

Government and regulators: the case of Ofgem

Tim Tutton

Regulatory Policy Institute Annual Competition and Regulation Conference 2012

Theme

- The relationship between government and regulators depends crucially on the nature of the political agenda in the area concerned, especially
 - how high a political profile the area has
 - how far political objectives conflict with each other
- Political agenda for energy in the 1980s and 1990s was favourable to independent and powerful regulators who were crucial to some of the biggest changes which happened in electricity and gas
- Since then, the politics of energy have moved on
- One result has been a significant curtailment of both Ofgem's scope and its autonomy
- This is unlikely to revert any time soon

Structure

- Why do governments use agencies?
- What – in particular, what sort of ‘deal’ between government and agency - makes the relationship work well (or not)?
- What was the initial deal between government and Ofgem?
- How has that deal evolved?
- What does that evolution imply for the future of Ofgem?

Why do governments use agencies/regulators?

- To enhance credibility of promises, e.g.
 - MPC's responsibility for interest rates
 - independent utility regulation as a reassurance to investors at privatisation
- To mitigate information asymmetries
 - easier to accumulate specialist expertise in agencies than in wider civil service
- To avoid taking the blame for unpopular policies
- Because it is an externally imposed legal requirement (e.g. the 'Third Package')

What makes the relationship work well: the idealist position

- House of Lords Select Committee on Regulators (2007):
 - ‘We conclude that
 - Independent regulators’ statutory remits should be comprised of limited, clearly set out duties and that the statutes should give a clear steer to the regulators on how those duties should be prioritised
 - Government should be careful not to offload political policy issues onto unelected regulators’
- In other words, regulators should have a few non-conflicting objectives and, if they do conflict, politicians should indicate explicitly how trade-offs should be made

In practice

- Lack of ‘real’ clarity about the agent’s duties - explicitness and clarity get in the way of the principal avoiding blame
- Problems of encapsulating objectives in targets, especially measurable ones
- Governments – and their ideologies – change but, in the UK, the bureaucracies typically do not
- Problem for the principal remaining an intelligent consumer in the face of informational advantages of the Agent
 - replication of the regulator-firm information asymmetry

Resulting ministerial control mechanisms

Internal

- Formal
 - agree new targets
 - appoint new chief executive
 - reform the Board
 - create ‘agency shadowing team’
- Informal
 - meetings
 - phone calls
 - lunches

External

- Formal
 - abolish organisation
 - reallocate responsibilities to another organisation
- Informal
 - speeches containing ‘policy steer’
 - press releases
 - media interviews

The initial deal with energy regulators: context

- Original electricity and gas acts driven, at least in part, by flotation objectives
 - primary duty in respect of financeability
- Emphasis on role of competition, at least for electricity (in the wake of criticism of gas privatisation)
 - break-up of the CEGB and appointment of Stephen Littlechild as first DGES
- Also a primary duty of securing that ‘all reasonable demands’ for electricity and gas are met but in context of an energy policy focused on facilitating market outcomes (the ‘Lawson Doctrine’)
 - not necessarily seen as implying interventions to achieve this objective
- Energy going through one of its low political profile periods
 - benign oil prices from mid 1980s to early 2000s
 - closure of the Department of Energy
 - (residual) energy ‘policy’ effectively contracted out to regulators

The initial deal with energy regulators, at least post electricity privatisation

- Foster competition in generation and supply (in electricity) and in supply in gas
 - 1990s Offer tussles with generators, culminating in plant divestment and NETA
 - British Gas MMC referrals
- Drive down energy network prices
 - not until 'DPCR4' that other criteria for price review 'success' given prominence in Offer/Ofgas/Ofgem press releases
- Deal broadly conformed with the House of Lords Select Committee prescription of few, non-conflicting objectives

How has the context changed?

- Inevitable post-flotation rebalancing of duties away from company financing and to consumers (albeit helped along by change of government in 1997)
- Rising concern with security of supply (not least on the back of declining gas output from the UK North Sea and declining nuclear output), without the presumption that market forces alone will deliver
- Increased emphasis on environmental/climate change/decarbonisation objectives (Climate Change Act 2008, EU Renewables Directive) and implications of some renewable energy technologies for security of supply
- Increased scope for conflicting objectives

How has the deal changed?

- Evolution of statutory obligations on SoS and Ofgem
- Environmental and Social Guidance
- DECC/Ofgem co-working

Evolution of statutory obligations through successive energy acts

- increasingly explicit upgrading of decarbonisation and security of supply objectives to sit alongside the (effective) objective of keeping prices down to consumers
- more sceptical/empiricist approach to competition
- increased role for the SoS in modifying licences

Failure of Environmental and Social Guidance to clarify Ofgem's priorities

- 2004 Guidance
 - reiteration of the 2003 Energy White Paper's objectives (achieve carbon reduction targets, maintain reliability of supplies, promote competitive markets, ensure that every home is adequately and affordably heated)
 - 'The Government has not sought to rank the four objectives set out in the White Paper. It is the Government's view that these objectives can be achieved together and the Government has put in place policies designed to achieve this'
- 2010 Guidance
 - Main (but not exclusive) focus on Ofgem's network regulation activities
 - Only specific nudges, beyond what Ofgem doing anyway
 - go beyond user commitment as a necessary condition for network investment: 'more preparatory work will need to take place before firm commitments are given by generators' and the need for 'strategic investment'
 - need to get a move on with offshore transmission
 - Still no clear overall guidance on relative ranking of price and other objectives

DECC/Ofgem co-working

- Previously, Ofgem largely left to get on with it on major projects – e.g. NETA
- Now, some projects re-classified as policy – e.g. EMR
- Others involve DECC sitting alongside Ofgem, e.g.
 - TAR
 - offshore transmission

So, what has happened?

- The government-Ofgem deal has changed from one with two non-conflicting objectives (promote competition, squeeze monopolies) to several conflicting ones
- Government has failed to indicate how these conflicts should be balanced
- Result: government has to find means, other than leaving the regulator to get on with it, to achieve its objectives

The current deal

‘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		

The future

- DECC has reviewed the role of Ofgem
 - accepted that ‘broadly scoped duties’ and ‘weak guidance’ are unsatisfactory
 - promised new ‘Strategy and Policy Statement’
- For debate, how far this likely to clarify Ofgem’s objectives
 - Clarity reduces the value of the regulator as a blame receptacle
 - DECC has found other ways of controlling Ofgem (repatriation of ‘policy’, insertion of political commissars into other change processes)
- None of this is necessarily wrong
 - energy now much more political than in the 1990s
 - HoL Select Committee not alone in thinking that political decisions should be taken by politicians
 - ‘independence’ of regulators in the UK (including Ofgem) continues to be greater than in many other countries
- But Ofgem’s future likely to be much less exciting than its past