

Independent regulation of government-owned monopolies: an oxymoron? The case of electricity distribution in Australia.

“The British Utility Regulation Model: Beyond Competition and Incentive Regulation”

London School of Economics and Political Science

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Outline

- Context
- Outcomes
- Reasons
- Summary

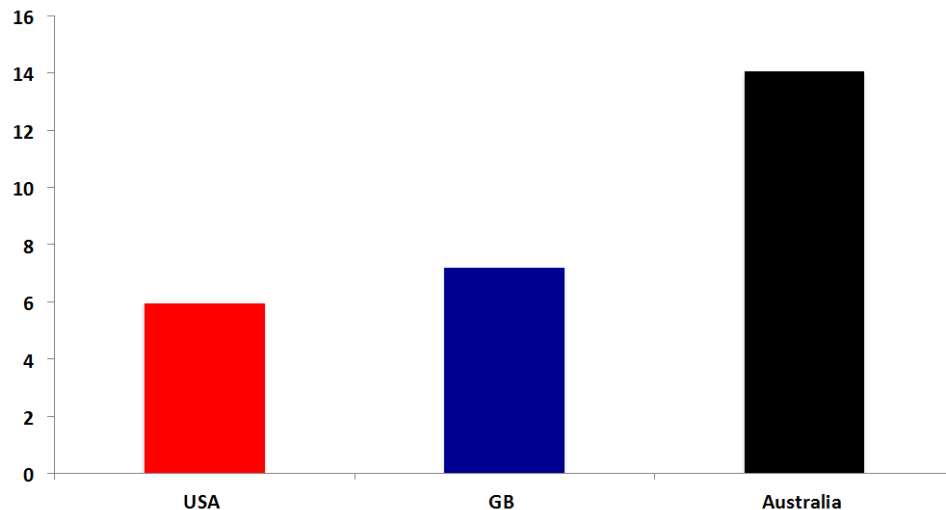
Context

- RPI-X adopted, as part of a package that included regulators, vertical separation (G-T-D-S). Many similarities (at first) with GB.
- RPI-X applied first to 5 privatised distributors in Victoria (1994) and 1 in South Australia (1999), 1 public-private partnership in ACT (2000), and then also to 3 (state) government-owned distributors in New South Wales, 2 in Queensland, 1 in Tasmania and 1 in Western Australia. Three quarters of consumers still served by govt. distributors.
- Govt. distributors “corporatised” and required to pay income tax (which the state governments collect).
- Privatisation politically problematic. As fall-back, regulator instructed to regulate govt. distributors as if private (and to ignore state governments’ collection of income tax and debt fees).
- Some believed ownership didn’t matter, others suggested wishful thinking.

Network services charges for average usage households

(PPP-adjusted exchange rates)

Australian cents per kWh

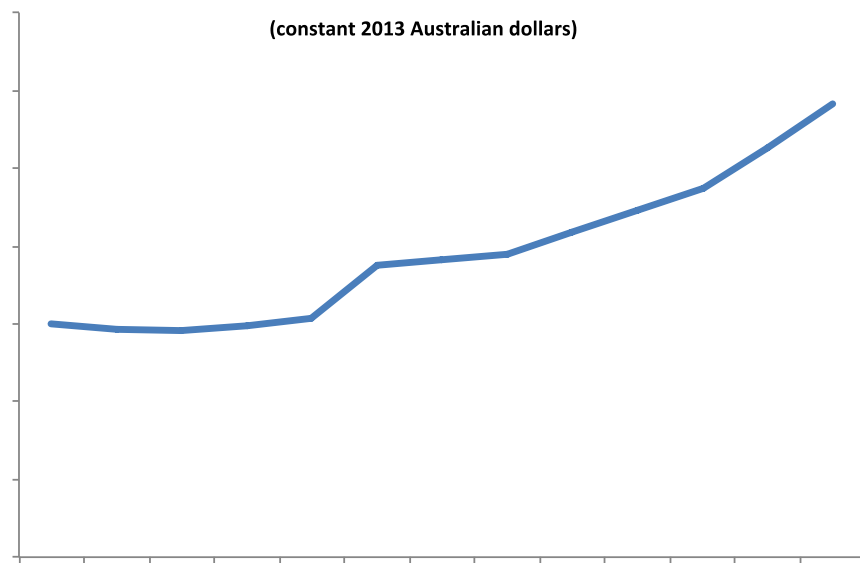


Regulated network charges in Australia now much higher than GB or U.S.

