

# The role of competition in enhancing consumer and producer welfare in energy matters

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# Outline

1. Presentation
2. Competition as an instrument of economic efficiency
3. Norwegian competition law
4. The Norwegian history of energy resource management
5. Deregulation of the electricity market
6. The Nordic market for electric power
7. Challenges for the Competition Authority





# EU/EEA law

- Prohibition principle
- Case law
- Enforced by the **European Commission** (1st instance), by the **Court of First Instance** (2nd instance) and by the **European Court of Justice** (3rd instance, procedural questions)
- Enforcement will be **decentralised** to member countries (EEA countries?)
- **EFTA Surveillance Authority** enforces within the EEA (parallel provisions)

# Norwegian Competition Law

- Under revision
- Explicit purpose: efficiency
- Intervention principle
- Enforced by the **Norwegian Competition Authority** (NCA) and by the **Ministry of Labour and Administration**
- NCA has overlapping competence with EFTA Surveillance Authority



# Norwegian Competition Act

## Section 1-1: The purpose of the Act

The purpose of the Act is to achieve **efficient utilization of society's resources** by providing the necessary conditions for effective competition.

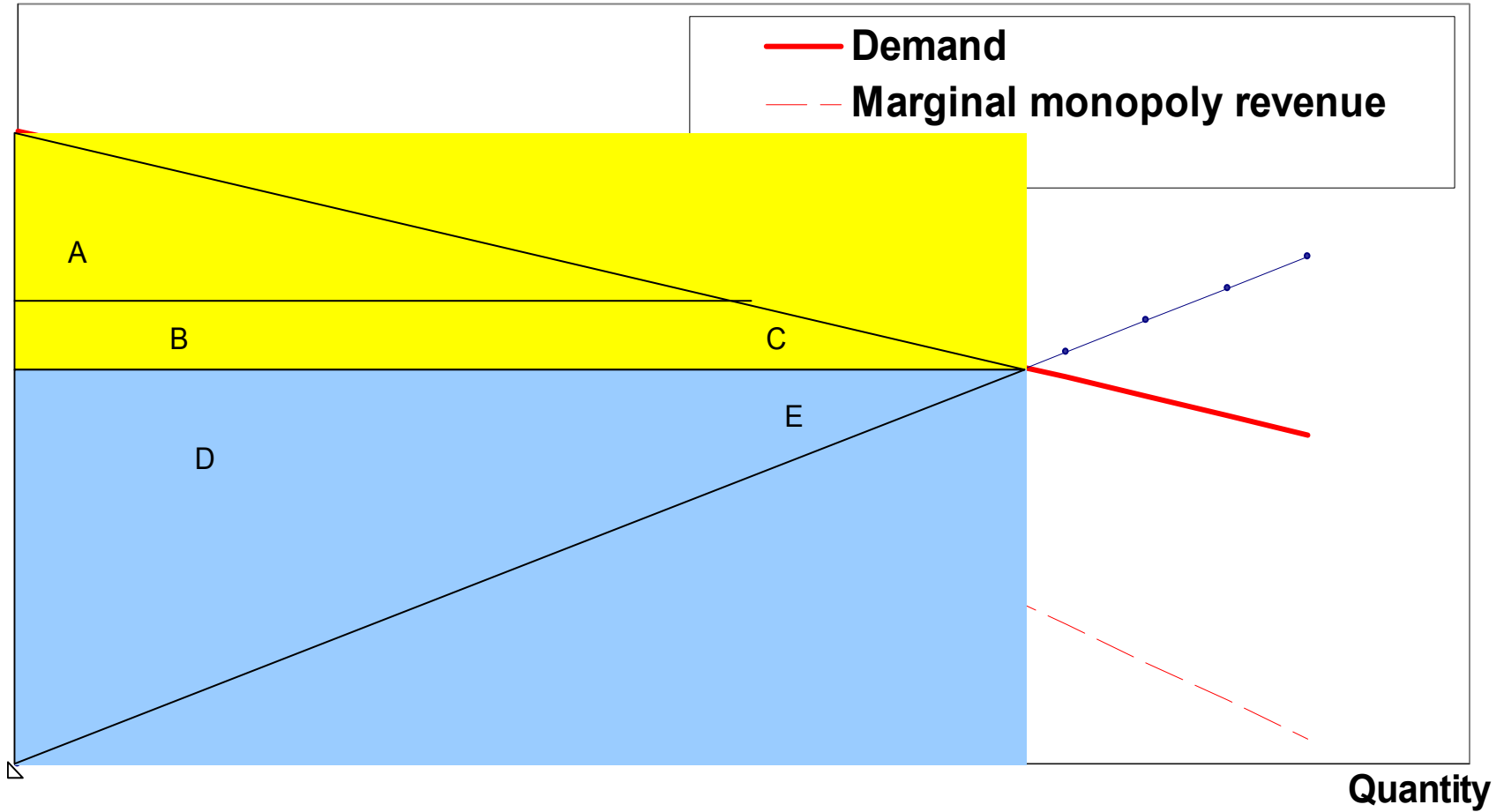
**Efficiency is the goal. Competition is the means.**

