



On the impact of government-initiated CfD's in Australia's National Electricity Market

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Abstract An intriguing characteristic of Australian energy market policymaking is the almost exclusive focus on spot market dynamics. The policy development cycle displays a virtual disregard for, and of, power system financial markets. The irony is that forward contract prices form the defining wholesale price input to end-user consumer tariffs. In this article, the impacts of a wide-ranging program of government-initiated CfDs on power system financial markets are analysed. Government-initiated CfDs are highly effective in correcting market failures, but they need to be used judiciously because – while they add to demand-side liquidity, they simultaneously extract supply-side forward contract market liquidity. Consequently, when used en-masse in loosely interconnected energy-only markets, CfDs have pro-competitive effects in the spot market by introducing ‘quasi-market participants’ but damage power system financial markets via the loss of liquidity. Power system modelling in this article demonstrates that a wide-ranging policy of government-initiated CfDs can produce shortages of ‘primary issuance’ hedge contract supply. This is far more than theory. In the South Australian region of the NEM, shortages of primary-issuance hedge contract supply have arisen through renewable entry and coal plant exit. Hedge shortages have had the effect of raising forward contract price premiums above efficient levels, needlessly forced the most price-elastic (Industrial/Manufacturing) customers into accepting unwanted spot market exposures, and unintentionally foreclosed non-integrated (2nd tier) energy retailers, all of which ultimately harms consumer welfare. CfDs have a targeted role to play in energy markets by correcting market failure; but broad-based market mechanisms are preferred.

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