

The role of policy in energy transitions: lessons from the energy liberalisation era

EPRG Working Paper 1208

Cambridge Working Paper in Economics 1216

Michael G.Pollitt

The aim of this paper is discuss the period of energy privatisation and liberalisation which began in the 1980s within its wider historical context. The key issues are: what has been learned from this recent period, and; how significant is it in the light of an energy transition to low carbon energy system by 2050?

We begin by characterising the timeline of the energy liberalisation era and outlining what it consists of. We go on to discuss why energy liberalisation occurred and, briefly, puts it in the historical context of the energy industries. We then evaluate the evidence on the effects of energy liberalisation and assesses its historical significance.

We conclude that the era of energy liberalisation has been a significant manifestation of the general trend towards liberalisation of the economy. The extent to which it has been pursued in each individual country has reflected general political beliefs in the efficacy of markets (see for example Ruffin, 2003). These beliefs in turn reflect the robustness of the competition policy associated with liberalisation and the independence of regulatory policy towards energy markets. Energy liberalisation has led to positive and globally widespread but modest efficiency gains across all energy sectors but a lack of clearly visible direct benefits to households in many countries. However it has significantly improved the governance of monopoly utilities (via independent regulators), the prospects for competition and innovation, and the quality of policy instruments for environmental emissions control (through the emergence of trading mechanisms).

Arnulf Grubler (2011) names Delhi compressed natural gas (CNG) buses, catalytic converter (cat) cars and UK smokeless zones as examples of energy policies which can be identified as successful energy transitions. Energy market liberalisation is a set of policies whose impact in the historical data is more subtle to detect. Indeed in the context of climate change the only policies which will prove identifiably significant will be those that significantly change energy consumption behaviour or energy production technology. By this reckoning liberalisation, or the lack of it, will either have a small effect or will be important in facilitating or hindering changes which will have a significant impact.

Grubler (2011) also notes the keys to effective energy policy are 'patience, predictability, credibility, alignment and documentation of success'. One of the consequences of liberalisation is to create a predictable, credible, aligned set of market based arrangements which are costly to change. Changes which are inconsistent with liberalised arrangements are, quite properly, problematic. Public transparency of corporate actions is a key consequence of the liberalisation of energy markets. Thus liberalisation induces patience and invites documentation of success (and failure). Whereas monopoly allowed often expensive policies to be implemented without informed criticism or scrutiny, liberalisation has made each individual policy change more difficult to implement.

The challenge for policy makers within a liberalised environment is that the costs of ambitious climate policy goals will be increasingly obvious to energy customers. Political support for liberalisation in the face of tougher climate policy will to some extent depend on the calculation of whether the monetary benefits of liberalisation outweigh the environmental benefits of accelerating decarbonisation via more government intervention. That calculation in turn hangs on whether a return to more state intervention in the energy market will successfully accelerate decarbonisation and at what cost. In the end, as the incomplete progress of liberalisation around the world demonstrates, it is not liberalisation per se that will determine the movement towards a low carbon energy transition, but the willingness of societies to bear the cost, which will be significant no matter what the extent of liberalisation.

Contact	m.pollitt@jbs.cam.ac.uk
Publication	March 2012
Financial Support	EPRG