Progressive Economics Group (PEG)
Policy Brief

Control of the Energy Sector

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Policy Issue

British governments implemented privatization and deregulation of energy sector with the stated purpose of increasing efficiency through competition and better service for users. This process started in the 1990s and has probably been unmatched by any other country. Since the 1990s, wide ranging efforts have been put in place to re-design various elements of the energy markets to improve competition and efficiency.

Privatization of energy failed to deliver on promises. While energy prices declined in the early years of privatization, partly because of falling gas prices, these gains were not maintained. Competition has not worked. The Big Six companies have maintained their domination. Users have been overcharged. Security of supply remains a protracted issue. Clean and renewable energy has grown not because of competition but government support. Opinion polls show that a large majority of public support re-nationalization of energy sector.

What is the appropriate policy for reversing failure of privatization of the energy sector?

Analysis

In its 2017 manifesto Labour Party promised to bring energy sector back under public control through a phased approach, which is most sensible. The transition phase is likely to be challenging and will need effective management.

There are suggestions to take over some of the existing plants and supply systems of the Big Six companies. This would not be optimal policy in the medium term for several reasons. Such takeovers should be prioritized to manage the financial costs of re-nationalization in monopolistic sectors. Therefore, the water industry should top the list.

In the energy sector, there are significant and pressing investment requirements to expand capacity, especially in base load supply. These requirements result from expected retirement of major generation units in the next ten years, which requires immediate action. As problems of Hinkley Point C have demonstrated, private investment in large scale projects is not forthcoming without major government guarantees and subsidies.

Public policy would be more effective to targeting new capacity creation rather than taking over existing and potentially overvalued capacities. This could be combined with incentives for smaller scale investments by local authorities and cooperatives, which would contribute to reducing the domination of the Big Six. In areas where capacity expansion is needed, it may be necessary to give priority to local authority and other public providers as well as cooperatives, subject to appropriate assessment of projects.

The diversification of suppliers in the energy market can put downward pressure on energy prices. However, this pressure is likely to be inadequate in the transition phase because of the time required to achieve sufficient public control of production. Therefore, energy prices will need to be regulated not only at the retail level but also in wholesale markets to deal with the problems arising from the market power of vertically integrated dominant suppliers.

During the transitional period with both private and public suppliers, the ability to regulate prices should be more effective. One of the main difficulties of price regulation arises from serious data inadequacies on the costs of the energy companies. This problem comes from lack of transparency in financial reporting which was acknowledged by the Competition and Markets Authority in its recent investigation. The rules on the disclosure and commercial sensitivity of company data also hinder effective regulation of prices. Significant public sector participation in the energy market at various scales of operation and with different generation technologies would enable the public authorities to have better understanding of the costs in the sector and therefore regulate the prices more effectively.

The regulation should encapsulate all providers, public, private, local authority and other suppliers. The current policy with its emphasis on ‘competition at whatever cost’ has to be reformulated to encapsulate and address affordability, environmental goals and security of supply.

Policy Framework

Expansion of public sector providers in the energy market together with price regulation will eliminate market power of private producers and lower energy prices on average.

The ongoing difficulties with investment and capacity should disappear with effective public management. The government would not have to entice in vain the private sector to take up the incentives, subsidies and guarantees it offers. Instead, direct public investment could be planned and undertaken in line with policy objectives, projections of growth of demand and expected retirement of existing plants and networks.

Gaining control of the energy sector will also enable bolder steps with respect CO_2 emissions and renewable energy.

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