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MEASURES NEEDED TO ARREST DETERIORATING SUPPLY-DEMAND POSITIONS IN PROVINCIAL ELECTRICITY SECTORS, SAY TD ECONOMISTS

- All provinces in this country currently enjoy an adequate supply of electricity – even Ontario, where challenges have captured considerable attention over the past few years.
- At the same time, however, most regions are already confronting, or are likely to encounter, deteriorating supply-demand positions.
- The challenges don't stop at merely scouting out new sources of supply, but investing heavily in transmission and distribution infrastructure.
- Above all, provincial and territorial governments need to encourage conservation by eliminating current gaps that persist between the cost of producing electricity and the price levied. Further moves toward market-based pricing would help to achieve this end.

TORONTO – Although electricity supplies across the country are currently sufficient to meet demand, most provinces are facing a growing electricity squeeze, say TD economists in a special report entitled *Electricity in Canada: Who Needs It? Who's Got It?* The report is available at www.td.com/economics. "To alter the status-quo, governments will need to ramp up efforts to encourage conservation, in part through smarter pricing policies, and achieving new supplies of power, led by 'green sources'," remarked Derek Burleton, a senior economist with TD Bank Financial Group.

Ontario has captured the most attention

Among the regions, Ontario's challenges on the power front have been the most well-documented in view of the power blackout with eight U.S. states in 2003 and a recent election promise by the provincial government to shut down its coal-fired generation units by 2007, which together account for about one-quarter of the province's supply. Yet, the TD study shows that Ontario is far from alone in facing electricity supply constraints over the next several years. Most regions – even hydro-rich Quebec and

British Columbia – have experienced weakening supply-demand positions in recent years, as evidenced by a combination of declining exports, rising imports and dropping reserve margins of electricity.

$150 billion in investment required

Addressing these hefty challenges on the supply and electricity infrastructure fronts will be necessary to ensure that Canadians continue to enjoy a reliable electricity system down the road. And, assurance of reliability will come with a price tag. The Canadian Electricity Association has estimated the combined cost across Canada's regions at $150 billion over the next two decades, or $7.5 billion per year. "With governments already facing rising health-care costs and high debt burdens, moves by governments to throw the door open more widely to private-sector involvement could assist greatly in covering these huge investment requirements," said Burleton. And, here, we're not just talking about private ownership of assets, but in areas where it makes sense, governments partnering with the private sector to design, build, operate, and/or finance projects.

Prices may need to rise before they fall

The report acknowledges that many governments have been moving in the right direction in many respects. Most have developed long-term strategies that aim to achieve, among other goals, new supplies of "clean" power. Ontario, for example, has been looking at requests for proposals (RFPs) for renewable and gas-fired projects, and exploring the possibility of working with other provinces, such as Manitoba and Newfoundland & Labrador, to develop hydroelectric projects in their regions. Above all, there is an acknowledgement that some of the solution rests in demand-side management, which entails shifting power use from peak to off-peak periods.

Still, despite the moves, there have been only limited efforts made at addressing one of the key barriers – namely, the practice of pricing electricity below its marginal cost. Historically, many governments across the land have opted to heavily subsidize electricity prices, in part as an implicit industrial strategy. Although gaps between price and cost have narrowed in recent years, as many provinces have worked to address the price side of the equation, they remain significant in many parts. "Case in point is Quebec, where it has been estimated that if domestic consumers had paid the export rate in 2003, their bills would have been $8 billion higher," said Burleton. Applying a similar methodology to other provinces would almost certainly show that price subsidization remains the rule rather than the exception in Canada.

Further progress in realigning prices with cost, and in moving to a more market-based pricing system in general, would appear to be a competitive strike against business. However, to the extent that prices increase in the short run, they would ultimately help to raise efficiency, attract investment in new generation capacity, and hence assist in averting a full-blown power crisis in the future. "In Alberta, the move to deregulation in the late 1990s created some short-term pain, as prices rose by about 60 per cent. Since then, there has been a wave of new private-sector investment and a sharp pull-back in prices," added Burleton. In any event, even if prices rise over the next few years, Canada will continue to enjoy a competitive advantage in this area on an international scale.

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Electricity in Canada: Who Needs It? Who's Got It? (including charts and detailed tables), is available in PDF format on TD Economics' Home Page at: www.td.com/economics.