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Supporting Aggregate Demand via Utility Mechanisms

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Lynne,

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As requested, we have considered how the energy sector, and possibly the essential utility services sector more generally, could be used to rapidly and effectively support aggregate demand in the Australian economy, which is now being challenged by the COVID-19 response, the economic impacts of the recent bushfires and the ongoing effects of drought.

We would be happy to discuss this with you and other stakeholders further.

Yours sincerely,

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Recommendations

In this short paper we conclude that there are **three higher-priority idea to consider further**:

1. Economy-wide stimulus at ~0.75% of GDP, via a relatively straightforward direct government bulk payment of regulated energy network costs – an already-known figure – to 28 entities;
2. A guarantee of no disconnections, by government underwriting and funding the cost of increased energy consumer bad debts experienced by retailers.
3. Defer all energy costs for targeted consumers via government funding a 6 month payment holiday.

We don't want more lines at Centrelink

In answering a question regarding the UK's 80% wage payments policy today, the Prime Minister stated:

"... one of the weaknesses of the system ... is that it has to build an entirely new payment system for that to be achieved. Which is never done quickly and never done well ... the best way to get help to people is through the existing payment channels ..."

We agree with the Prime Minister on this. Unfortunately we also agree that it is quite conceivable that a form of universal fiscal support directly to households and small businesses will be required, beyond what can be achieved via the taxation system and already-announced measures.

Australia's utility businesses represent a world-class payment system which touches every household and business in the economy. It should be brought to the fore in policy considerations.

Assumptions

We assume:

- the coming months will – without effective interventions from government – see **very large contractions in both supply and demand** in the Australian economy.
- State and federal governments are seeking effective mechanisms to mitigate this, including by **supporting demand among households and small businesses**.
- **Unconventional ideas are worth considering**, if they offer advantages in terms of speed or scale.

Criteria

In considering possible alternatives to provide stimulus to households and small businesses we have considered whether a concept is:

1. **Scalable**: can it deliver material stimulus consistent with \$2 trillion of GDP and a potential shock of perhaps 10-20% of GDP if unmitigated?
2. **Rapid**: can it be delivered via existing mechanisms, without capacity constraints or new systems?
3. **Flexible**: can the nature of the stimulus be adjusted – for example:
 - a. to expand or extend it if necessary?
 - b. to flex between targeted and general application among recipients?
 - c. to take a varying form including on-budget outright fiscal transfers, temporary relief (such as loans or deferral of expenses) or underwriting risks accepted within the private sector.
4. **Equitable**: a programme should not materially compromise the businesses of the energy sector participants, either overall or in terms of creating inequity between participants. The industry will be facing its own challenges to overcome without creating new ones.

The opportunity and need in the energy sector

In very rough numbers, 10 million NEM electricity residential and small business customers incur annual electricity bills in the NEM of on average \$1,500 and \$6,000 respectively. We estimate this at between a \$15-\$26 billion expense by these consumers on an essential service which cannot be effectively substituted and which is largely inelastic demand, in the short term.

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This number grows if extended to gas, water and telecommunications, and to households outside the NEM. There is an opportunity of about of 1% of GDP in energy, which we consider material under the circumstances.

Energy and other utility expenses are rising for households now

Over the balance of this year, a large proportion of Australian households are likely to experience a higher volume of demand for energy and other essential utility services, associated with working from home and social distancing. The unavoidable household cost of these services is likely to rise.

Many households will face new conditions of vulnerability, including unemployment, underemployment or a significant change in income and/or sickness.

We note that while there has been some targeted assistance offered by governments for relief from energy bills, this also comes at a time when the community organisations that provide relief through emergency assistance are coming under pressure as could the hardship programs and payment plans offered by retailers. We do not expect the existing mechanisms will be adequate to meet the scale of the problem, let alone proactively deliver meaningful stimulus against the many other headwinds faced by households and small businesses.

Small businesses that are not classified as essential services have been forced to close, with loss of revenue, some of which is being made up by the Australian Government's assistance measures and supplemented by State Government programs in some instances.

As a result, the capacity of households and small businesses to pay their energy bills will become a more acute problem.

Meanwhile, utility companies provide sophisticated billing services which collect these revenues regularly from every household and small business in Australia. This is a ubiquitous payment system which can be used to deliver relief and economic stimulus quickly and cheaply to these consumers. Unlike Centrelink, it does not need to be scaled up and it does not need consumers to take any action.

In short – **rather than seeking to increase payment TO households via bottlenecked social welfare or other grants mechanisms, Finncorn believes government should first decrease expenses FROM households, by directly alleviating energy bills for the balance of the crisis period.**

We examine some mechanisms to achieve this overleaf, and we conclude there is an opportunity – a scheme which is attractive based on its scale, breadth, ease of execution, and relatively straightforward ability for government to exit the mechanism when appropriate (but to flex or target it further over the course of the year if required).

Energy Sector relief (1): ideas for broad, outright stimulus

We have looked at the “bill stack” – the various components of cost in the energy value chain which make up a consumer's final bill – and considered how feasible it would be for government to intervene and provide relief to the economy through reduced energy bills to consumers.

Wholesale – very hard to avoid distortions and inequity to generators

The electricity market relies on a complex system to allocate and price supply against demand in real time.

The only mechanism we believe COULD work is government paying some or all of generators' fuel costs, allowing the wholesale offers to fall to only cover non-fuel costs.