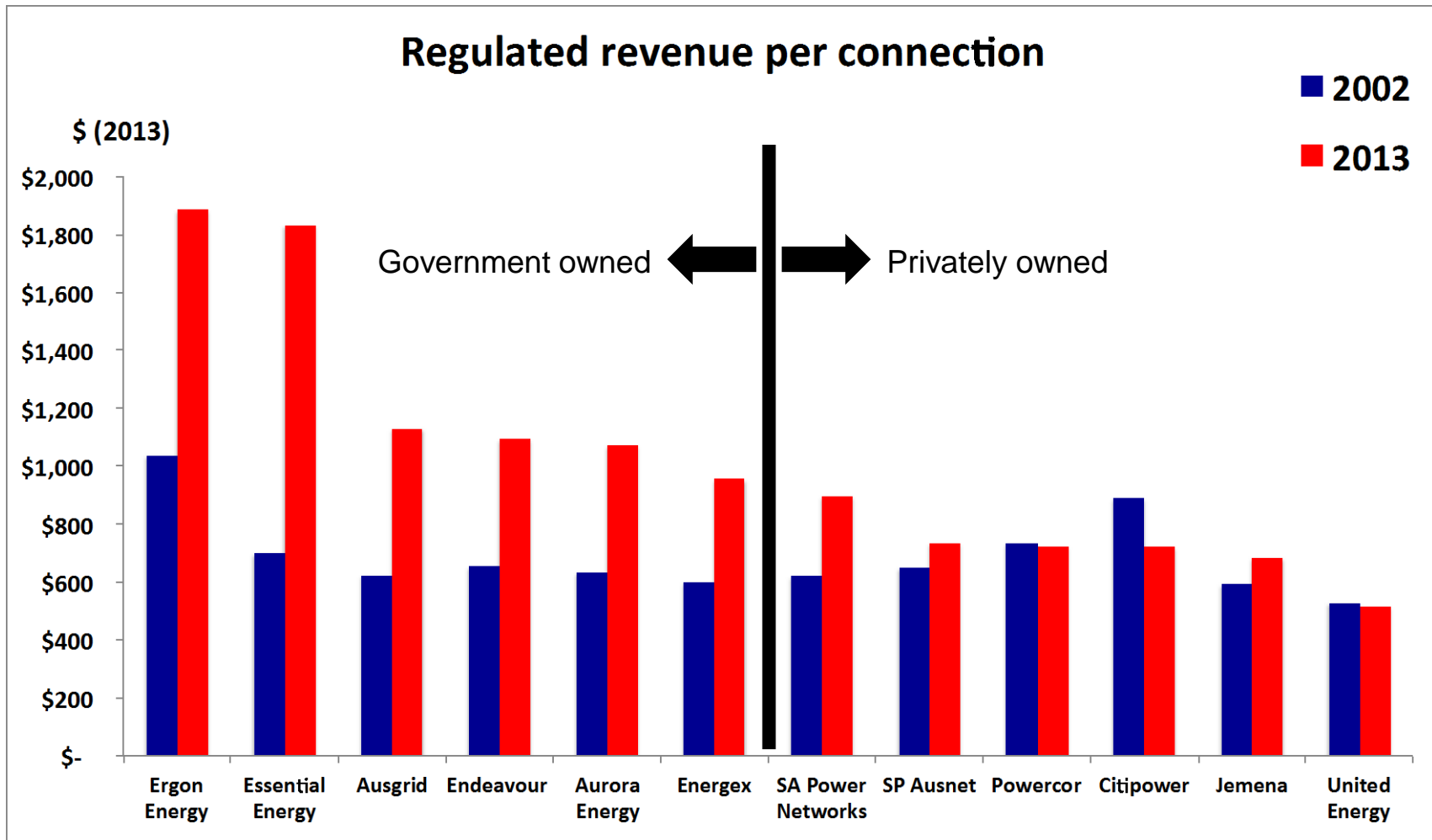
Source: US (EPRI), GB (Ofgem), Australia (gazetted network tariffs, average household consumption data, OECD PPP)

It never used to be this way: regulated revenue per connection doubled in constant currency between 2005 and 2013

(constant 2013 Australian dollars)

