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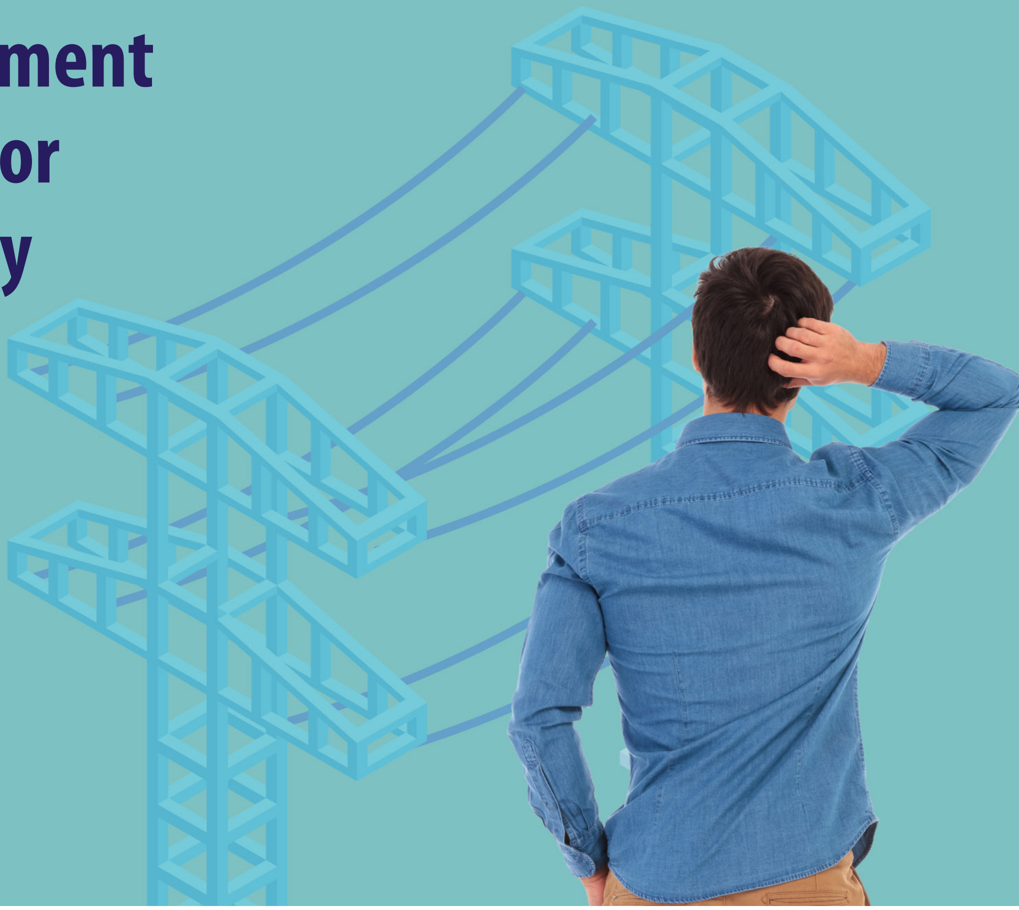
Ontario Government Perpetuates Poor Electricity Policy



by Philip Cross

Summary

- The sharply rising cost of electricity in Ontario for more than a decade has been a major drain on both the province's economy and its public finances. Electricity prices for hydro consumers have risen by more than 50 percent since 2001, especially after the attempt to shift to renewable energy sources with the Green Energy Act in 2009.

- While ratepayers have seen prices increase sharply, governments have attempted to cushion the impact by subsidizing the difference between what customers pay and the actual price paid to producers. This has shifted the burden of electricity costs from ratepayers to taxpayers.

- Both of these trends have continued under the Ford government. Consumers of electricity continue to see prices rise, especially large and medium-sized businesses.

- Meanwhile, producers continue to receive government subsidies to produce costly power that often exceeds Ontario's demand.

- Subsidizing hydro prices continues to add to Ontario's already large and growing public debt.

