Energy regulation and government interference

Privatising the energy market promised low prices through competition. This has failed in practice with continued government involvement and rising prices for consumers. Martin Stanley explores why it has been impossible for government to stay clear of energy regulation, and the consequences for today's energy market.

Some areas of regulation have such important social consequences that they cannot be left to independent (and unelected) experts. But this has meant that the bold experiment with gas and electricity privatisation has resulted in a highly politicised and expensive energy market.

The privatisation of the energy industries was intended to free them from government interference, not least in their investment and employment practices. Before privatisation, the government not only had a hand in all significant decisions, but it also tasked those industries with a number of incompatible objectives, and especially social objectives. The intention was that post-privatisation competition would drive down prices, whilst strong independent regulation would protect consumers against the exercise of any remaining monopoly power. This chart (median household energy spend as a % of income) shows the welcome effect on households' energy bills though to 2004:

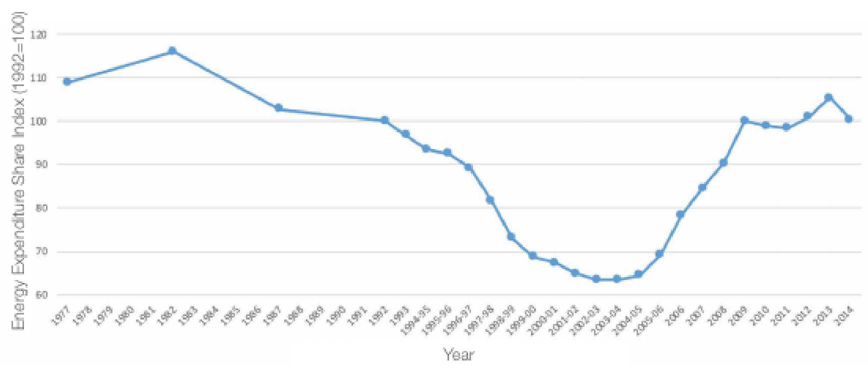


Figure 1 Index of the median energy expenditure share[4] 1977-2014 (Base year: 1992)

(Data: Living Costs and Food Survey and precursors)[5]

But the same chart shows that most of the gains have since been lost, mainly because political fingers are now all over energy policy, including the following policy interventions:

- Carbon emission reduction 'obligations' – paid for by customers:
    - Energy Company Obligations
    - The Renewables Obligation
    - The Non-Fossil Fuel Obligation
- Non-discrimination clauses. (Suppliers were told to reduce the differences between the higher prices they charged in their home territories and the lower prices they charged when trying to attract customers elsewhere in the UK.)

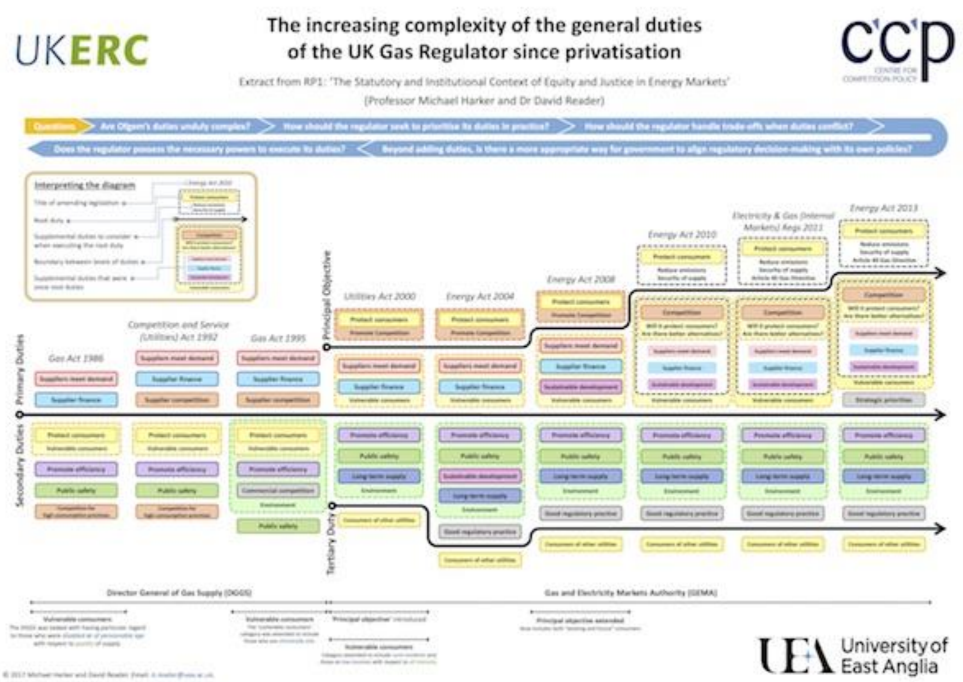
- Suppliers were forced to reduce the number of their tariffs.
- The 'Warm Home Discount.'
- Price capped single variable tariffs.

Several of these interventions were driven by the need to reduce CO_2 emissions, but others - although intended to protect certain consumers – will have reduced competitive pressures and so indirectly encouraged higher prices for the majority. We have therefore returned to the government having a hand in all significant energy industry decisions, and again tasking the industry with a number of incompatible objectives, and especially social objectives.

There has accordingly been a consequential and profound change in the role of the energy regulator Ofgem, and in its relationship with government, nicely summarised in Chapter 3 of a recent report Fairness in Retail Energy Markets by the Centre for Competition Policy and the UK Energy Research Centre.

Ofgem's increased responsibilities

First, the following chart provides stark evidence of the increase in Ofgem's responsibilities (if that is the right word) since the Gas Act 1986. The regulator now has Primary Duties, Principal Objectives, Secondary Duties, and Tertiary Duties. It must also comply with HMG's Strategy and Policy Statement for the industry – a future document yet to appear. The total number of duties has risen from eight to twenty-one.



One key result has been the effective demotion of Ofgem's duty to encourage competition, hence the consequences for energy prices since 2004. The CMA picked this up in its 2016 report when it recommended that the role of competition within Ofgem's duties should be clarified, but this was the only recommendation that the government rejected outright.

Ofgem no-longer independent

Ofgem's independence has also been compromised. Independence was a central tenet of economic regulation back in the 1980s and 90s, even being likened to a quasi-constitutional principle. Now, however, even the Committee on Standards in Public Life has noted a widespread view that "the imperatives of independence are now less well understood and given less weight". Ofgem's policy decisions, in particular, are developed in the shadow of threatened government intervention. (The government has legislated for 'back stop' powers in the event that the regulator fails to act.) Consultees also told CCP that the introduction of an Ofgem Board – to replace powerful Directors-General - had diluted the organisation's independence.

Where is the Strategy Policy Statement?

A further complication was added to Ofgem's tottering edifice of responsibilities when the Energy Act 2013 made provision for Ministers to set Ofgem's strategic priorities in a Strategy and Policy Statement. This statement as yet un-issued five years later, speaks volumes about the policy confusion in this sector.

In conclusion, the authors of the CCP/UKERC report note that the period through to the early 2000s was characterised by a separation of responsibilities which reflected textbook economics; the market maximised efficiency whilst distributional objectives were left to taxes and benefits. But policymakers in the UK and elsewhere have to face the 'trilemma' that low prices, greener energy and adequate investment are ultimately incompatible - political choices have to be made.

A broader range of objectives, including distributional objectives, have now been given to Ofgem. The resultant ambiguities require increased communication between government and regulator, and to opportunities for the government to 'pressure' the regulator – a massive change since the heady days of true independence.

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