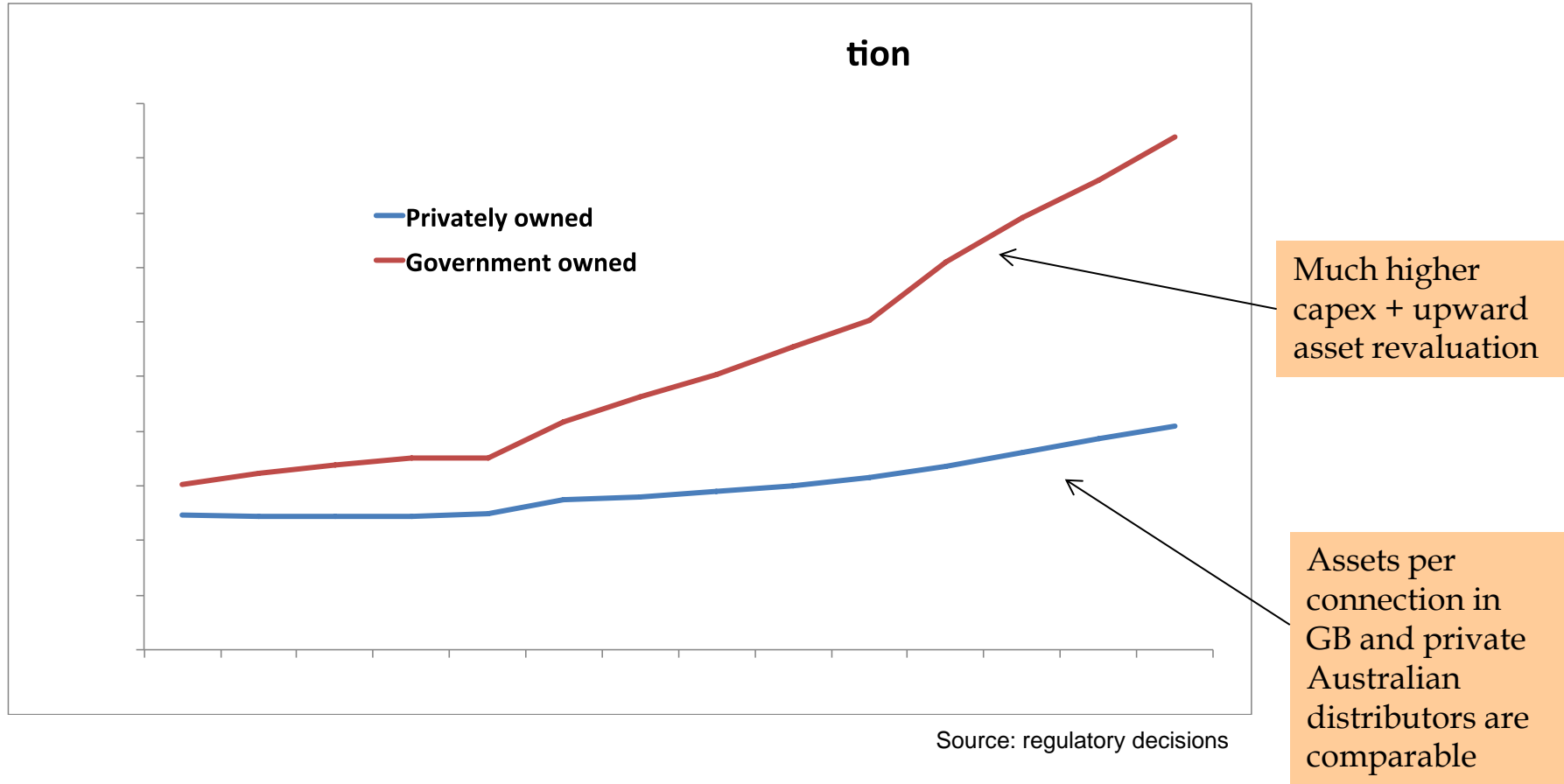


And there is a government / private split

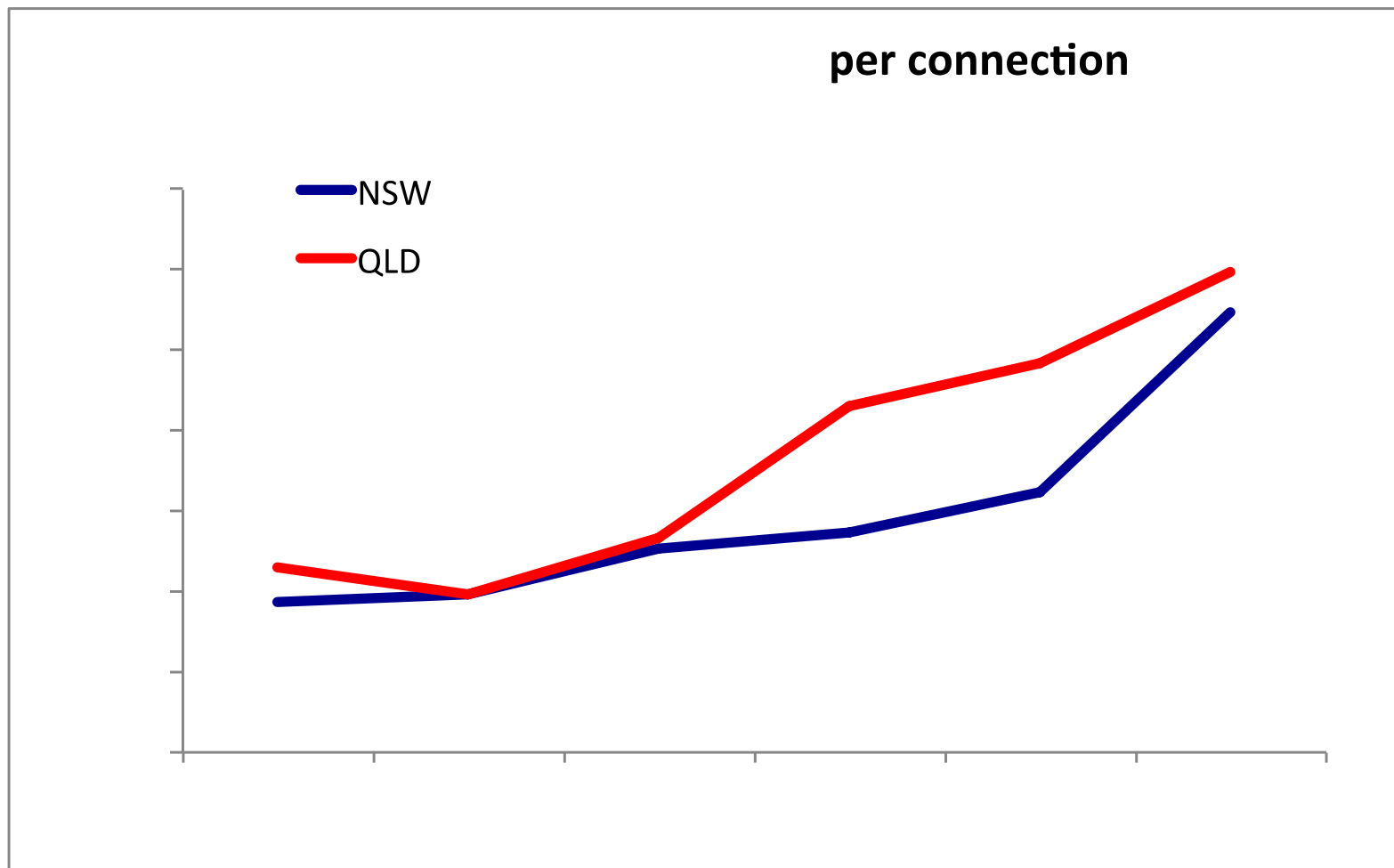


Source: regulatory decisions

Many factors, but higher regulated assets of government-owned networks is the main explanation ...



