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Symposium on Regulation and Competition in Utility Industries: Introduction

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I. INTRODUCTION

This collection of papers examines regulation and competition issues in the UK water, gas and electricity industries. These are three vitally important network industries that have undergone significant structural change over the last 15 years and where efforts to extend competition continue in those parts of the industries not deemed to be naturally monopolistic. This is a timely collection, given recent price reviews of the electricity distribution and water companies and the current Transco review. Further, current regulatory issues, such as implementation of the 2000 Utilities Act and the possible structural changes to water companies as some attempt to move away from the equity model, have far-reaching implications.¹ A significant length of time has elapsed since the burst of privatisation activity in the 1980s, and most companies have been subject to two price reviews. As such, it is an appropriate time to reflect on the UK experience from which lessons are being drawn as regulatory regimes are designed and implemented around the world.

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¹Long-term investment funding issues have led two water companies — first Kelda, owner of Yorkshire Water, and then Welsh Water in the form of Glas Cymru — to propose restructuring by separating asset ownership from operations to form a not-for-profit asset-owning company as a prerequisite for obtaining debt finance at the lowest possible cost. Regulatory approval was given to the Glas Cymru proposal subject to stringent conditions on 31 January 2001.

II. KEY ISSUES

A number of key issues with the potential to change fundamentally utility companies and their operating environments are currently facing UK utility industries. Government and relevant regulatory authorities continue to attempt to separate the naturally monopolistic parts of the privatised utility industries from the potentially competitive parts, often in the context of changing industrial structures resulting from rapid technological developments. In those parts of network industries where competition is feasible, it is important to avoid expensive mistakes in the introduction of competition such as the introduction of the electricity pool market, now being replaced by NETA (the New Electricity Trading Arrangements). In this context, Inset appointments² and common carriage arrangements are being facilitated in the water industry, whilst auctions for third-generation mobile licences and gas storage have been held with varying degrees of success. At the same time, greater opportunities are opening up for firms to enter and compete in other European markets, whilst being subject to increased competition from international competitors.

Where the introduction of competition is inappropriate, the question as to the most suitable form of industry structure remains. Competition for the market (i.e. competition to supply a market) could be an alternative to competition in the market. Competition can be introduced by a separation of asset ownership from operations, with the operations contracts being opened up to competitive tender. Such a market structure could bring competitive benefits resulting from the process of competitive tendering for contracts, along the lines of the contracting-out of UK local government waste collection services. Where the need for direct regulation remains, the respective roles of industry-specific regulators and the competition authorities need to be clearly delineated, as do the details of the specific regulatory instruments adopted.

These changes are being introduced at a time when the complexion of regulation and competition policy is being thoroughly reviewed. There is a move from *ex-ante* regulation to *ex-post* punishment of market abuses. For example, firms now face the possibility of fines of up to 10 per cent of UK turnover for three years for competition policy violations under the Competition Act 1998. The Utilities Act 2000 gives industry regulators the power to put companies' revenue at risk if performance targets are not met. The competition authorities are being given greater autonomy and there is continued hope that the role of industry-specific regulators can be reduced, rather than increased, as competition begins to take hold in various parts of network industries. Nevertheless, there has simultaneously been an expansion of regulators' primary duties: they have been given greater social and environmental responsibilities under, for example, the

²Inset appointments allow customers to choose an alternative regulated supplier. They allow one company to replace another as the statutory undertaker for a specified geographical area.

2000 Utilities Act, as illustrated by the Office of Gas and Electricity Markets (Ofgem)'s Environmental Action Plan.

III. THE COLLECTION OF PAPERS

Each of the papers begins by surveying regulation and competition developments in the industry under consideration. Sawkins reviews efforts to introduce competition in the English and Welsh water industry, the utility industry often perceived as offering the fewest opportunities for the emergence of competition. The paper focuses on the efforts by the Office of Water Services (Ofwat) to introduce comparative, yardstick competition between firms, as well as advances in capital market competition through mergers and take-overs, and the use of Inset appointments to encourage product market competition. Sawkins describes the extent to which each of the above types of competition has emerged, as well as discussing the potential for further increasing competition in the water industry. However, he concludes that, given the underlying characteristics of the industry, it is never likely to be considered a contestable market.

Hawdon and Stevens evaluate the use of auctions as a means of introducing competition into gas storage, a part of the industry in which competition has only very recently been introduced. Both this paper and the paper by Sawkins contribute to the theme of attempts to extend the breadth of competition into previously non-competitive parts of utility industries, the methods of introducing competition often necessarily being more novel than moves to restructure (horizontally and/or vertically) firms and industries.

Weyman-Jones recognises that not all parts of utility industries can be made competitive and that a need for regulation of some form often remains. He focuses on the electricity distribution market, in which prices remain regulated due to the inherent difficulties of introducing direct competition into this market. The nature of electricity distribution price regulation is described, and the associated efforts by the Office of Electricity Regulation (OFFER), and now Ofgem, to incorporate comparative yardstick competition into regulatory pricing policy are analysed. International price comparisons are also made.

IV. CONCLUSIONS

Many interesting issues continue to evolve with respect to the governance of utility industries as attempts to facilitate competition continue and the form of regulation in the remaining natural monopoly parts is continually re-examined. This collection of papers contributes to the ongoing debates regarding the success of competition and regulatory policies in the UK water, gas and electricity industries, often focusing on parts of those industries, such as the gas storage market, that are sometimes neglected in the existing literature.