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Energy collapse: it all begins with a market cap

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Thousands of years of experience – from the ancient Babylonians and Roman Emperor Diocletian, through to modern times – have demonstrated how price controls prevent the allocation of scarce goods to their most valuable uses, lower short-term production, and cause investment to seize up.

The inevitability of such outcomes is lost on Australia's political class. Politicians, egged on by self-interested and socialists, are once more embracing price controls that were abandoned in the 1980s when the Hawke-Keating government accepted market prices stemming from supply and demand as the most efficient means of running the economy.

Years of government maladministration of energy markets, exacerbated by the Ukraine War, have brought a recrudescence of political hubris that the political class can fix gas and coal supply to the greater benefit of the nation as a whole. Welcome, once again, to price caps which are miraculously supposed to bring about a more just distribution of energy supplies at lower costs, while also increasing the quantities that will be made available.

For gas, there will be an immediate $12 per gigajoule domestic price cap (half of the present price but compared with $4-6 historically) with future price levels to be determined by the Commonwealth price controller, the ACCC.

For east coast thermal black coal, the maximum price is set at $125 per tonne which, though twice the historical price, is only one-third of what can be earned from exporting.

The penalty for selling coal above the price cap is not yet specified. The penalty for exceeding the stipulated maximum gas price is $50 million. Beheading was the punishment imposed on suppliers selling above the price cap in Diocletian's Rome. Whether or not $50 million is more lenient – it should be noted that capital punishment failed to prevent ancient laws being circumvented and supplies drying up. Even Diocletian had to abandon his attempts to control the market.

Australia's price controls, by changing market conditions, amount to a retrospective tax. Credit Suisse likened them to a 'near nationalisation of the east coast gas market' which will inevitably damage the risk profile for Australia, at least as a venue for energy investment. Exxon, Woodside, and Shell have already announced consequent revisions in investment expenditures.

The new controls apply only to uncontracted volumes but the definition of this will be contested. In any event, they will bring a chilling effect on new supplies.

Price controls are administrative nightmares, especially when they are on products located in areas with dissimilar costs, comprising products with varying qualities, and being sold on conditions that will give rise to disputes on how the contracts fall into the regulators' categories.

In Queensland, power stations and their coal are largely owned by the state government. And though, as in New South Wales, coal is predominantly earmarked with infrastructure geared either to domestic or export markets, there is some flexibility that will give rise to suppliers seeking to sell into the more lucrative export market.

While price controls legislated on December 15, 2022, may in future be lamented as marking the day when the government sounded the energy market's death knell, the legislation was really only the *coup de grace*.

It consummated measures that had been progressively undermining the energy market for 20 years. During that period Australia slipped from having just about the world's lowest-cost gas and electricity supply to experiencing among the highest-cost supplies – and showing an increasingly precarious availability.

Market meddling began with John Howard's unfortunate 2002 decision to subsidise wind and solar electricity. This lit a slow fire under the previous conditions that outlawed discrimination among supply types. Governments also increased direct taxes on coal under the rationale of justifiably higher royalties.

The ongoing expansion of the subsidies, under the umbrella of climate change prevention, now means this form of energy supplies a fifth of demand and contaminates other supplies by forcing them to adapt to the variability that is concomitant with wind/solar facilities.

The subsidies to variable renewables have been augmented by subsidies to their transmission which is four times as costly as that of the higher density, greater reliability that characterises coal and gas-generated electricity.

Compounding these de facto taxes on coal and gas – a demonisation of coal generation (and gas to a lesser degree) – has deterred any new investment.

These measures have been amplified by disallowing the search for new supplies of gas in Victoria, New South Wales, and South Australia – a denial that has had increasing impacts as the existing supplies are running down.

The energy market had been collapsing under the onslaught of these regulations and the price controls will merely accelerate this process. Without reform, the outcome will be, at best, a renewables-based electricity system that is five times the cost of the coal/hydro system we have outlawed.

Reform and restoration of the previous competitive low-cost supply system needs to start with the immediate removal of all direct subsidies, government purchase preference arrangements, and transmission assistance. But there is, right now, little appetite for this among the political class and the public.

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