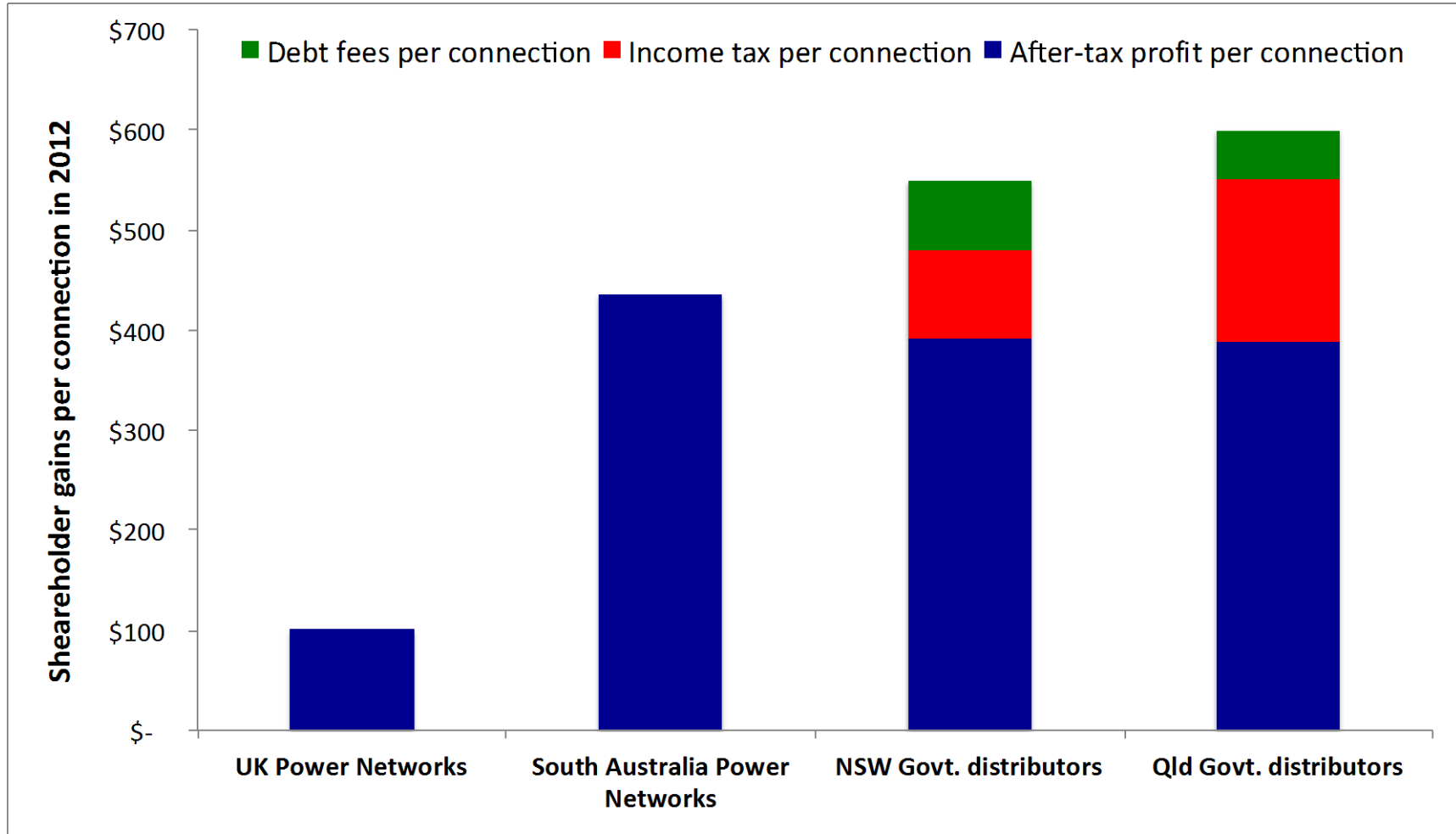
... and larger asset base has translated into remarkable financial gains for the government owners



Source: Statutory accounts

6 Pecuniary benefit = Pre-tax attributable profits + income tax (which state government collects) + “guarantee” fees on the debt provided by state governments.

Shareholders in private distributors in Australia have also done well



Operating conditions don't explain govt/private cost differences ...

- No evidence of systematic or enduring quality of supply problems
- Peak and average demand contracting since 2009, and unremarkable growth before that.
- Asset age data of government-owned distributors does not support “catch-up” hypothesis.
- Rationale for introduction of RPI-X 15 years ago - low capital and labour productivity - does not support claims of historic “under-spending”

So, why these outcomes ?

Factors common to government and private NSPs

- Quasi-judicial merits review arrangements combined with opportunity to cherry pick has undermined regulator
- Generous cost of capital compared to US and GB
- Consumers' willingness to pay largely ignored.

Factors specific to government NSPs

- Incentives
- *De jure* but not *de facto* regulatory independence

Incentives: RPI-X applied to government distributors has over-compensated capital expenditure

- For govt. distributors allowed rate of return \gg cost of capital, so more money to be made (and more easily) by inflating expectations and then expanding the RAB rather than under-spending regulated expenditure allowances.
- State regulators approved large intra-period capex and opex increases when govt. distributors said they would spend above controls.
- Recent evidence that state govt. credit-rating worries are now providing “capital market” discipline to govt. distributors. But deep cuts needed to restore reasonable prices not on the radar, and little political or regulatory appetite to deal with stranded assets.

Independent regulation in word, much less deed

- Australian Energy Regulator (AER) created (2005) through federal-state bargain, along with Australian Energy Markets Commission (AEMC), a powerful advisor / rule maker answerable to the jurisdictions (states and territories).
- Seeming dilution of state government political control suggests greater regulatory independence. But:
 - AER implements regulation designed by AEMC (globally, a unique bifurcation).
 - Some key factors (e.g. network planning standards, inability to adjust WACC to account for income tax receipt by govt. distributors) determined by state governments.

AER is convenient whipping boy for state energy ministers but AER gave the govt. distributors most of what they asked for (which their govt. owners strongly supported).

Summary: Ownership is 9/10^{ths} of the law

- RPI-X applied to govt. distributors has encouraged the discovery of wants, rather than efficiency.
- Those suggesting that it was wishful thinking to ignore ownership when applying RPI-X seem to be right.
- Cost and price outcomes by private distributors more encouraging but shareholders seem to have had more than their fair share of the spoils.
- Fresh thinking and willingness to consider major reforms needed.