Efficient monopolies are OK. The Act is not concerned with distribution.



Price

### Market equilibrium



# Cartels are prohibited

## Section 3-1

Prohibition of collaboration and influence on **prices, markups and discounts**

## Section 3-2

Prohibition of collaboration and influence on **tenders**

## Section 3-3

Prohibition of collaboration on, or use of influence to achieve, **market sharing**

**Facit collusion** may be prohibited, but hard to prove.



# The relevant market

To assess a company's market power or dominance, or a competition restriction, one must define the relevant market.

The relevant market is defined in terms of **substitutability** as well as **geography**.



# Market power/dominance

A company has a dominant position (market power) if it can enact a non-negligible price increase within losing major parts of its sales.

A market share of at least 50 % always amounts to dominance.

A market share below 10% never gives rise to dominance.

Collective dominance may be presumed when several companies behave collectively.

# Norwegian Competition Act

## Section 3-10: Intervention against anti-competitive behaviour

The Competition Authority may intervene by individual decision or regulations against terms of business, agreements and actions where the Authority finds that these **have the purpose or effect of restricting, or are liable to restrict, competition** contrary to the purpose of Section 1-1 of the Act.



## Section 3-10

Examples: terms of business, agreements and actions that can:

- a) maintain or strengthen a dominant position in a market with the help of anti-competitive methods, or
- b) restrict clients' choices, make production, distribution or sales more expensive, bar competitors, refuse dealing with or deny membership of associations of undertakings.



# Norwegian Competition Act

## Section 3-11: Intervention against acquisition of enterprises

The Competition Authority may intervene against acquisition of enterprises where the Authority finds that the acquisition in question will **create, or strengthen, a significant restriction of competition** contrary to the purpose of Section 1-1.

By acquisition is also meant mergers, acquisition of stocks or shares and partial acquisition of enterprises.



# Norwegian Competition Act

## Section 6-6: Penal provisions

Any person shall be liable to **fin**es or to **imprisonment for up to three years** who intentionally or negligently

- a) infringes Sections 3-1, 3-2, 3-3, 3-4 or 4-1 first paragraph,
- b) infringes decisions pursuant to Sections 3-10, 3-11 or 4-1 second or third paragraph,
- c) fails to comply with orders pursuant to Sections 6-1 or 6-2,
- d) gives incorrect or incomplete information to the competition authorities, or
- e) contributes to infringement as stated in litrae a to d.

Under aggravating circumstances imprisonment for up to **six years** may be imposed.



# Energy resources in Norway

The country is rich in energy:

- Hydro power
- Oil and gas
- Wind and waves

Hydro power development accelerated in the early 20th century (1906-1920).

Off-shore petroleum fields were developed from the 1970s.



