

Competition Benefits

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Outline

- Regulatory test in Australia
- Ernst and Young Report
- Experience in UK and European Union
- Policy and experience in Argentina
- The nature of competition
- Summarising the questions
- Next steps?
- Conclusions

Regulatory Test

- Creation of NEM, customer benefits test for transmission investments. Aims: competitive neutrality and prudent investment
- NEMMCO found problems: measurement, volatile, difficult to satisfy test
- Ernst and Young: public benefits test instead
- Problems? Slow process, difficult co-existence regulated and non-regulated, competition benefits not included

Ernst and Young Report 1999

- Identified four criteria for designing test:
 - 1. Competitive neutrality:
 - not favour one group of generators over another, or regulated transmission over other investment
 - 2. Prudent investment: sufficient & efficient
 - 3. Simple to understand and administer.
 - complexity: inconsistent interpretation & added cost
 - 4. Regulatory certainty
 - risk will deter investors & non-regulated alternatives
- 1 & 2 acknowledged, 3 & 4 worth attention

Transmission regulation in UK

- No regulatory test: little scope for new entry
- But same aims underlie policy. In fact ...
- Stronger duties on regulator & transco to promote competition and efficient operation
 - eg RPI-X incentive regulation
 - shallow rather than deep connection charges
 - incentives to reduce transmission services costs by encouraging competition among providers
- Active & focused regulatory regime geared to promote competition & efficiency

Interconnector regulation in UK

- Interconnectors with Scotland and France
- Upgrades would increase competition? But issue did not arise since Scottish upgrades (several) were made on unregulated basis
- Now transfer to regulated status to avoid bottlenecks in extending EW market to GB
- So both approaches used in practice in UK, and competition an important consideration

EU Interconnector Directive

- Concern that market power and control of interconnectors will prevent internal market
- New Directive to be implemented July 2004
 - all interconnectors to be regulated, but
 - can exempt new ones if will enhance competition & security of supply and no investment otherwise
- Will exemption suffice to ensure new build?
- Could deal with market power directly?

Argentina

- Excessive transmission investment in past
- Privatisation: radical restructuring of generation removed market power
- Transmission company may not invest
 - unless users agree to finance each project
 - competition benefits not relevant
- Outcome: delays? system has worked well?
- Geared to particular problems: investment appraisal & regulation, not market power

Complexity of regulatory test

- Transmission assessment covers many items
 - right type, extent and location of investment?
 - effect on competition across network?
 - interactions between regions?
 - competition in provision of networks?
 - competition between networks & generation?
- Complications of mixed ownership
 - private & public incentives - both need regulation
- Sometimes government involvement too

Implications of complexity

- Many factors means test is a complex issue
- Need to estimate possible future outcomes
- Regulatory test thus involves subjective judgement - not just 'objective analysis'
- Outcome necessarily uncertain
- Adding competition benefits: more factors, more investment scope but more uncertainty

Estimating competition benefits

- How do competition benefits relate to test?
 - Include? Not include? Already included?
- Calculation depends on view of competition
- Conventional view: reduces market power
 - prices closer to cost, greater output, net value of greater output is ‘welfare triangle’
- Needs estimate of future parameters
 - prices, costs, outputs, investments & changes thereto
- Can be done, but how reliable?
 - Usually left to investors whose own money at risk?

The nature of competition

- Inelastic demand so welfare triangle small
- Are there other benefits of competition?
- Impact on efficiency in generation & supply?
- & efficiency of transmission & distribution?
- & on quality and variety of service?
- & on innovation? rate of adaptation? skills?
- But how far is it sensible to give a regulator or transco the duty to quantify all this?

Summarising the questions

- Would explicit inclusion of competition benefits in regulatory test be desirable?
- Enable economic investments to proceed, protect customers, stimulate efficiency?
- Or expand incumbents excessively, increase uncertainty, deter entrants, less efficiency?
- Some of both? answer in between?
- Which concerns most relevant in Australia?

Next steps?

- If aim is to understand how revised regulatory test would work, it would seem useful to review experience to date
 - how have companies applied test?
 - How are outcomes different? Are they beneficial?
- What problems most important in Australia?
 - Concerns in generation & supply? Or networks?
 - Problems with ownership, regulation, government?
- How will competition benefits test impact?

Conclusions

- Competition benefits role in transmission?
- UK and EU Yes - in context where competition weak & regulation active
- Argentina No - in context where competition strong & regulation not to be relied on
- Australia? Nature of competition and regulation? this route versus others?
- Helpful to consider these prior questions