Power struggle: why fixing NZ's 'broken' electricity market is such a formidable challenge

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The growing view that New Zealand's energy market is "broken" has brought with it a stream of suggestions for piecemeal changes that nibble at the edges of the problem, without tackling the real structural, legal and distributional issues.

Nor do those suggestions demonstrate how such changes would fit into a coherent overall scheme for the future industry, or truly bring down soaring prices that are crippling households and businesses.

NZ First's Shane Jones seems to agree, and recently called for his party to consider a policy of renationalising the big "gentailers" (the combined generation and retail companies). But his solutions appear designed to lock in dependence on fossil fuels rather than hasten the 100% renewable energy future that now beckons.

From the outset, it's important to set clear goals for the electricity industry. Mine are: reliable abundant supply, and the lowest possible price to end-users, especially households.

Those were the goals of the old New Zealand Electricity Department, and they had been largely achieved by 1986. So-called reforms since then have reduced reliability while massively increasing prices and profits for the benefit of asset owners (including the government).

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So, it's also important to remember there are now entrenched vested interests whose incomes and asset portfolios are dependent on high prices and monopoly profits.

Bringing prices and profits down will mean writing down the asset values of the gentailers, the national grid and the lines companies – at the expense of their shareholders.

New Zealanders in general may be big winners. But there would be powerful and noisy losers. The sums involved will be large, and the politics will be difficult.

Rents and rising prices

Most of New Zealand's electricity is generated from low-cost renewables – hydro, geothermal and wind – but also some high-cost thermal generation (mainly from the coal-and-gas-fired Huntly power station).

Before reform, the wholesale electricity price was set to cover the average cost of generation. Since reform, the wholesale price has been set by the highest-priced supplier, which these days mostly means Huntly.

That highest price is paid to all generators, despite the fact most of them will have offered to supply (and would have covered their genuine costs) at much lower prices.

As long as Huntly is kept in the mix as the highest-cost supplier that sets the market price, the market design will keep prices high – far above the cost of the solar and wind generation, whose entry to the market is being blocked by that same market design.

The result has been to enrich the owners of low-cost hydro and geothermal plant inherited from the old New Zealand Electricity Department.

From the moment this market mechanism was proposed in the mid-1980s, it was obvious it would drive prices up and deliver large rents (pure excess profits) on the legacy hydro and geothermal assets.

Equally, from the moment the Tiwai Point aluminium smelter's cut-price supply contract was signed in 1960, it was clear that exceptions could be made. It was – and is – possible to impose long-term contracts to have electricity supplied to target groups of consumers at a low price.

In 1992, I and colleagues suggested how a contract similar to Tiwai Point's could have provided 20,000 gigawatt-hours per year at two cents per kilowatt hour, to be passed through to consumers. The same contract structure remains an option today to lessen the burden of energy poverty on residential consumers.

However, what would have been simple back in 1992 was rejected as too "regulatory" by the head of Electricorp, which was overseeing the deregulation of the electricity market in the 1980s and 1990s. Now, it is politically hard because of the overblown asset values, dividends and tax revenues that have flowed from the high-price regime.

Worse, the first beneficiaries of monopolistic prices and asset values throughout the 1990s and 2000s have in many cases taken their capital gains and departed. The investors who bought their shares at high prices are now exposed to regulatory risk if the flow of economic rent is cut back.

Energy poverty and job losses

In 2012, in my submission to the select committee considering the Mixed Ownership Model Bill, I warned that future governments might find themselves forced to restrain anti-consumer and anti-competitive behaviour, which would push down the gentailers' asset values and share prices.

I wrote then that this would "be financially devastating for the balance sheets of the companies, in precisely the same way as their conduct since 1990 has been devastating for the household budgets of millions of ordinary people".

In the 13 years since, the conflict between monopoly profit and the public interest has worsened steadily, producing energy poverty for households and job losses in manufacturing, while asset values have soared.

Meanwhile, the arrival of energy-hungry computer data centres threatens to preempt any low-cost new generation that comes online.

Bringing down prices

Governments seem paralysed, both by their own conflicts of interest as owner-shareholders and by the prospect of backlash from powerful corporate and shareholder interests that benefit from the status quo.

Several broad solutions are straightforward in principle:

- breaking up the gentailers
- bringing in enough wind, solar, geothermal and battery power to remove the need for Huntly, even in dry years
- and redirecting the legacy hydro assets to operate as a battery-equivalent rather than a profit centre.

But for electricity prices to come down significantly, the government would need to do at least these four things:

- break down monopoly power and the sympathetic regulatory regime of the Electricity Authority and Commerce Commission
- resurrect local electrical supply authorities to operate "energy communities", combining the cost benefits of local small and medium-scale sources of renewable supply, with local network operators as coordinators
- tender out procurement contracts for large-scale offshore wind, onshore solar and battery storage, owned and operated outside of the gentailers
- and factor the true economics of renewable energy into the market by forcing the established vested interests to genuinely compete in the face of the renewables revolution.

Consumers and small business deserve a break after three decades of the current system. The outlook, alas, is for more of the same government fiddling while the economy suffers.