# Energy resource management in Norway (1)

Since independence (1905), the primary goal of energy policy has been to maximise value **for the community**.

Industrial Concessions Act (1917):

- waterfall pre-emption rights,
- waterfall licences of limited duration,
- right of reversion to the state when a licence expires (challenged 2002 by EFTA Surveillance Authority).

Taxation

Private-public ownership



## EFTA Surveillance Authority, 20 Feb 2002: Restrictions on the acquisition of waterfalls in Norway in breach of the EEA Agreement

According to the Authority, the very existence of the difference in treatment between Norwegian **public** undertakings which enjoy concessions for an unlimited period of time, and **private** undertakings which are only granted concessions for a maximum of 60 years and which must return all installations to the State without compensation at the end of the period, only favours undertakings of Norwegian nationality.



# Industrial development

Hydro power development provided cheap electricity and formed the basis for energy intensive manufacturing industries in rural Norway. Bottleneck: transmission lines.

Until 1991, the hydro power industry was heavily regulated.



# Deregulation and competition

Through the Energy Act of January 1 1991, the market was deregulated.

## Objectives

- smooth out artificial price differences between different areas and different consumers,
- improve consumers' utilisation of electric power,
- increase efficiency in both production and distribution of electric power,
- secure efficient building of new production capacity, in the right scale and order.

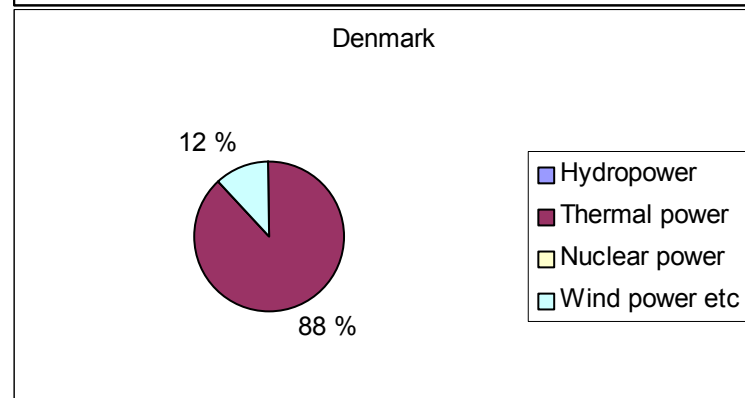
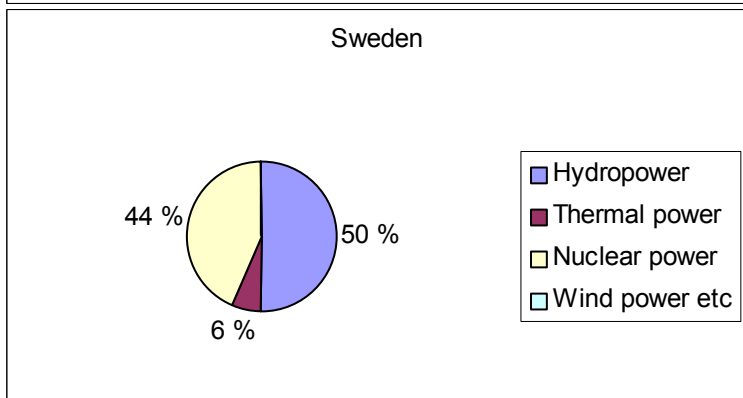
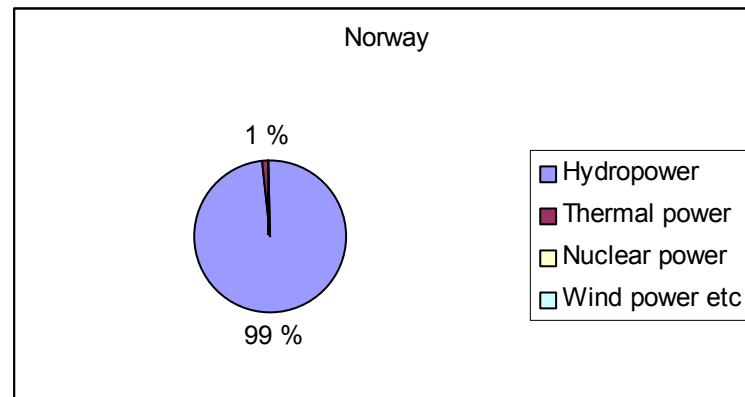
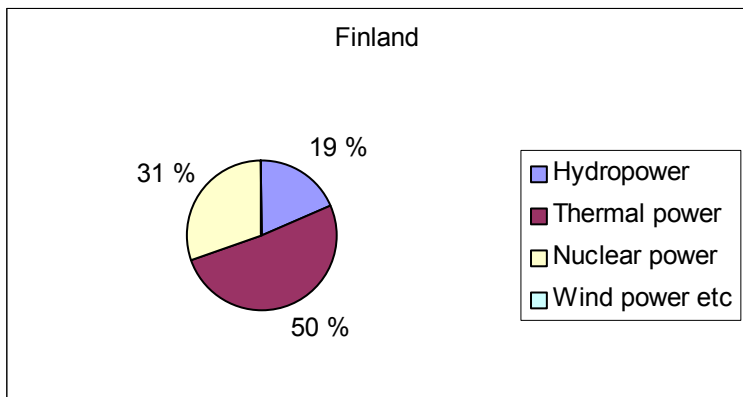


