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15 July 2020

Mr Warwick Anderson
General Manager, Networks Finance and Reporting
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Sent by email to: InflationReview2020@aer.gov.au

Dear Sir/Madam,

DISCUSSION PAPER ON THE REVIEW OF TREATMENT OF INFLATION 2020 – AUSTRALIAN ENERGY REGULATOR

We would like to extend our gratitude for the opportunity to provide a discussion paper to the *Review of Treatment of Inflation 2020* by the Australian Energy Regulator.

ABOUT FAIRBANE

The Fairbane Group ("Fairbane") is a consulting and private investment group that provides advice and opinions on policy issues to various industry groups and interested stakeholders. Fairbane is the successor entity to a series of consulting and investment groups that date back to the early 2000s. With experience in finance, legal services, accounting, management consulting, our operations include in Australia, the United States of America, the United Kingdom of Great Britain, Canada, Dubai, as well as parts of South-East Asia and Europe.

Fairbane is fortunate enough to have had members work with organisations such as: Deloitte, Ernst & Young, the Australian Government in the Departments of Defence, Trade, Health and Aged Care, the United Kingdom Departments of Defence, and National Health Service, various medium to large companies in industries ranging from Finance, Aerospace, Biotechnology, Communications, Computing, Construction and Resources.

Fairbane is a truly future-oriented organisation with a unique vision for the world. Fairbane's vision is to push the boundaries and reach out to the horizons of scientific and technological boundaries and do so by ensuring there is the freedom and flexibility available to individual businesses and their industries as a whole to compete and prosper.

At Fairbane, the world in the year 2020 is seen through the lens of what the world could and may well be like in the year 2100 and 2200. This means encouraging development of new ideas and providing a foundation for the new technologies that come from them.

Fairbane provides advice to various companies and individuals in the media industry, primarily in the emerging sub-markets and emerging technologies and platforms, particularly start-ups. Our expertise comes from a management consulting perspective and from legal advice to clients and partners, and policy advice to various entities.

"You have sown much, and harvested little. You eat, but you never have enough; you drink, but you never have your fill. You clothe yourselves, but no one is warm. And he who earns wages does so to put them into a bag with holes." - Haggai 1:6-7

REVIEW OF TREATMENT OF INFLATION 2020

This paper will discuss in more broadly issues flowing from regulation as a whole and not just regulation of inflation. Clearly the fact that a discussion paper is required on such a narrow topic and not the broader issues facing everyday consumers, is reason enough to warrant the broad line of inquiry that this discussion paper will take.

Reading through the 37-page consultation paper from the AER with a fresh set of eyes – removed from the specific discussion, one cannot escape how frightening Orwellian the regulatory approach has become in Australia in the year 2020.

This is not to criticise the government or regulator, rather to critically inquire as to the nature of regulation itself. After all the Australian Energy Regulator (AER) has the purpose to:

"to make all Australian energy consumers better off, now and in the future."

One would hope that would be to listen to views and commentary outside of the scope of its own consultations, or else we have no hope of finding a better way of doing things.

Furthermore, while it may be a foregone conclusion, self-awareness would invite the idea that regulation itself does not promote the goals of efficiency in any market – energy or otherwise.

> *The National Electricity Law and Rules (NEL and NER) and the National Gas Law and Rules (NGL and NGR) provide the regulatory framework which govern the NSPs. Our role is guided by the National Electricity and Gas Objectives (NEO and NGO).*
>
> *NEO:1*
> *…to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:*
> *(a) price, quality, safety, reliability and security of supply of electricity; and*
> *(b) the reliability, safety and security of the national electricity system.*
>
> *NGO:2*
> *…to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*

The consultation paper sets out that revenue and therefore effectively "price" needs to be set in order to achieve price stability. This paper is going to take an altogether contrarian view which undoubtedly will fall on deaf ears, but the economic reality for the everyday consumer (who more often than not is also a voter) remains prevalent.

