

Read the Series



SERIES ARTICLES

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Strategy should rest principally on competitive markets, private investment and prices

The era of market-based energy policies has been hugely advantageous to Canadian producers and consumers and to Canadian society at large. However, several sources of pressure are eroding faith in those ideas—from the dominance of state energy companies world-wide to fears about security or protecting jobs to environmental measures that become thinly disguised protectionism. Canada should be a leader in the world in sustaining the case for market-based approaches.

This doesn't say that governments have no role—far from it. Governments are the owners of natural resources and rightly claim the benefits of that ownership for citizens of the jurisdiction. Governments ensure that natural monopolies are well regulated; they make arrangements for power system operation and long term planning; they regulate or create taxes to capture environmental externalities; and they step in to address other market failures such as those that inhibit energy efficiency or investment in R&D. Above all, governments set and enforce the rules of the game through such measures as consumer protection, anti-trust and trade rules.

Governments also own many energy system assets, but by and large this is a historical artifact reflecting the way that electricity systems developed; it is by no means a necessary government role or a very desirable one. Ownership of energy systems adds unnecessary management burdens to already overstretched government capabilities and puts governments in a conflict of interest when they are both economic players and the setters of rules.

Competitive Markets

Most aspects of the energy value chain lend themselves to competitive markets as is the case in other network industries such as telecommunications and transportation; in other resource industries such as mining or forestry; and in other basic human needs such as food and shelter. Where competitive markets work well they tend to drive the most advantageous outcomes because they create incentives for cost management and for innovation in technologies, service offerings and business models. Policy measures that inhibit otherwise viable competition or which fragment energy markets create a cost burden and a drag on innovation that we can't afford.

That said, about half of the energy we consume is delivered directly by systems that are natural monopolies and are, therefore, necessarily subject to economic regulation. Canada shares with the United States a distinctive institutional structure for dealing with economic regulation in the form of independent regulatory tribunals whose basic operating premise is to try to mimic the effects of competitive markets as far as possible. Sustaining this highly successful, independent, and market sensitive regulatory model should be a Canadian objective.



Food For Thought

The International Energy Agency estimates that \$26 trillion in energy investment between now and 2030 is necessary to meet rising global energy demand levels in a “business-as-usual” scenario. In 2009, Canadian capital investment in the energy sector was \$58 billion and worldwide investment was estimated at approximately \$540 billion. Based on the IEA estimate, investment needs to more than double.

LARGEST SECTORS FOR CANADIAN CAPITAL INVESTMENT (2006-2010 AVERAGE)

Housing	26 %
Oil, Gas and Mining	16 %
Public administration	11 %
Utilities	6 %
Transportation	6 %
Manufacturing	6 %

Learn more: *International Energy Agency* (www.iea.org), *Natural Resources Canada* (www.nrcan.gc.ca) and *Newton Evans* (www.newton-evans.com)

Investment

Governments will not be in a position to meet the energy investment needs of the coming decade. The scale of the required investment is simply too large (see sidebar) and governments are facing potentially crushing fiscal requirements on the social side (e.g., health and education) where private investment is less well suited to the job. Policy needs to create conditions to attract private capital whether to competitive energy markets, to regulated markets where they exist or, where public ownership still exists, to Public-Private Partnership (3P) arrangements.

Prices

Market derived prices mediate investor, supplier and purchaser behaviour in virtually every aspect of the economy. The system works well as our living standards attest. Much of the energy system works this way but electricity remains a laggard in many jurisdictions where prices often still fail to reflect real costs. Power systems are the parts of the energy system most under stress and at risk: they are the fastest growing part of energy demand; the biggest focus of policy efforts to encourage efficiency; the focus of large amounts of technological innovation; and they require the largest, highest risk capital investment. Masking real costs while trying to tackle these challenges makes the job much harder. In any event, doing so simply shifts the costs from energy consumers to taxpayers or, worse, to future generations. Prices are the most important information available to investors, producers and consumers; they need to be clear and unmistakable and include all costs.

Prices should include environmental costs, including whatever cost society chooses to attribute to carbon. Carbon policy needs to come to grips with the politically fraught fact that the worst thing that can be done with carbon costs is to impose them and then try to hide them—as some do when they argue for cap and trade as a way of disguising the fact that it is a tax. Consumers are smarter than policy elites give them credit for. They will find out and they will punish deceivers. Just possibly, if we avoid trying to fool consumers and instead engage them we may be able to find ways forward that they will trust even if they don't relish them. That sounds politically naive but the only alternative is to not deal with carbon.

A note of caution is in order. Market-based energy prices, especially for electric power can fluctuate widely. Players in wholesale markets need to see these fluctuations and they typically have the capability to manage them. The same is not true for small consumers. There are many ways of smoothing the short term fluctuations in energy markets so that consumers have some stability while still seeing an effective real price signal.