# Basic elements of deregulation reform

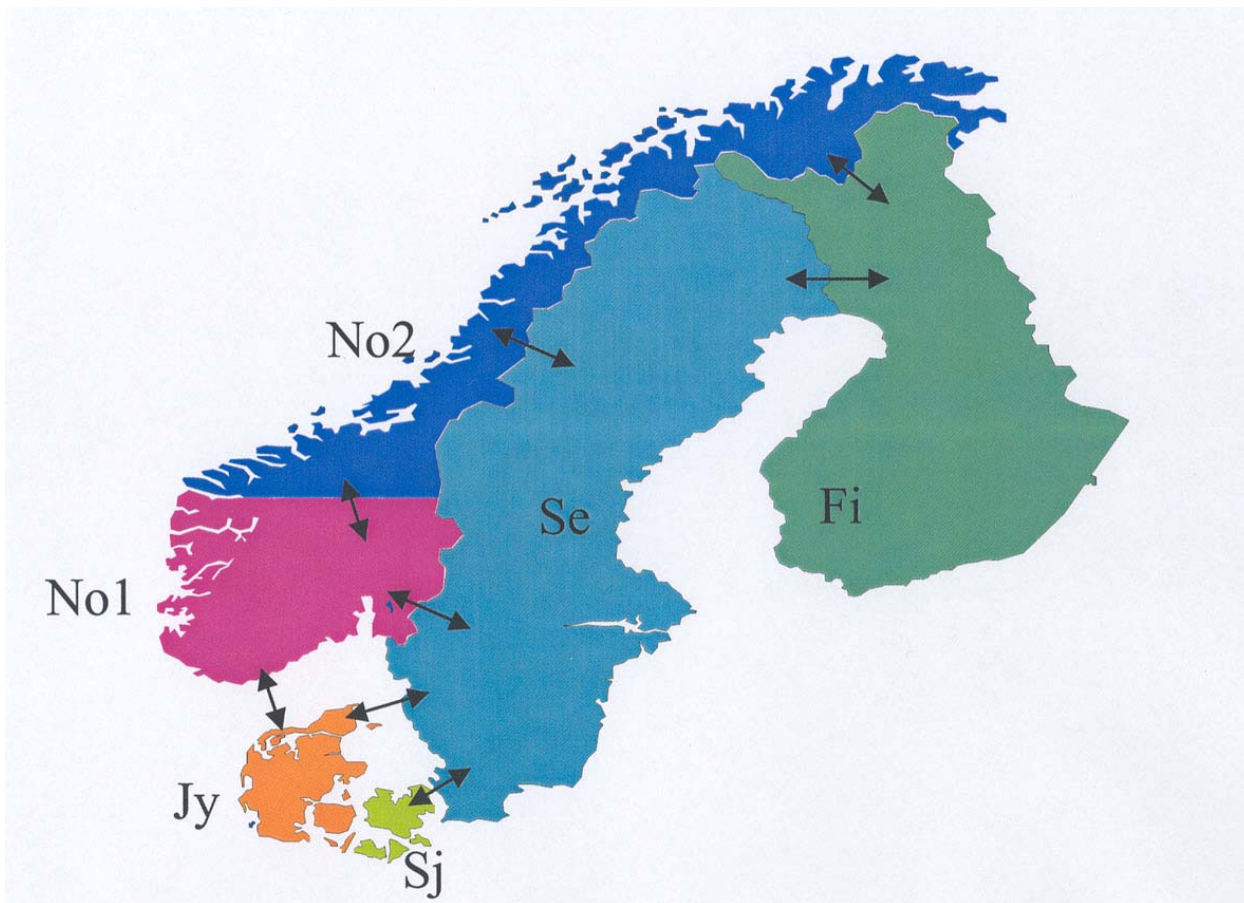
- abrogation of the local monopolies of supply - consumers are free to buy electricity from a wide range of suppliers in all parts of Norway,
- establishment of common carriage principle,
- regulation of transmission tariffs,
- obligations for vertically integrated companies to split trade/production and transmission into separate divisions and have separate budgets and accounts
- divestment of Statnett SF (the Norwegian Power Grid Company) from Statkraft, which was thus transformed into a pure generating company,
- establishment of organised spot, future and regulation markets.