Introduction

Cheap and reliable energy sources are one of the foundations of economic growth. As a result, the doubling of electricity prices in Ontario over the last two decades has had widespread implications for household spending, business investment, government finances, and export competitiveness. To offset their adverse impact, governments in Ontario increasingly have resorted to subsidizing electricity rates. Despite promising to lower electricity prices and restore transparency to Ontario's finances, the Ford government has raised prices because it was unable to rein in the Global Adjustment surcharge and it has not made public the contracts granted to renewable power generators.

However, the rising price of electricity in Ontario does not fully capture the cost of electricity to its economy, because the government continues to subsidize prices. This shifts the burden of electricity costs from ratepayers to taxpayers. The continuing reliance on subsidies to mask the true cost of electricity diverts policymakers and the public from focusing on the solution, which is returning to competitive pricing of electricity generation. The problem would have been averted if government had relied on market forces rather than government dictates to determine energy choices, as wind and solar power were never competitive with the cost of natural gas or hydro. Lower electricity costs would help restore Ontario's competitiveness, sound public finances, and public trust in government.

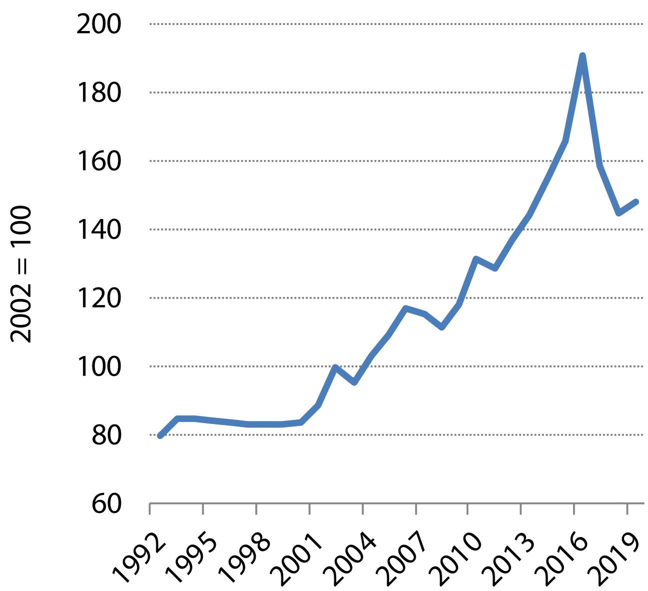
Background

Electricity prices in Ontario barely budged between 1993 and 2001. This reflected a freeze on retail hydro rates at 4.3 cents an hour introduced by the NDP government in 1994 and maintained by Mike Harris's Progressive Conservative government after 1995. Ontario tentatively deregulated electricity prices in 2002 as part of a move to privatize Hydro One (which owns the transmission network of power lines and towers). Almost immediately the wholesale price shot above 5 cents per kilowatt hour to reach a peak of 10.9 cents in September of that year, a reflection of intense summer heat, drought, and the failure to restart two nuclear generating units.

Public outrage, already primed for stoking by rolling blackouts and price spikes in California's electricity market, led Premier Ernie Eves on November 11, 2002, to cap retail electricity prices at 4.3 cents per kilowatt hour retroactive to May (Mackie, 2002, November 12). This began a decades-long pattern of sharply rising electricity prices punctuated by brief periods of price cuts, almost always introduced just before a provincial election (see figure 1). As one academic study of the tentative move to privitization concluded, "Ontario's competitive market has been destroyed by the government" (Dewees, 2005: 145). The competitive market for electricity in Ontario has never been restored as governments increasingly took control of energy policy, which resulted in steadily worsening outcomes for Ontario's energy users and all taxpayers.

Partly due to the fiasco surrounding Eves' handling of electricity prices, Dalton McGuinty's Liberals won the October 2003 election. The new government soon decided that the cap on electricity prices was too costly, and raised rates by 22.5 percent between 2003 and 2006. It briefly lowered prices in 2007 prior to a provincial general election, which the Liberal government won with another majority.