ENERGY REGULATION AND 21ST CENTURY ECONOMIC THINKING

Regulation of the energy industry, not unlike any other regulation, has the unintended effect of limiting freedom and limiting options for consumers and intermediate parties in the supply chain. It also has the effect of creating artificial barriers for new entrants by creating an increase in business costs that larger businesses can absorb, but which smaller businesses will often struggle to deal with, and which is always passed on to consumers.

This concept is increasingly difficult to explain to policy makers in government across almost all industries. Often the counterarguments are conveniently veiled in justifications such as preserving public confidence, or for product or business integrity.

The argument in the context of energy markets is that the infrastructure both for energy generation and distribution by its very nature is inherently capital intensive and requires either a monopolistic or at best – an oligopolistic market structure.

This could not be more of an inaccurate and inappropriate position viewed through the narrowminded lens of regulatory myopia. In the absence of regulation an energy market would be driven by new technology encouraged by less barriers to entry and less red-tape. This would create more competition and in turn drive lower prices.

With less regulation, independent energy provision could be decoupled from the traditional power network and would result in less dependence by consumers on any one of the large energy providers who have increasingly more bargaining power with which to take advantage of consumers.

It is worth noting that the Energy Ombudsman system is abhorrently hopeless and helpless to bring any redress to this imbalance. This is no fault of the people in that system rather that there are just inadequate laws to protect consumers.

There is an anathema to using words such as “free-market” so much so that any reference to “capitalism” is something of a profanity in the mainstream economic discourse of the 21st century. Need we be reminded that the term capitalism first arose in German in the 19th century in Karl Marx’s book *Das Kapital* which ironically is more well known for coining socialist views than libertarian ones.[1]

It would seem the obsession with regulation will only continue to evolve further over the next 150 years as much as it has over the last 150 years as any notion of economic freedom continual erodes, as a regulator in a system so embedded with the notion of regulating.

The respectful view of this paper is to reduce the amount of price setting or price controls, allow the distribution networks to be open to more smaller players and more importantly open the energy grids up to allow consumers the choice to find alternate means of electricity (and gas) as many people at the present time just do not have.

Support for this idea that regulation (as a part of fiscal policy) is supported by Keynesian notions of managing economic activity – including inflation – and is well explained by a 2013 Forbes article:

> *“Keynesians presume that speedy growth leads to labor and capacity shortages that result in higher prices. Of course if we ignore that labor and capacity are dynamic as opposed to static, and similarly ignore technological enhancements that allow companies to produce increasing amounts with less labor and capacity.”*[2]

Therefore, there is a prevailing sentiment that for the most part inflation is good, but it needs to be managed. This is fundamentally wrong. The same article takes the alternate view that in fact, deflation is a function of increased production and improved efficiency – both from more competitors driving the price down and from new technology.

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[1] Karl Marx, *Das Kapital*, 1867.
[2] John Tammy, *Monetarism and Keynesianism: Identical Sides of the Same Adolescent Coin,* 7 April 2013. https://www.forbes.com/sites/johntamny/2013/04/07/monetarism-and-keynesianism-identical-adolescent-sides-of-the-same-coin/#59c025ff44dc.

In basic terms, the same general principles of economics that apply to monetary policy or any other market – a supply and demand environment – will still apply in the supply of energy. The argument that prices need to be set in order to provide stability or because there are infrastructure requirements or limitations from the power or gas distribution networks are absolutely artificial.

Price volatility, if even a little, encourages new entrants into the market, new investment and further competition, it also provides consumers with the opportunity to benefit from the price reductions and be smarter about energy usage when prices rise. The natural order of the universe, dare it be said – 'market forces' – will always find their way into the synthetically orchestrated economic systems that are created by governments. The longer nature is ignored, the more chaotic it will be when the time comes to restore balance.

Price volatility and moreover, managing inflation, are both viewed through the lens of government regulation as being required to maintain stability and ensure deflation does not occur. This is the mainstream view that pervades every area of policy making, not just energy. The question is however, why?

