessdesk*, Dr Woods faithfully parroted key themes from a Concept Consulting report written for the Electricity Networks Association last November, and assiduously pushed at the incoming Government by industry lobbyists.

"The government", the Minister declared, "is watching to make sure low-income consumers don't end up facing higher electricity costs caused by wealthier people installing solar power units".

"This is particularly in the context of the rise of emerging technologies like solar panels and distributed generation which mean that more people who can afford to are able to draw less electricity from the grid, pushing the price of electricity up for everyone else - often the people who are least able to afford it."

Here in a nutshell is the industry's strategy for blocking the entry of rooftop solar and preventing customers from breaking free of the incumbent electricity cartel's price-gouging. The threat is that when households who can afford to install their own solar generation and batteries do so (and thereby reduce their purchases of cartel-supplied power), the industry will respond by raising the prices it charges low-income households who can't afford to make the switch to independent renewable supply.

"Nice little bunch of low-income folks you have there. Pity if something were to happen to them…" The protection-racket line comes straight from the Godfather movies. It is plausible because the industry does indeed have the ability, and the legal right, to carry out the threat. The Government, unwilling to face down the oligarchs, seems likely to cave in to their demands.

For those lacking the time or inclination to plod through the detail of the debate, here is a quick summary. When new renewable technologies such as rooftop solar come into the market and provide serious competition to the established generators and lines networks, those existing players see their profits threatened. To protect those profits they must either kill off the new technologies, or extract more money from their remaining customers, or both. If the attempt to protect profits fails, the big companies face write-downs on their asset values and share prices – which would, of course, be the normal and expected outcome in competitive industries subject to market forces.

The New Zealand electricity industry is not, however, a competitive industry subject to market forces. The production and retailing of electricity is done by a tight oligopoly of five big companies, while distribution of power takes place through natural-monopoly networks whose prices and asset values are protected by a compliant Commerce Commission.

Over the three decades of so-called “reform” the big players have written into their balance sheets over $14 billion of “revaluations” - pure capital gains, representing the value of wealth extracted from electricity consumers via the industry’s successful rent-seeking.

Those huge wealth transfers, and the price-gouging of captive customers to sustain them, are directly threatened by the arrival of independent supply based on economically-viable renewables technology. Faced with the reality, rather than just the mirage, of real choice for consumers, the industry has rushed to hide behind the skirts of the Commerce Commission and the Government.

The network companies declare that their asset values are “sacrosanct” because they are enshrined as a Regulatory Asset Base signed off by the Commerce Commission. Therefore, they say, they are required to secure enough revenue to get their regulated rate of return on those assets – which amounts to saying that their regulator-approved revenue is their “cost of supply”. To guarantee recovery of this revenue the simplest procedure is to impose high fixed charges on customers, forcing them to pay for the full “cost” of having electricity delivered to them.

A previous Labour Government gave some relief from this burden for low-income households by bringing in the Low User Fixed Charges Regulations which have enabled low-income households to reduce their power bills by cutting back their use of electricity, and have thereby provided at least a shred of consumer protection for large numbers of the most vulnerable. These regulations, Minister Woods has now signalled, are to be dumped overboard to clear the way for the industry to increase its squeeze on the poor.

Recognising that will probably leave more and more poor households unable to pay, and so cut off from supply, the industry’s solution is for taxpayers to subsidise electricity purchases by the poor, thereby underwriting the electricity industry’s profits in the same way as the Accommodation Supplement has enabled landlords to hold up rents. Minister Woods duly refers to “the wider context of supporting New Zealanders to afford their energy bills”.

We are, in short, a long way from 2013, when the Labour and Green Parties announced plans to force the electricity industry’s prices and asset values down. The next round of price hikes is on its way, underwritten by Government policy and the law of the land (blame Parliament for that), and enforced by the debt collectors.

A real commitment to reducing poverty in this country could usefully start by tackling directly the landlords, loan sharks, and electricity companies that prey on the meagre household budgets of the poor.