Figure 1: Ontario Electricity Price Index



Source: Statistics Canada, Consumer Price Index: Table 18-10-0005-01.

The Green Energy Act raises prices significantly

In 2009 the Liberal government adopted the Green Energy and Green Economy Act as part of its policy response to the global recession. The program's aim was to accelerate the phase-out of coal-fired electricity and jump-start the development of renewable energy, which it saw "as a potential replacement for the traditional manufacturing industries that were in decline" (Winfield, 2017: 258). These goals were to be accomplished through Feed-in-Tariffs (FIT) that guaranteed access and prices for renewable energy and local content requirements for participants in the FIT program (the local manufacturing content requirements were later ruled illegal by the World Trade Organization). These policies explicitly substituted government planning for market prices to determine what energy sources to use, with increasingly harmful results lasting over a decade.

The cost of providing guaranteed above-market rates to generators of renewable sources is paid by a surcharge on electricity bills called the Global Adjustment, which also covers the cost of refurbishing nuclear plants and conservation programs. As the wholesale price of electricity rises, this boosts the subsidy needed to keep the retail price steady, which helps boost the Global Adjustment. The cost of the Global Adjustment has soared from $700 million to $12.1 billion by 2019, with almost one-third directly attributable to renewable energy contracts (Office of the Auditor General of Ontario, 2011: 94; Aliakbari and Yunis, 2019: 13). Ontario's Auditor General (OAG) said hydro customers paid $37 billion more than necessary between 2006 and 2014 due to adjustment charges to pay for renewable energy. The end result helped send nominal electricity prices soaring by 71.3 percent between 2008 and 2016.

With an election approaching and Ontario Hydro projecting electricity rates would increase a further 46 percent over the next five years (Canadian Niagara Power Inc., undated), the government introduced the Clean Energy Benefit, which lowered rates by 10 percent on January 1, 2011 for five years, at a cost of over $1 billion a year (Winfield, 2017: 261). The Liberals won a majority government in that year's election.

The Wynne government uses more debt to lower prices

By 2016, electricity prices had exactly doubled since the Liberal administration began in 2003, an average yearly increase of nearly 8 percent. A popular backlash led the Liberal government to rebate the provincial portion of the Harmonized Sales Tax for residential and small businesses as of January 1, 2017. It announced a further 25 percent drop in electricity rates for these same customers starting July 1, 2017, for a period of four years (Office of the Auditor General of Ontario, 2017: 235). This extended the now-familiar pattern of several years of rate hikes followed by rebates just before elections in 2003 (when electricity prices fell 4.3 percent), 2007 (-1.4 percent), 2011 (-1.9 percent), and 2018 (-8.8 percent). The only election year when prices rose was 2014, when they increased 7.7 percent.[1]

Using debt to subsidize lower electricity prices transfers the cost from ratepayers to taxpayers. What ratepayers saved on their monthly hydro bills is more than offset by higher taxes to pay for these savings years in the future. In the words of the Financial Accountability Office (FAO), "The HST rebate and adjusting the electricity relief programs will transfer costs from ratepayers to the Province, thereby providing savings to eligible electricity ratepayers but a corresponding increase in costs to the Province. However, the proposed electricity cost refinancing provides a temporary savings but higher costs to eligible electricity ratepayers due to the interest payments on borrowed funds" (FAO, 2017: 4). The Financial Accountability Office estimated the two rate cuts would cost the province $45 billion over 29 years, including $5.6 billion for the HST rebate and $39.4 billion for the rate cut. Including $24 billion from lower hydro rates, it estimated the net cost was $21 billion (FAO, 2017: 1).

[1] The CPI for electricity in Ontario fell in November 2007 until January 2008 due to rebates from the government. Prices then rose slowly through 2008, but not enough to lift the annual average for all of 2008 compared with 2007.