The typically weak counterargument from policy makers and regulators alike is that deflation is always bad. Deflation is a natural consequence of an economy producing more goods. Where there are more goods in supply the price will drop – resulting in deflation. For example, if there are 10,000 megawatts-per-hour being generated and that is the supply at a given time. And there are 1 billion dollars available to spend on that amount of power, if the production increases to 15,000 megawatts-per-hour, then it will cost less to purchase the same amount of power.

However, the problem is two-fold because both supply is not increasing at a faster pace than static demand for power and at the same time there is arguably 1.2 billion dollars bidding for the same amount of 10,000 megawatts-per-hour, which has the natural consequence of driving the price up.

The idea that inflation is a natural consequence of a more productive economy is a myopic monetarist viewpoint and the view that it needs to be regulated is a correspondingly painful Keynesian one.[3] To rephrase the point: that same inflation is driven by a diminishing supply of a given product or goods – in this case gas and electricity – and the problem is compounded by increasing monetary supply driving prices higher because those goods become even more scarce in relative terms.

Deflation has but quiet but subtle echoes of support in political and economic commentary, but one article in the US National Bureau of Economic Research gives a glimmer of hope with reference to a golden era of economic enlightenment:

> *"…[It is important to observe] the price level and growth experience of the United States, Britain, and Germany during the late 1800s. This period, not unlike the present era, was notable for low inflation or even deflation, for rapid expansion resulting largely from technological innovation…"*[4]

The fact of the matter is that in the current 21st century world that we live in, government and large suppliers will operate together to create a favourable environment for increased control and taxation, and market share and profitability respectively – and regulation is the instrument by which this occurs.

The question then is, what is the result for the end consumer? Less freedom of choice, less bargaining power, and more susceptibility to being dictated prices. None of this is good for the consumer.

Furthermore, there are also the consequences of less competition, less innovation and less efficiency on the part of the players that are in the market. Nobody benefits from this.

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[3] John Tammy, *Monetarism and Keynesianism: Identical Sides of the Same Adolescent Coin,* 7 April 2013. https://www.forbes.com/sites/johntamny/2013/04/07/monetarism-and-keynesianism-identical-adolescent-sides-of-the-same-coin/#59c025ff44dc.

[4] Michael D. Bordo, John Landon Lane, Angela Redish, *Good versus Bad Deflation: Lessons from the Gold Standard Era,* National Bureau of Economic Research Working Paper No. 10329, February 2004.

In a world where so much attention is apparently focused on the ecological environment and sustainability, there should be a more open environment for consumers to economically vote with their dollars for cleaner and better energy, and industries should be conducive to facilitating this.

An unregulated energy market would allow for new entrants, and in turn new technologies to arise, forcing existing large players to become more efficient (and more profitable in the long run) as well as provide a basis for decentralising the distribution of gas and electricity to give the consumer more freedom and independence. There would definitely be lower prices because in simple economic terms, the supply of gas and electricity could (and would) increase to such a level that the prices would be affordable.

To spell it out: This downward pressure on the cost of energy would make the Australian cost of living much more affordable. This deflationary environment is a good thing.

> *"The major threat to the economy then is not deflation but policies aimed at countering it."*[5]

There is no reason why people should not have the choice to not connect to the grid and instead buy gas bottles sourced by themselves in an open market. Some consumers do have this choice, whilst others are stuck with sometimes 1 or 2 options being connected to the grid. The situation is arguably worse in the context of electricity. Solar panels are supposed to reduce the cost of electricity for the consumer but so many consumers are seeing an increase in the rate of electricity exceeding the amount that they are able to gain from any feedback tariffs.

Fairbane is supportive of any energy – cleaner or renewable – but it should not be interfered with by subsidies and government because the technological development and generation of that 'new energy' is undermined and so too the efficiency and quality of it.

[5] Frank Shostak, *Deflation Is Always Good for the Economy*, 4 August 2016, https://mises.org/wire/deflation-always-good-economy.