# The Nordic power market



# Geographical markets



# Cross-ownership

- Producers have ownership interests in each other
- Widespread in Finland and Norway
- Reduced incentives to compete
- Possibilities to exert control
- Market concentration figures should be adjusted

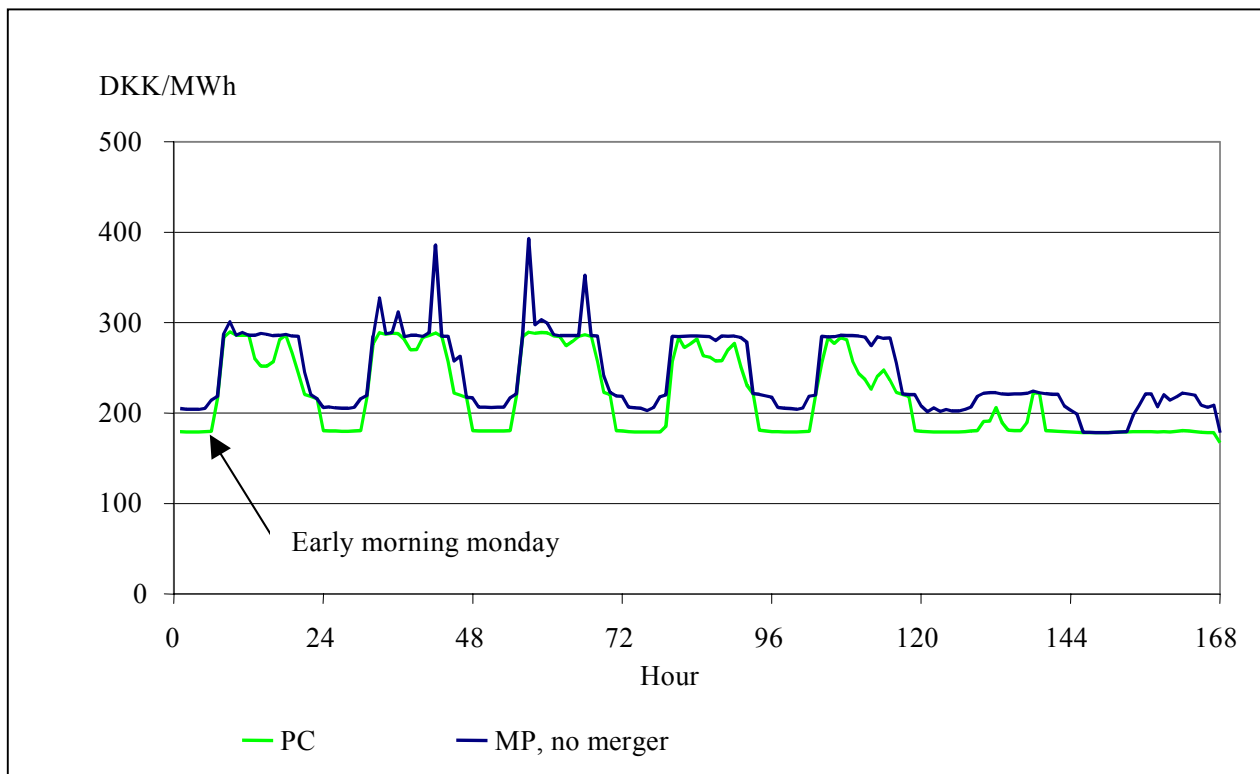


# Market concentration

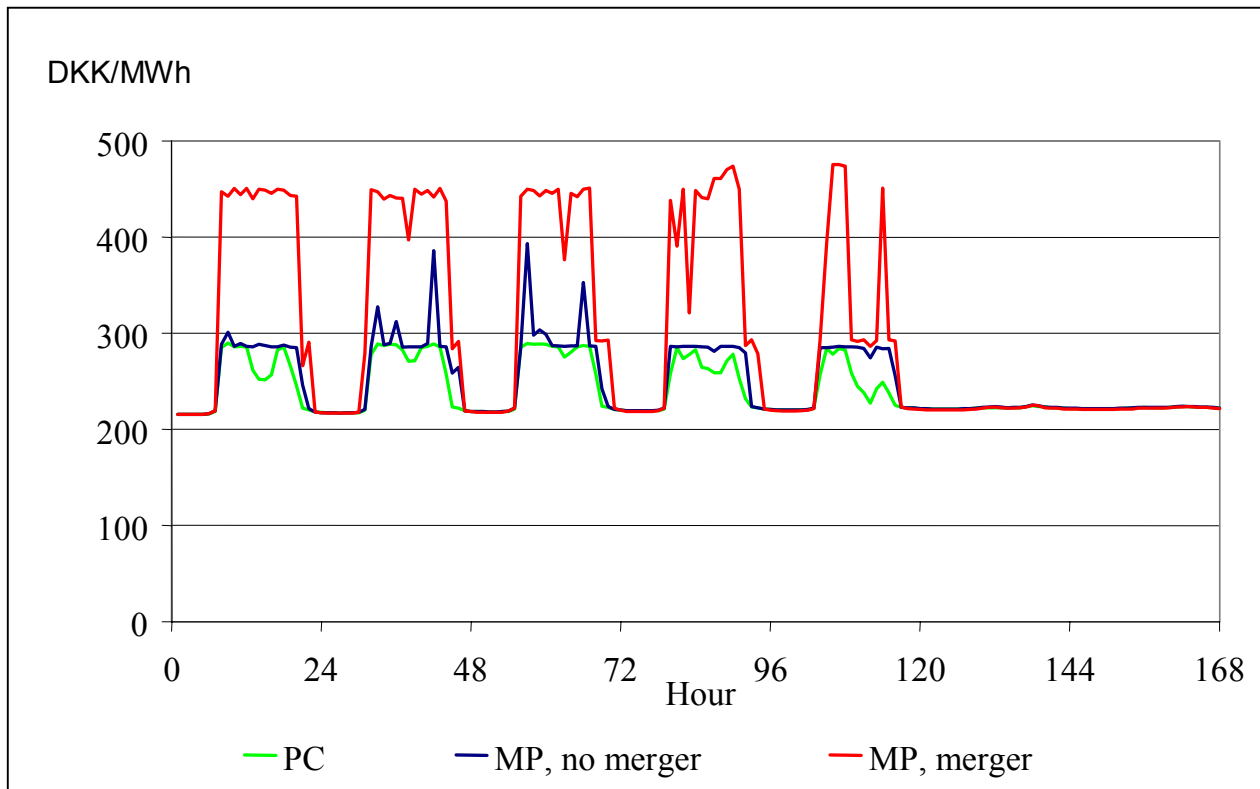
	HHI	HHI <sup>i</sup>	HHI <sup>ic</sup>
Finland	1766	2037	3005
Norway	1634	1980	3325
Sweden	2893	2923	2988
Denmark	4844	4844	4844
Nordic reg.	892	989	1138



