Perspectives - Thoughts for 2015 (pt 2)

1. Beating the Law of Unintended Consequences?

The Law of Unintended Consequences is alive and well in the energy utilities just as it is in the world of finance – just as we all are far too painfully aware.

Let us just take a couple of examples.

a: In order to alleviate distress in vulnerable households in the UK politicians, regulators, and consumer bodies lobbied energy companies to reduce disconnections for debt. This they did – by more than 90%.

The means was to grow the population of pre-payment meters. As this technology enables self disconnection – the statistics were fine but in reality disconnection had simply been made “self-service”.

Another consequence of this was to ensure that the poorest segments of the population became burdened with the highest cost technology and administration for their energy supply – which led to them suffering the highest costs. Over this period fuel poverty (for this and many other reasons) has now grown to between 5 and 7 million households.

b: In order to improve energy efficiency and reduce carbon emissions the CERT scheme (Carbon and Energy Reduction Target) was introduced which forced, and still forces suppliers to spend circa £1.5 billion over the next three years on energy efficiency initiatives. These are micro-managed by OFGEM (the regulator) whereby a proscribed list of allowable initiatives are deemed to have certain carbon reduction levels over their lifetime. Suppliers have a carbon reduction target to meet – so what do they do? They go for the least cost mechanism to get them the required amount of deemed carbon savings based on the proscribed list. The cheapest option on the list is energy saving light bulbs – not making sure they are used – merely dispatching them. So what happens? We now have over 150 million light-bulbs in the possession of UK consumers but most of them are just filling up cupboards!

These things should not, and need not happen. We should by now know that the world operates as a complex system. We need to understand what the system looks like and how it operates. We have had the technology to do this for over 50 years. This technology comprises the system modelling tools used to model fluid flows in our water systems and electricity flows in our transmission and distribution systems. This modelling technology is called systems dynamics and has been around since the 1950’s. It has now been joined by its sister technologies, event driven and agent based modelling. Between the three any complex system can be modelled, and unintended consequences explored and highlighted before they happen. We can then adopt a strategy to avoid them.

When we look back from the vantage point of 2015 will we see these modelling technologies becoming “business as usual”? If we don’t we can continue to expect to be caught out by the Law of Unintended Consequences.

Fuel Poverty – is there a third way?

In the good (??) old days of the gas and electricity boards Government social policy was delivered through these nationalised institutions. Cross-subsidies were a political choice and were built into the tariffs charged by these public bodies.

Then came privatisation and competition with the unravelling of these cross subsidies and increased value for consumers as the efficiency of operation of the industry was transformed.

However, the need to cross subsidise has not gone away with between 5 and 7 million households deemed to be in Fuel Poverty (spending more than 10% of their disposable income on energy). The Government has a legally binding target of eliminating Fuel Poverty by 2016, and to have eliminated it for vulnerable households in 2010. The reality unfortunately is that the number of Fuel Poor has been growing not shrinking.

So what we have seen is the resurgence of the industry being used as the delivery arm of the social policies of the state. Social Tariffs, (and you could also argue CERT and CESP), are a manifestation of the industry being made to deliver these goals rather than the state doing it directly through the welfare and benefits systems.

It is all perfectly understandable since you then keep state expenditure and taxes down, or at least invisible. The consumer pays through the price mechanism.

However, this sits badly with a competitive market since the Law of unintended consequences thrives in this type of hybrid market. Suppliers will do what they can to protect their interests and will vie with each other to lose unprofitable customers.

Those consumers who require the most attention will receive the least.

Alternatively the burden of social policy delivery will become so great that only the largest of the existing market players can operate such that competition is in effect rolled back – and again the consumer will pay through higher prices.

So if Government does not wish to be the delivery arm of social policy in order to keep the costs of their books, and if suppliers don't want to be forced to take on this mantle since it inhibits their free market activity what alternative is there?

Well, the industry could take the initiative and set up a charitable trust funded inter-alia by a levy (which is shown on bills) on consumers. This Trust would be charged with eliminating Fuel Poverty enabling the Government to discharge its legal obligation and Suppliers free to act fully commercially ensuring that market mechanisms deliver the best deals for consumers. Fuel Poor customers will have purchasing power put into their hands by the Trust – which will then entice suppliers to fight for their custom, rather than ignore them. Surely a much better outcome from all perspectives.

One could argue that a transparent levy would be unacceptable. However, if you look at the option of the status quo against the Charitable Trust I know which I would pick as the most likely to make a real impact on Fuel Poverty and to deliver the best deal to consumers overall.

What will happen over the next five years?

The one thing that is certain is that the status quo is not the optimum way forward.

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