Price discrimination in Australia’s retail electricity markets: an analysis of Victoria & Southeast Queensland

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Abstract
When capital-intensive monopoly industries are restructured and deregulated, consumer prices commence a natural drift from regulated uniform ‘average cost’ tariffs to competitive differential prices, and this can raise problems for policymakers. Deep discounts are welcomed, high Standing Offers are not. But price discrimination is unremarkable in economics. Indeed, in industries where fixed & sunk costs represent a significant portion of total cost, discriminatory pricing is usually welfare enhancing. Conversely, theory predicts and empirical evidence confirms that regulatory efforts to cherry-pick differential prices in asymmetric markets will damage consumer welfare. In this article, we analyse differential retail electricity offer prices in the Australian States of Victoria and Southeast Queensland and contrast these with industry average total cost and the marginal cost of retail supply. We find deregulated Victoria displays high price dispersion with Standing Offer tariffs 10% above industry average total cost and marginal offers at break-even prices (i.e. 20% below average total cost). In the semi-regulated Southeast Queensland market where a regulated price-cap exists, there is lower dispersion but marginal offers include a 6.7% retail mark-up. Efficient pricing requires the marginal unit produced to be priced at marginal cost and Victoria meets this criteria – but we identify an episode of inter-consumer misallocation due to high Standing Offers. We conclude policy initiatives designed to help firms shift vulnerable households from Standing Offer tariffs is desirable.

Keywords: Price Discrimination, Non-Linear Prices, Electricity Tariffs.

JEL Codes: D4, L9 and Q4.

1. Introduction
A seemingly problematic issue facing policymakers in competitive retail electricity markets is the dispersion of residential tariffs that naturally follows deregulation events. To be sure, price dispersion at the residential level represents a material change from a 120-year history of uniform tariffs. Under regulated monopoly conditions in Australia, State Electricity Commissions gazetted two-part tariffs and all households faced that uniform (non-linear) price.

During the 1990s, industry restructuring led to the creation of rival retailers and by the early-2000s Full Retail Contestability was implemented (initially with regulated price-caps). Standing Offer tariffs – comprising generation, network charges, retail supply, environmental charges and taxes – were declared by the regulator. Incumbent retailers were obliged to offer this tariff and default levels of service to all customers in their former franchise. The regulated Standing Offer price-cap formed a price-to-beat. Rival new entrant and adjacent franchise retailers would poach the incumbent’s former franchise customers by offering discounts off the Standing Offer price-
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