# Market simulation (1)



# Market simulation (2)



# After deregulation

Most hydro power companies are still publicly owned, by municipalities, counties, or the State.

The transmission network is a publicly owned natural monopoly.

Households and firms may, in principle, buy electricity from any producer.

Statkraft has significant market power. The NCA has forbidden further take-overs.

Cross-ownership between power companies increases market concentration and reduces competition.



# Results of deregulation

Prices may respond to local water shortages when transmission capacity is insufficient. A company with market power may exploit this.

Prices become not necessarily lower, but more resource efficient.

Prices are smoothed out between countries. The opportunity cost of Norwegian hydropower increases. This adds to the national income, but not necessarily to the consumer surplus.



# Possible pro-competitive actions

- The NCA entertains comprehensive web site on electricity prices, as a guide to consumers ( <http://www.konkurransetilsynet.no/kraftpriser/kraftpriser.php> )
- Mergers should be carefully reviewed.
- Authorities should consider if and how more procompetitive company and ownership structures could be created.
- Transmission system operators should endeavour to increase the effective capacity utilisation of the transmission grids.



# Thanks for listening!



**Konkurransetilsynet**  
Norwegian Competition Authority

# Evaluation of experiences in the application of competition policy and consumer protection policies in oil producing countries

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# Petroleum resource management in Norway

As for electricity, the primary goal of the petroleum policy has been to maximise value (resource rent) for the community.

Instruments:

- Licensing
- Statoil
- SDFI – the State's Direct Financial Interest
- Taxation
- Retail prices reflecting opportunity cost, external effects and fiscal needs
- GNC – the Gas Negotiating Committee



# Licensing

Decisions on opening new areas are made by the Parliament.

Licences for petroleum operations are awarded by the government.

Foreign companies dominated exploration off Norway in the initial phase, developing the country's first oil and gas fields.

Statoil was created as a state-owned oil company, and the principle of 50 per cent state participation in each production licence was established. The Parliament later decided that the level of state participation could be higher or lower than 50 per cent, depending on circumstances.



# Statoil ASA

Established by Parliamentary decision 2 June 1972.

Objective: exploration, production, transport, refining and marketing of petroleum and petroleum-derived products, either by itself or through participation with other companies.

Partially privatised and listed on the Oslo and New York stock exchanges on 18 June 2001, with 18.2 per cent of the company sold to private shareholders in Norway and abroad. The state owned 81.7 per cent of the company's shares at 1 January 2003.

The Storting has opened for further reductions in the state's share-holding, down to two-thirds.



# SDFI – the State’s Direct Financial Interest

Established 1 January 1985, when most of Statoil’s licence interests on the NCS were split into a direct financial component for the state (the SDFI) and a component for the company. Thus, the state’s direct involvement is split from the independent commercial operations of Statoil.

Petoro AS manages the SDFI on behalf of the state.

From 1985 until 1993, the SDFI received a holding in each production licence awarded. In later awards participation reflects the resource potential and expected profitability. The SDFI holding is set to zero in some production licences.



