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Dismantling a Competitive Retail Electricity Market: Residential Market Reforms in Great Britain

By 2008 Great Britain had one of the most competitive residential electricity markets in the world, with high levels of consumer engagement and competitive retail margins. However rising electricity prices, driven by international gas price rises, have led to a series of increasingly misguided regulatory interventions which are reducing competition, driving up prices, and undermining political support for a competitive residential energy market.

Michael G. Pollitt and Aoife Brophy Haney

I. Introduction and Historical Developments

In this article we begin with a review of the history of residential electricity market competition in Great Britain. We then discuss recent debates and proposals for market reform that have been made, before going on to an analysis of their actual and likely impact, before closing with lessons for other countries. Our argument

is that a once showcase example of residential electricity market competition is being undermined by increasingly misguided politically motivated interventions in the way the market operates.

The retail market for residential electricity customers in Great Britain was fully opened to competition in 1999. It is generally thought to have been among the earliest

most successful reforms of a residential electricity market globally (Littlechild, 2006). Residential market competition followed the introduction of competition into the generation and large industrial customer market in 1990.

Figure 1 shows that following 1990 electricity prices fell significantly in real terms up until 2004. However prices have risen sharply since then. Between the last quarter of 2003 and the last quarter of 2008 prices rose 66 percent in real terms. Figure 2 unpacks some of the potential drivers behind the annual rise in average prices for a typical customer. This shows that between 2004 and 2008 average prices rise 47 percent in real terms, but by only 12 percent if one subtracts large rises in environmental charges, the cost of gas at a typical CCGT and the associated impact of 5 percent VAT.

Significant regulatory action began to occur in 2008 when increases in electricity prices and concerns over fuel poverty were high on the political agenda. In 2008, the regulator, Ofgem, began its "Energy Supply Probe" to assess the state of the retail markets. Findings from the Probe have informed changes to supplier obligations since then and have also informed the Retail Market Review (RMR) which is currently about to be implemented. For parallel developments in the UK's wholesale electricity market see our companion article in this Journal, Pollitt and Haney (2013).

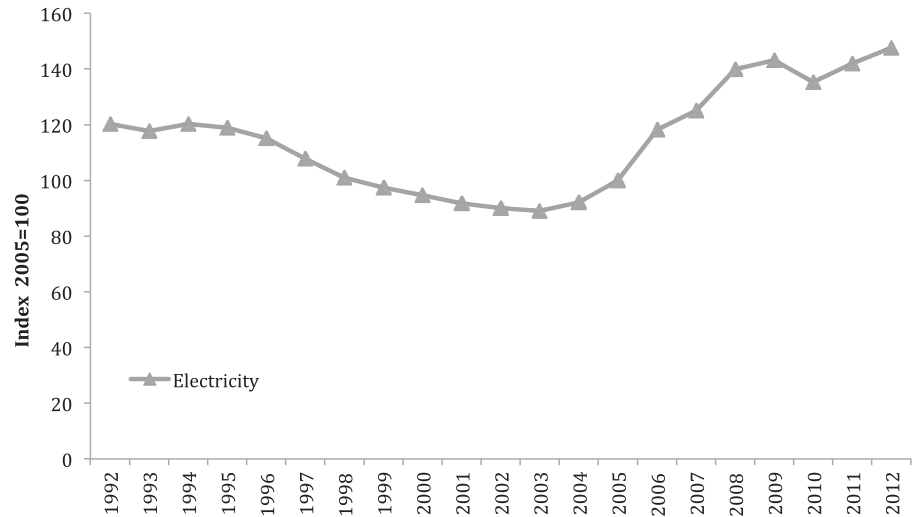


Figure 1: Real Electricity Prices (Relative to Retail Prices Index)
Source: DECC Tables QEP 211, Chart 2.1.2.

In 1990 generation and retail were conducted by separate, non-integrated companies. Retail was a regional monopoly. However by 2010, as shown in

Figure 3, the retail market had gone through a phase of consolidation and vertical integration. The "Big 6" suppliers (SSE, E.ON, Centrica, RWE

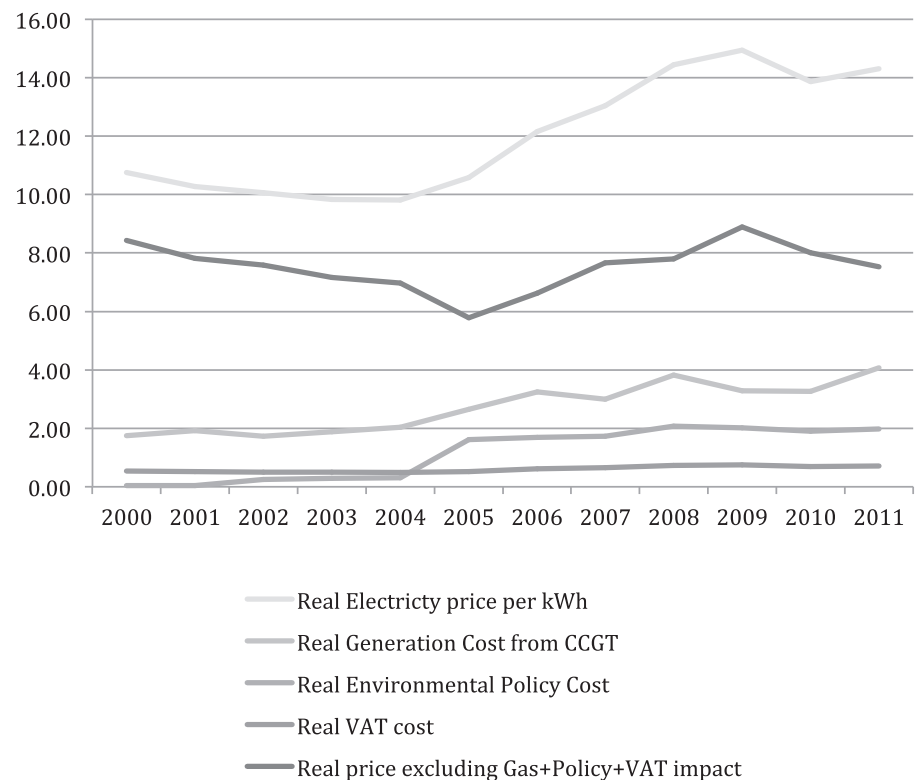


Figure 2: Real Unit Price of Residential Electricity Less VAT, Environmental Policies and Gas Prices
Source: Derived from DECC QEP221, QEP321 and Chawla and Pollitt (2012). (Based on a Standard Credit Customer consuming 3,300 kWh per year. Gas costs assume 47 percent thermal efficiency, but ignore power system losses.)

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