Partly because high electricity prices and a weak economy dampened demand (which only reinforced the increase in the provincial debt), the generation of solar and wind power was superfluous to Ontario's needs and ended up being exported at below what it cost to produce it. By 2014, the OAG estimated Ontario had nearly twice the energy capacity it needed (Office of the Auditor General of Ontario, 2011: 99). At the same time, the government renewed its commitment to nuclear power as the centrepiece of Ontario's electrical power. However, with electricity demand continuing to decline after the recession ended, nuclear power supplied a growing portion of Ontario's power, leaving little need for the growing supply of renewable power. Because storing surplus power is difficult, most of the excess power was exported at less than half the price charged to domestic ratepayers. Subsidized power exported to customers and competitors in nearby states cost Ontarians $1.3 billion from 2005 to 2011 (Office of the Auditor General of Ontario, 2011: 112).

The OAG detailed how the Ontario government tried to keep the growing debt that arose from subsidizing electricity rates off its balance sheet and annual deficits. The Auditor General concluded that "In essence, the government is making up its own accounting rules" (Office of the Auditor General of Ontario, 2017: 6).[2] This proved costly as well as deceitful. By not showing the debt as belonging to the Ontario government, the FAO estimated that the province would pay $4 billion more in higher interest costs than if the Ontario Financing Authority had done the borrowing.

[2] The government tried to hide the subsidy by calling the shortfall between what ratepayers paid to local distribution companies an asset funded by a trust established under Ontario Power Generation, an asset the OAG called "non-existent" (p. 11).

The Ford government reneges on price cuts and transparency

The Ford government was elected partly on the promise of cutting electricity prices by 12 percent, with lower prices starting in January 2019. It was never clear if it would lower prices by raising subsidies or by ending payments for costly wind and solar power.

So far it has delivered a 2.3 percent price increase in 2019 for households and small businesses. The increases reflected continuing hikes in the Global Adjustment, up 13 percent between June 2018 and June 2019 to remain the largest portion of hydro rates (Aliakbari and Yunis, 2019: i–ii).[3] While the new government did cancel some renewable energy contracts before they were fully implemented, so far it has refused to cancel existing contracts, the burden of which continues to push up the Global Adjustment.

Electricity prices rose even faster for medium and large businesses. Prices for medium-sized firms rose 15 percent in Toronto in 2019 and 12 percent in Ottawa; large firms paid 10 percent and 7 percent more (Aliakbari and Yunis, 2019: 9). As a result, large firms in Ontario pay significantly higher electricity prices than anywhere else in Canada, and twice as much as large establishments in Montreal or Vancouver (Aliakbari and Yunis, 2019: 12).

The Ford government deserves some credit for acknowledging that the subsidies embedded in the Global Adjustment are part of public debt. The previous administration tried to mask this subsidy through a complicated accounting scheme, even as it altered the governance of Ontario Hydro to allow more direct intervention by the Minister of Energy. By issuing the debt directly through the Ontario Financing Authority, the government lowered the interest cost.

The new government's commitment to transparency, however, does not extend to revealing the rate guarantees given to Non-Utility Generators, which contribute to rising subsidies under the Global Adjustment (Aliakbari and Yunis, 2019: 15). Neither has the Ford government addressed the related problem of exporting excess power generation to nearby competitors at below cost, especially from renewable sources.

3 As of June 2019, the Global Adjustment accounted for almost all of the cost of electricity in Ontario, according to the same report (p. 7).

Conclusion

The basic truism that subsidies today must be paid, with interest, by taxes tomorrow holds for the Ford government as much as for its predecessors. Ontario's refusal to stop purchasing unnecessary and costly wind and solar power keeps its electricity prices unnecessarily high. Subsidizing electricity prices is a drain on public finances. Both of these policies dampen the province's potential economic growth. Had Ontario relied on market prices to determine energy sources, it would have avoided building expensive wind and solar power generators, lowered electricity rates, curbed government deficits, restored the province's competitiveness for trade and investment, and prevented the loss of public trust eroded by secret deals with power producers.

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