Geoff Bertram
Senior Associate, Institute for Governance and Policy Studies, Victoria University

A protection-racket line straight out of The Godfather

GEOFF BERTRAM

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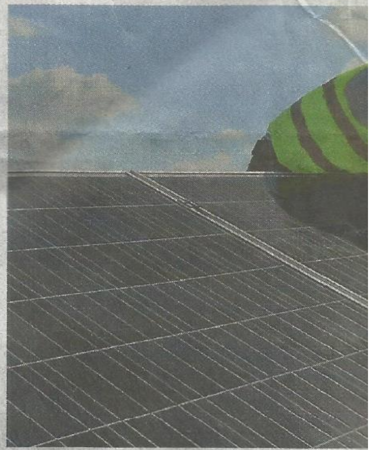

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Geoff Bertram is Senior Associate at the Institute for Governance and Policy Studies, Victoria University.

Dominion Post 16 April 2018 p.A7

Storm brewing in country's power markets

Electricity industry policy is on the money when the price is right, says **Eric Crampton**.

The autumn storm that took out parts of Auckland's power grid last week spared Wellington. The weather in the capital remained relatively calm – or at least no worse than any other wintry day. But storms are not the only threat to the grid. Policy decisions in Wellington can be a threat as well, if pricing models do not keep up with technological change.

Geoff Bertram wrote that solar generation poses only a threat to power companies' bottom lines (A protection-racket line straight out of *The Godfather*, *Dominion Post*, April 4). But it seems a little more complicated than that. New Zealand's overall electricity market works rather well. Generators compete with each other to supply power into the grid. Retailers compete with each other to provide electricity to end-users. And regulation on the lines companies avoids problems in natural monopoly pricing. But there is a bug in the system – and one that will get worse as rooftop solar panel installation rises.

Economists will generally tell you that it is a mistake to try to solve an incomes problem with a pricing solution. If we collectively think that it is a bad thing that poorer people cannot afford something important, it is much better to just give more money to poorer people than it is to try to put a thumb on the pricing scales. Regulating prices might or might not wind up helping the people it's intended to help but will always wind up causing collateral damage.

New Zealand's low-user charging system for electricity is an attempt to help low-income consumers afford power. Households that do not use much electricity face a regulated lower daily fixed charge that goes to help maintain the overall grid.

But the measure seems badly targeted. Poor people in cold, uninsulated homes can easily wind up using more electricity than richer people in well insulated houses. And baches owned by wealthier people that sit unused most days use very little electricity. But nobody really knows what proportion of households on the low-user charge are actually on lower incomes.

When rooftop solar becomes more affordable, richer people like me will put the panels up on the roof. But the costs of running an electricity network depend on the loading on the network at peak hours. If home generation is not accompanied by home battery storage, then the grid will still have to roughly match the power demand at current demand peak. But it will be harder to pay for that when a lot of users have flipped over to home solar generation.

Even if, like Bertram, you think the electricity industry is run by a bunch of oligarchs intent on doing evil things, there seems to be a real issue in funding a sustainable power network if regulation does not keep up with technological change.

Part of a solution would be to do away with the low-user regulated tariff and to compensate poorer people by lifting benefit rates and by increasing payments through Working for Families. In that sense, Labour's winter energy payment seems a less bad solution than mucking about with the price of electricity. But that too remains badly targeted: a lot of rich elderly people will receive the payment and a lot of poorer working families will not.

It is easy to make a mess of things if you try to solve a poverty problem by regulating prices – and especially in areas where technological change matters. Nobody would have anticipated distributed home solar electricity generation when the low-user tariff was established.

Distributed solar generation offers a lot of opportunities. Where Bertram laments that the minister might let regulation adapt to technological change, we should instead celebrate it. Not letting regulation keep up with change can have long run consequences at least as bad as autumn storms.

Eric Crampton is chief economist with The New Zealand Initiative.

Dominion Post 18 April 2018 letters

Column response

The NZ Initiative's Eric Crampton (Storm brewing in country's power markets, April 16) accuses me of claiming that "the electricity industry is run by a bunch of oligarchs intent on doing evil things". He misses my point entirely. The electricity industry is run by a bunch of oligarchs intent simply on making money.

In this country, as the Commerce Commission has reminded us, "the exercise of market power to earn rents is not by itself a contravention of the Commerce Act, but is a lawful, rational exploitation of the ability and incentives available to the generators". Price-gouging captive, low-income customers is the easiest way to bring in heaps of money, and has the blessing of our Parliament.

The resulting energy poverty is simply collateral damage – nothing personal, just business.

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