To use one of the best examples of government regulation driving higher prices, Germany, a country that is known for having nuclear energy, which in theory should drive lower prices, is viciously stunted by regulation.

> *In 1998, the average price was 17.11 ct/ kWh and it dropped to 14 cents in 2000 following the liberalization of the electricity market. Since then, the price has risen to about 29 cents in 2014 and then declined slightly by about 0.5 ct/kWh. This price increase, particularly since 2009, has to a large degree been driven by* ***taxes, fees and levies****.*[6]

THE OPPORTUNITIES FOR AUSTRALIA

There is no reason why Australia cannot both decentralise its energy distribution networks and open the door to a freer energy market, including geothermal energy and nuclear energy. If opportunities are shunned merely because of events such as Chernobyl and Fukushima, then the Titanic sinking in 1912 should have dissuaded humanity from ever building a ship and setting out to open sea ever again. The logic is counter-intuitive to the human spirit and the human condition. We need to look past the political smoke screens and embrace new technology as new opportunities to advance human civilisation.

It stands to reason why Australia, one of the most geologically wealthy countries in the world also has one of the highest energy costs in the world.

There are differing and conflicting bodies of evidence from various sources supporting Australia as a country with more affordable energy than the world average and others more accurately factoring in actual costs.

Whether accepting or critiquing various sources, there is a certain trajectory that all of them appear to find common ground on. This is that over time, energy costs are rising, either in per-capita terms, or in inflation adjusted terms.

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[6] W. Fischer, J.-Fr. Hake, W. Kuckshinrichs, T. Schroder, S. Venghaus, *German energy policy and the way to sustainability: Five controversial issues in the debate on the "Energiewende"*, Institute for Energy and Climate Research e Systems Analysis and Technology Evaluation (IEK-STE), Forschungszentrum Jülich GmbH, Germany, 17 May 2016.

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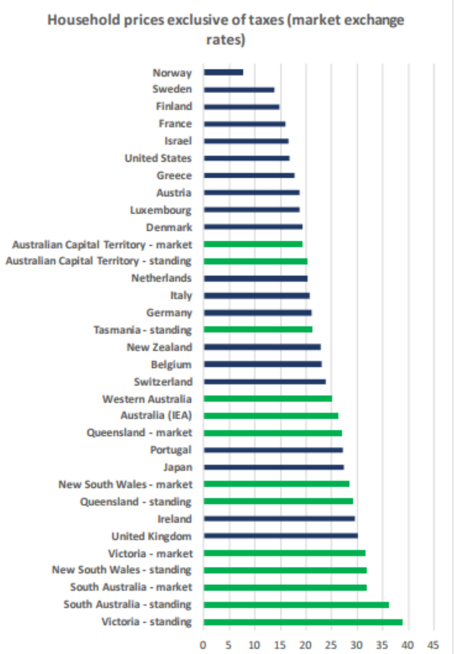
At the risk of using anecdotal evidence, one could as a matter of personal curiosity go out on the street and ask 25 people at random if they feel energy prices have risen over the last 10 years or 20 years. Nonetheless, there are numerous studies supporting the argument that Australia has comparatively high energy prices – and that those prices are caused by regulation.

One such study was conducted by Carbon + Energy Markets' MarkIntell data service in 2016 that provided more granulated analysis down to state level indicated that Australia has an exorbitantly high rate of electricity cost and that this was due to regulation and lack of supply in the market. Fig 1.0 below provides comparison in Kilowatt -per-hour (KwH) to other countries.

Fig 1.0



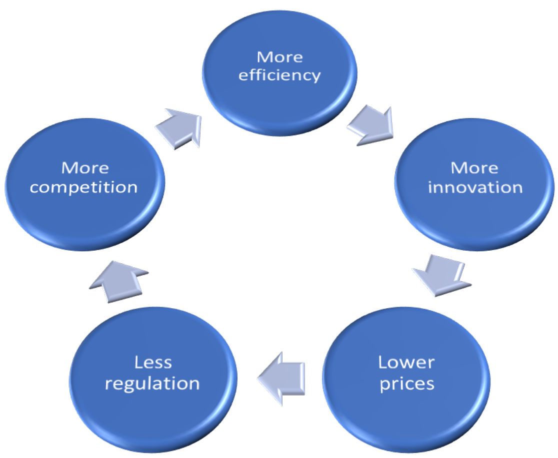
None of this is to put blame on governments or to put blame on regulators. That is not the intent nor the design of this discussion. This discussion paper is centred on how to best achieve lower energy prices.

