

The viability of institutional separation: lessons from GB energy regulation

Tim Tutton

Theme and structure of presentation

- Why separate?
 - Viability of separation at least in part a matter of whether the objectives of separation continue to be achieved
- Has separation worked in GB energy regulation?
 - Yes, at least in the past and, even now, maybe more than some think
- Why did it work?
 - The past political and economic environments
- What has made things more difficult since
 - In particular, changes in both of those environments
- What are the consequences for separation of those changes?
 - In the main, a notable reduction in separation/independence
- Does this mean that separation can only work in a politically and economically 'easy' environment?
 - Only up to a point
- Is all of the above just a little bit over-materialist/deterministic?
 - Maybe but would need an even longer presentation

Why separate regulator from 'core' government?

- Independent regulator required by the 'Third Package'
- Government desire to avoid blame for unpopular policies

But also, amongst other things

- Reassure investors (and underpin investment)
- Accumulate specialist expertise in specialist agency (an endemic problem for mainstream civil service)

Has separation worked? Well, it did for a while

- Pro-competitive restructuring of gas and electricity industries – resulting in substantial increases in measured wholesale and retail competition and substantially accelerated productivity growth- largely the work of industry regulators
- As a result of RPI-X price control, substantial reductions in network prices, compared with incremental squeezes applied to nationalised industries

Why did it work then? (1)

- Energy going through one of its low political profile periods (obvious clue being closure of Department of Energy), underpinned by benign oil prices from mid 1980s to early 2000s
- Government belief in letting markets make key energy investment decisions, not least on composition of electricity generation
- CCGTs clearly the economic choice for new generation

Why did it work then? (2)

- Above economic and political context meant that possible for government to write a simple contract with regulators
 - few non-conflicting objectives, in effect
 - facilitate competition where possible (i.e. mainly in generation and shipping/supply)
 - bear down on (monopoly) network prices
 - or, in sum, deliver an efficient energy industry

What has since made separation more difficult?

- Political profile of energy has risen
 - much higher global energy prices, with knock-on to retail prices – which increases pressure on politicians to be seen to be doing something
 - climate change agenda – which has meant, inter alia, favouring of types of generation (nuclear or renewables) which the market, left to itself, would not choose
- Result
 - government now interested in energy in a way that it just was not in the earlier period
 - few non-conflicting objectives have been replaced by more and conflicting ones
 - keep prices down
 - ensure security of supply **and**
 - encourage forms of electricity generation which are problematic both for electricity prices and security of supply
 - trade-offs between those objectives cannot easily be left to unelected agencies

What have been the consequences?

Repatriation of powers by government

- EMR
 - classified as ‘energy policy’
 - DECC explicitly in the lead with National Grid as its ‘delivery agent’
 - clear contrast with the past delivery of, for example, NETA (DTI nominally taking high level decisions but actually with Ofgem in charge and NG again as main delivery agent)
- RMR
 - heavy government involvement in deciding the form which retail market competition would take
 - substantial restrictions on the way in which suppliers compete, largely driven by a DECC (and even No.10) agenda
- More generally, DECC’s determination to be involved in all industry change processes with ‘policy’ implications

Or, put differently, what is the current division of labour between DECC and Ofgem?

‘Routine’/technocratic regulation – Ofgem	Implications for energy policy – DECC works ‘alongside’ Ofgem	Re-defined as ‘policy’ – reserved to DECC
‘Routine’ network regulation – e.g. price reviews	Significant changes to network regulation, especially when important to delivery of policy outcomes	‘Big’ changes to structure of energy markets, e.g. EMR
‘Delivery’ of specified programmes - Eserve	Tweaking of operation of wholesale and retail markets	
Monitoring of wholesale and retail markets	RMR	

Does the GB energy experience suggest that separation is non-viable once the going gets tough?

- Separation certainly easier when dealing with the (politically) boring
- At any one time, some bits of each regulated industry may be more boring or more fraught than others
- As things stand in energy, independent regulation continues to have some meaning for (boring) networks
 - investor confidence in investing in networks continues to be underpinned by price controls administered by Ofgem
- For electricity generation and supply, Ofgem's independent role more or less reduced to market monitoring (including its concurrency powers with OFT under competition legislation)
 - plan is that investor confidence will be underpinned by neither regulation nor the market but by
 - power purchase contracts with government for low-carbon generation
 - a capacity mechanism for other generation

In sum, the GB energy experience suggests that

- Separation/independence is difficult to sustain in the face of high political profile, at least when there are conflicting objectives which require political decisions about trade-offs between those objectives
 - issue unlikely to be resolved by DECC's planned 'Strategy and Policy Statement'
- But, separation can still be worthwhile (for reasons other than EU requirements), e.g.
 - its role in underpinning investor confidence, even if the scope of that underpinning has been reduced
 - to date at least, the quality of analysis produced by DECC and Ofgem suggests that the skills argument for a specialist agency remains
- Regulatory 'romantics' may also have been misled by the unusually large area of responsibility (including for 'policy') delegated to energy regulators in the 1990s

Finally, some (dangling) questions

- Is the above analysis too materialist/deterministic?
- In particular, would the outcome, to date, have been different if
 - the government did not have a Renewables Obligation – which has at least exacerbated the division between the government's focus on volume (of low-carbon energy) and Ofgem's focus on economics/price
 - the government had adopted a more market-friendly approach to EMR
 - Ofgem had reacted differently to the earlier pressure to do more to support achievement of the government's renewable energy targets?