

Why Australia's entire power sector should support the Renewable Energy Target

November 10 2014, by Dr Ariel Liebman



Falling demand and prices are leaving no incentive to invest in Australia's electricity sector. Credit: Indigo Skies Photography [\[?\]/Flickr](#), CC BY-NC-ND

There's been much talk about how uncertainty over the future of the (RET) is affecting the renewable energy industry.

Investment in [renewable energy](#) is at its [lowest level](#) since 2002, while a Baker and McKenzie and Clean Energy Council report released in

October argued uncertainty over the RET was undermining the industry.

Renewable company Pacific Hydro also recently saw a [A\\$685 million write-down](#) in its value, while Australia's largest wind tower producer [cut 100 jobs](#). Both were linked to [uncertainty](#) over the RET.

The Coalition government has announced its position: to reduce the Renewable Energy Target to a "real 20%"—or 20% of the expected electricity demand in 2020. This will result in a cut to around 27,000 gigawatt hours from the current target of 41,000 gigawatt hours.

But with demand falling and a significant oversupply of electricity, the RET is vital for stimulating investment in the electricity sector, not just renewables.

No room in the electricity sector

At the moment, there is a massive split between the proponents of renewables development and those who see increased penetration of renewables as a threat to their business.

Opponents appear to have the upper hand, with the government pushing to have the 20% target reduced to a "real" target that would be much lower.

The arguments to reduce the Renewable Energy Target are many-fold. They run something like this:

The target was set when electricity demand was expected to continue rising indefinitely. Therefore there was room for both renewable and fossil fuel sources.

This is no longer true as demand has actually been declining since

2008-09. It took another three to four years for the industry and government to accept that the end of demand growth had occurred and may continue indefinitely.

It is difficult to overstate how unusual and important this is for companies operating in a competitive environment. How many companies can thrive in a market where customer demand is falling?

Tough times for fossil fuels

Those supporting reduction of the target, or its complete elimination, argue that with no growth in electricity demand the current target 20% or even a "real 20%" is unnecessary and damaging.

Damaging to whom? To those companies that own and operate coal and gas-fired power stations. The argument is that the decline in electricity demand in combination with the roll-out of RET-driven generation, mostly wind, has resulted in lower wholesale electricity prices than expected.

At just over [A\\$30 per megawatt hour](#) over the months since the repeal of the Carbon Price, wholesale spot prices are now at [near historical lows](#). This is indeed making it tough for most fossil fuel plants.

The underlying problem for the wholesale price is twofold: firstly, with the more generation capacity you have in general, the more downward pressure there is on the price.

This is exacerbated by wind generators. Like most current large-scale renewable technologies, wind is not easily controllable and has no fuel requirements. This means operating costs are zero, and economic incentives allow them to run in preference to other power plants.

Hence those that operate fossil plant prefer to see less renewable generation in the market, while those specialising in building, owning and operating renewable plant will be squeezed severely if the target is revised downwards.

Review paralysis

The problem for investment in the renewable sector is more complex. As all investment in this sector is policy-driven, ongoing reviews with suggestion of changes to the parameters of the policy are painful. They paralyse decision making and planning.

This is because renewable projects rely on revenues from selling renewable certificates (so-called LGCs), as well as from collecting electricity spot market revenue.

The electricity market, and particularly the Australian electricity market, is the most volatile commodity market in the world.

On top of this, renewable projects rely on selling certificates into a traded market, hence the value of the subsidy they receive is subject to supply, demand and market sentiment. The renewable certificate market price is thus also a very volatile one, as volatile as the global crude oil price, for example.

Derivative market hedging does not help much as contracts have a maximum tenure of three years, while the lifetime of the project can be up to 30 years.

Note that the declining [electricity demand](#) is also hurting renewable projects' viability as well as fossil fuel incumbents. This may not have been such a problem had we still had the carbon price but now without RET policy certainty there is a major problem.

Moreover, benefits for consumers are not at all certain in the long term as incumbent operators have the option of mothballing/decommissioning plants, partially offsetting downward pressure on prices due to falling demand.

The RET is dead, long live the RET

In the environment of declining demand and the prospect of new technologies such as PV panels, increased consumer engagement, electric vehicles and smart grids, this tension between the renewable industry and the incumbent generation sector is unnecessary. It is clear that both would benefit from a strong renewable target.

Why? As demand is shrinking, all players need a policy that stimulates investment. Without the RET, there will be no incentive to build any power plants at all! The market is oversupplied and will continue to be for perhaps another seven to ten years.

Taking advantage of the RET and the other new technologies is the only way modern [electricity](#) utilities can innovate, grow and successfully compete in a rapidly changing environment. Freezing the RET would be a false win for its opponents.

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