# Taxation

- **Ordinary corporate tax** (28 per cent of profit) applies to the petroleum sector
- In addition, a special **petroleum tax** of 50 per cent is levied on oil and gas extraction.
- **Royalty** is being phased out
- All production licences must pay the **area fee** after the exploration period has expired: NOK 7 000 to 70 000 per sq km per annum.
- **Carbon tax** is levied at a rate per scm of gas burnt or directly released and per litre of oil burnt. The rate for 2003 is NOK 0.75 per litre of oil/scm of gas.



# Retail prices

Petroleum products are sold at world market prices (opportunity cost) in Norway – no subsidies!

Petrol (gasoline) is heavily taxed, to reflect external costs of transport (environment, road wear, congestion, and accidents) and to collect fiscal revenue.

Thus, fuel prices in Norway are among the highest in Europe ( $> \text{€}1$  per litre).



# Powerful instruments

Taken together, Statoil, SDFI and taxation allow the community (represented by the state) to reap more than 90 per cent of the rent, while allowing for competition and the efficiency of a market economy.

The flip side of this coin is that the state carries a major part of the risk (more than 90 per cent at the margin).



# GNC – the Gas Negotiating Committee (GFU in Norwegian)

From 1986 to 2001, Norway's gas sales were coordinated by the GNC, which negotiated sales for all producers on the NCS.

Following a heavy dispute with the European Commission, the GNC was permanently discontinued in 2002. The Commission saw the GNC as a cartel in breach of Art 81 of the EC Treaty (= Art 53 of the EEA Agreement)

This will probably result in much lower revenue for Norwegian producers, as they will be competing away large parts of the profits.



# GNC

The Norwegian position had been that the GNC system was a state measure imposed on the producers by Norwegian law and therefore outside the scope of the EU and EEA competition rules.

The resource management rationale for the GNC law in the huge, sunk investment costs, which presuppose long-term take-or-pay contracts with purchasers.



# Vertical separation

From a competition policy point of view, third-party access to the existing network of gas pipelines is important. The Norwegian Government has taken the first steps towards a separation of the distribution network (the pipelines) from the production (Gassco AS).

Transport and treatment facilities must serve all gas producers, and be neutral in relation to all users of the transport system.



# The basic dilemma of a small, open, oil exporting economy

- The profitability of the oil sector drains resources and puts upward pressure on factor prices elsewhere (esp labour).
- Consumers and taxpayers expect (more than?) their share.
- Public petroleum revenue cannot be spent without creating inflationary pressure and hence threaten the competitiveness of non-oil sectors (confer Spanish gold).
- To alleviate this problem and ensure budgetary discipline, the Norwegian Parliament has created the Petroleum Fund.



# The Petroleum Fund

Buffer against fluctuating revenues from the petroleum sector. It helps to buffer fiscal and monetary policy against variations in the oil price and in production volume, which may be substantial.

Instrument for transferring wealth from oil and gas reserves to a broad-based portfolio of international securities. This provides a better balance between expected return and the expected risk associated with overall asset management.

Only the normalised annual return of the Fund is spent within each budget year.



# Size of Petroleum Fund

Market value as of 31 March 2003: NOK 682 billion  
= appr US\$ 95 bn.

The Fund is forecast to grow to appr NOK 1 700 bn  
by 2010.

Transfers amounting to NOK 43.3 billion have been  
made by the Ministry of Finance during 2003.

The Fund is administered by the Bank of Norway  
(central bank).



# Summary

There is little reason not to apply standard economic efficiency and competition policy principles to the domestic energy market. This applies to energy exporting countries like any other country.

A country seeking to maximise the value of its resource rent may want to coordinate its exports, as in a cartel, especially if met by a monopsony or similar.

There is not necessarily any conflict between competition policy principles and maximisation of petroleum wealth. One must distinguish sound profit maximisation from inefficient restraints to competition.