Using the United States of America as an example, there has been marked investment through lower taxes and less regulation since 2016 and there has been an influx in the supply of energy and this has driven economic prosperity and resilience – particularly in a time of some turbulence over the course of 2020, but it has also provided a foundation for further investment in the future, more economic independence and a strong base for future technology in the energy sub-industries.

The USA is a great example of the idea that freeing up a market gives the opportunity to drive prices lower for consumers and drive further incentives for efficiency and future technologies. This has obvious detractors in the form of political opponents seeking to pursue more regulation to stifle economic freedoms, but the power of nature in the form the free market has a way of overcoming such obstacles. This idea of efficiency is central to driving new technology and a freer market.

This paper would seek to coin the term "economic efficiency cycle" as the following:

The Fairbane Economic Efficiency Cycle[7]



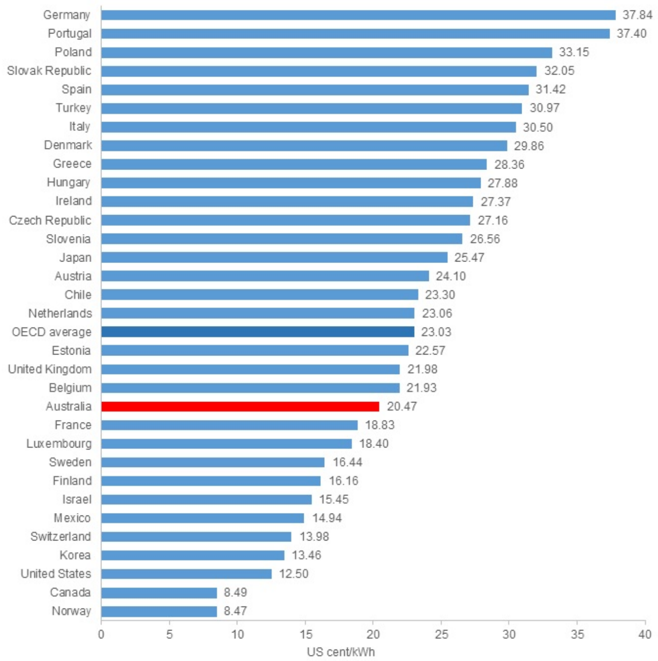
[7] Fairbane, The Fairbane Group, 15 July 2020.

At the risk of unintentionally plagiarising, none of this is particularly ground-breaking and various similar incarnations exist, but they would be more likely found in the British and American philosophical thinkers of the late 18th century than in 21st century economic discourse.

Part of the problem with our obsession with regulation is in the disinformation from various bodies, for example the OECD who paint a favourable picture of Australia relative to other countries, without factoring the impact of PPP factors (which involve foreign exchange rate fluctuations that affect the determination of Purchasing Power Parity) and it is worth noting that the below OECD figures are from 2014 which notwithstanding the inaccuracies mentioned above, would indicate a continuing rise in the cost of energy in Australia. See Fig 2.0 below.

It is also relevant to note that all countries in Europe are highly regulated and their trends toward increasingly centralised nature of their energy regulation is also driving a trend toward higher costs of energy.

Figure 2.0: OECD household electricity prices, PPP measure 2014



Australia has the resources to achieve much lower electricity (and gas) prices but it needs the political will and a fundamental shift in its regulatory mindset to steer away from further regulation.

In Australia, we are fortunate to have a current federal government recognising that more regulation, unnecessary regulation, is not good governance. Energy policy is undoubtedly politically charged in Australia.

