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PRESS RELEASE

Implications of liberalisation for methods of setting retail gas prices in Belgium

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In recent years, gas (and electricity) prices on the retail market in Belgium have made a significant contribution to inflation and have increased the volatility measured by the harmonised index of consumer prices. A number of reasons have been put forward, including the ways in which liberalisation has changed the methods of setting the prices charged to residential customers. In practice, liberalisation has entailed in-depth restructuring of the segments of the gas supply chain, including the establishment of new channels and market mechanisms between segments. The effects of these changes were also felt by end users in Belgium, who have all been able to choose from a range of suppliers since 1 January 2007. Previously, gas was supplied by a vertically integrated operator at the same price for everyone, but nowadays Belgian consumers have the choice between several operators all offering their own tariff formulas.

As commercial intermediaries, gas resellers pass on the purchase price of the gas plus a margin, so that purchase cost movements tend to be reflected in selling prices. For that purpose, operators active on the retail market have retained practices from the days of regulation, all adopting automatic indexation of selling prices on the basis of parameters reflecting the trend in the cost of buying the gas month by month. That situation is very convenient for all the operators, because a large part of the price risk is automatically passed on to consumers without the extra cost of informing them. On the other hand, it leads to monthly price adjustments and short-term volatility. Consumers can remove the uncertainty associated with variable-price contracts by signing a fixed-price contract, but they have to do so on their old contract renewal date, giving due notice if they want to avoid any additional charges.

The disclosure of the automatic indexation mechanisms applicable in Belgium has the advantage of being relatively simple and transparent in regard to fundamental movements in the parameters and their influence on prices. However, for the average consumer, the calculation of index-linked prices appears complex and the information supplied seems incomplete, as it is not easy to find out about movements in the price each month, even if only to understand the price on the invoice. Changes to the tariff formulas themselves, which are left to the operators' discretion, do not stand out very clearly. Their justification in the light of actual changes in the costs incurred in purchasing gas on the wholesale markets remains an issue, since the relevant data are not published. In that regard, verification by the competent institutions regarding the representativeness of the indices used in terms of cost movements and the justification for successive adjustments merits support.

The use in Belgium of automatic indexation with publication of the underlying formula applied differs from the practices seen in neighbouring countries. None of the countries analysed except one had any systematic indexation mechanism like that adopted by all the suppliers active in Belgium. In those countries, prices are adjusted less frequently or on an *ad hoc* basis, always with prior notification of the consumers. That limits the frequency of adjustments in view of the costs associated with those procedures, hence attenuating gas price volatility.

Moreover, the freedom to set prices enjoyed by operators in Belgium has led to discretionary adjustments to indexation involving an increase in the stable portion of the price unconnected with movements in the energy parameters.

For the purpose of international comparison, these findings have to be viewed in the European context in which varying situations coexist and distort the movement in gas prices. The process of gas market liberalisation launched at European level is in fact following different agendas in the various national markets and is based on arrangements determined autonomously by the national authorities. This leads to levels of (de)regulation which vary from one country to another with – depending on the country – regulated prices, price approval procedures, maximum prices or totally unregulated prices. However, these prices are still at

least subject to supervision owing to the authorities' concern that the retail prices charged should reflect the true trend in costs. Regulators, competition authorities and bodies protecting consumers' rights intervene to that end in varying degrees, in accordance with their respective powers. In that context, the scope for generating effective competition on the retail market nevertheless remains dependent on competition conditions on the wholesale markets and the associated issues, very often international in scale.

Since consumer prices of gas are more volatile in Belgium than in other countries, with the ensuing second-round effects on inflation, measures capable of reducing that volatility could be attractive. However, any intervention by the authorities concerning methods of setting retail prices must take place in a context in which Belgium already has totally deregulated prices. Moreover, any adjustment in the frequency of indexation must be preceded by an assessment of the benefits of reduced price volatility compared to the risk of operators passing on to consumers the costs of price-risk hedging and any menu costs. Two measures might be envisaged, in line with developments seen in other countries: the introduction of "supervised" freedom to set prices with effective checks on the justification for tariff adjustments, and information on tariff formulas which is easier for consumers to understand.