There are a number of problems:

- Indirect mechanism which would need to be passed through the value chain over time, and blunted by hedging arrangements.
- Grossly unfair for wind and solar (with no fuel costs) and having highly uncertain impacts on the orderly dispatch of generation in general.
- Very complex to establish what fuel costs, in fact, are at the margin.
- Clearly some risk of profiteering in some manner.

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Although wholesale costs are a material 33% of the bill, **we see little if anything to recommend intervention to reduce wholesale costs** in light of this.

Retail – too complex

Retailer costs and margins account for 15% of the bill, but we see no feasible means to provide relief simply and quickly via reducing this element. Much of this is people and amortised system costs, which cannot be alleviated easily.

The retail subsector is competitive and complex. It is also the key delivery mechanism for our proposed broader relief via their billing systems. It should probably not be disturbed further than by requiring billing processes to be adjusted to pass through savings from other parts of the value chain, as we describe elsewhere.

Retailers may have a more direct role to play in more targeted schemes – such as **assisting identified vulnerable customers, or avoiding disconnections. We discuss this later.**

Green schemes – uncertain trade off between materiality and complexity

Green costs are not immaterial at 8% of the bill, but are spread across several schemes including the LRET, the SRES, and state-based programmes. As a result we think relief here may be more complex than it would be worth.

LRET obligations could be suspended but this would crash the LGC market, creating some innocent victims among renewable energy assets. The same could be said if the SRES subsidy was eliminated (as the ACCC has recommended) but the losers there are both the solar industry and consumers who evidently find the scheme attractive.

Less-distortive relief mechanisms might be delivered under the Clean Energy Regulator's RET. For example, instead of surrendering the required certificates under the LRET and SRES, retailers might be paid by government for them, with the funds being rebated to customers in proportion to their volume.

We question whether this would be worth the trouble, given the obvious question of how much to pay? It becomes an arbitrary distribution, again somewhat indirect, although requiring a rapid rebate on every customer's next bill may not be too onerous or difficult to audit.

We see this as a **marginal opportunity – perhaps worthy of some discussion.** However if it is, it would be simpler to just disburse general funds to retailers against a rebate.

Network costs – the clearest and simplest large-scale opportunity

Regulated networks' revenue is fixed in \$ terms by the AER over a five-year period, and is already billed to retailers specifically for each end-consumer account. It is a known, non-competitive payment by consumers to infrastructure owners, passed through via retailers. According to the Australian Competition and Consumer Commission (ACCC) these charges are 43% of the small consumer electricity bill on average across the NEM.

As a result, we suspect **the easiest means to provide very substantial bill relief would be for government to directly provide networks with their regulated revenue for a period.** Networks would cease billing retailers, and retailers would remove the cost from their bills to consumers.

Given such a scheme would apply generally, this would also support small businesses and (unless specifically excluded) large businesses – it is a very broad stimulus measure and goes directly to both household costs, as well as business expenses which may be the difference between profit and loss, solvency and insolvency in this recession.

Regulated energy network revenue is \$14.1bn annually, across five electricity transmission entities, 14 electricity distributors, three gas transmission entities and six gas distributors.

Via relatively straightforward arrangements with these 28 entities, government could deliver immediate stimulus to all energy consumers at the rate of about 0.75% of GDP.

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Stimulus would be related to energy consumption, which is ubiquitous at household level, but would favour some business users over others – a disadvantage in theoretical terms, but perhaps not politically given the perception of manufacturers as both large energy users and employers, and already under pressure from high energy costs.

At the household level, such a measure could be considered equivalent to a \$650 per annum per household¹ “helicopter money” policy (a little more for gas-connected households) – delivered very quickly and efficiently, as soon as the next utility bill and for as long as necessary.

It has the attraction of more than offsetting the additional energy costs which unemployed or working-from-home householders will incur.

Energy Sector relief (2): more targeted measures

There are other means by which the energy sector (in particular, retailers) can work with government to blunt the economic impact of the pandemic.

1. **Bad Debt underwriting to prevent disconnections:** It seems obvious that the minimum which should be expected of energy retailers in these circumstances is to cease disconnections – but we should not underestimate the severe impact of the retailers bearing the brunt of a default on an entire value chain in energy costs well in excess of the retailers’ costs. Government could agree to underwrite each retailer’s bad debts from energy consumers, over and above the baseline from last year, in return for a no-disconnections policy. This may assist more vulnerable customers as they sadly emerge.
2. **Targeted assistance via bill deferral:** For identified vulnerable customers, including those in receipt of other COVID-19 related assistance, energy bills might be deferred for an initial period of 6 months. Implementation of this is as simple as retailers adjusting the due date on bills to a point in the future. To support this, government may pay retailers a commercial cost of capital to fund the additional working capital, or (if necessary) a loan to fund the working capital via the already-announced concessional business loans scheme supported by the RBA’s provision of three-year funding to banks.

Exit strategies from these programmes would be challenging but there is time to design them.

This may require some element of write-off being accepted by government as well as retailers (given a sharp rise in bad debt is the counterfactual for retailers right now).

The industry and government would need to cooperate in developing suitable payment plans with possibly some means-tested relief (a detail for post-crisis).

END.

¹ ACCC reports network charges in the NEM average 43% of an average \$1,509 annual electricity bill.