Fairbane takes the view that we can have both renewable and clean energy alongside historical stalwarts such as coal and nuclear. Energy should be viewed in its entirety. It would be heartening to remove the politics and political debate from something that should be as much a human right as the freedom of association and the freedom of movement.

Economic freedom has become a lost concept in the 21st century. We have become slaves to a system that stifles ingenuity and draws division along political lines when energy, something we as a species are so reliant on, should be so much more affordable. The right to have energy is in a sense an economic right and one that should not be hindered.

Through pursuing both old and new, traditional and emerging energy generation, it will be possible to make traditional energy sources cleaner and emerging energy sources more efficient and powerful.

To emphasis the above point, coal has been used for over 2,000 years ago: The earliest reference to the use of coal in metalworking is found in the geological treatise on stones (Lap. 16) by the Greek scientist Theophrastus (c. 371–287 BC).[8] At the time nobody would have conceived that in the 1800s coal would be used to power steam engines. That thought would have been so far-fetched.

[8] Carol Mattusch, "Metalworking and Tools", in: Oleson, John Peter (ed.): The Oxford Handbook of Engineering and Technology in the Classical World, Oxford University Press, ISBN 978-0-19-518731-1, pp. 418–38 (432).

Taking that example, in 1,000 or 2,000 years from now, we will have developed new ways to use coal or experimented with coal or nuclear or solar power or merged them together to form some other form of power that has not even been thought up yet. Perhaps a form of energy that restores plant life and removes all harmful chemical agents from our atmosphere and earth?

We can reach that point in the future by allowing science and technology to flourish. However, to reach that point becomes so much harder when government – through regulators – effectively enslave people by limiting their freedom to pursue more affordable, more efficient and new forms of energy.

It should be reminded as already noted in a recent senate submission by Fairbane that, interestingly, J.P. Morgan are removing the terms "master" and "slave" from their computer programming software infrastructure.[9] In the chaos of wanting governments to provide more for the citizens that it represents, we could take pause to consider that regulation in and of itself creates an environment by which citizens are slaves to masters, whether those masters are big businesses protected by regulation or the government and its agents seeking to regulate. As consumers we are very much slaves to the energy market.

Closing remarks

Fairbane takes the view that the best regulatory mechanisms are those that allow for self-regulation and regulation by peers, not by governments, not by masters, not by those who would make others subservient.

This is not to say there is no place for government. However, such a role as regulator should be to oversee the market rather than determine any price within it. A more expedient system could include arbitration and dispute resolution mechanisms, or even better dispute prevention mechanisms. If price volatility is a concern, then better information to consumers will help

[9] Elizabeth Dilts Marshall, *JPMorgan drops terms 'master,' 'slave' from internal tech code and materials*, 3 July 2020. https://www.reuters.com/article/us-minneapolis-police-jp-morgan-race-exc/exclusive-jpmorgan-drops-terms-master-slave-from-internal-tech-code-and-materials-idUSKBN2433E4.

ameliorate the impact of adverse price movements. There is a myriad of other alternate options to more regulation, and definitely more so than price determination.

Price determination is a concept that should find its place in the annals of the communist Soviet Union where it belongs. There should be no place for it in the future of any Australian regulatory system. There certainly will not be efficiency and better outcomes for the Australian consumer from a continuation of price setting and regulation.

Price setting has never worked, it is an egregious afront to the natural order and the basic fundamental principles of economics.

"There should be cheapness…unprincipled greed appears wherever our armies march… Our law shall fix a measure and a limit to this greed." - Roman Emperor Diocletian, 302 A.D.[10]

We want to again express our gratitude for having an opportunity to comment. We would welcome the opportunity to both write and speak to the issues raised in this paper so any further discussion or public hearing would be gratefully appreciated.

If you have any questions or wish to invite us to talk on any issues, we welcome any further consultation. You can contact us at office@fairbane.com.au.

Yours faithfully

Fairbane

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[10] Walter E. Williams, *Economics for the Citizen* (1978).