Experience across the regulators: The use of regulatory and competition powers for promoting consumer welfare

The British Utility Regulation Model: beyond competition and incentive regulation?
London School of Economics, 31 March 2014

Richard Price
Chief Executive, Office of Rail Regulation
Chair, UK Regulators' Network

What I'll cover:

- What has economic regulation delivered?
- What happened to regulation 'withering on the vine'?
- Why haven't we seen more market reform and less regulation?
- Are we making enough of cross-sectoral experience?
- How should regulators work together, and with the CMA?

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Office of Rail Regulation

Benefits of economic regulation

The UK's approach to independent economic regulation has

- given investors certainty and confidence
- helped to consumers' experiences for the better, and
- protected taxpayers

Water sector

- £116billion of investment since 1989 – better infrastructure and services to customers at no cost to the taxpayer.

Energy:

- Halving in cost of network charges in 15 years post-privatisation; over next 8 years enables a 50 per cent increase in investment at a lower cost of capital.

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Benefits of economic regulation (2)

Communications

- strong competition, innovation and investment
- transformational innovations in now-ubiquitous mobile and broadband services
- Yet average family in UK now spends less on these services than it did a decade ago
- And less than families in other leading developed economies.

Airports

- enormous choice and value for consumers by supporting competition and regional airport expansion
- underpinned £11bn of investment in world class facilities during the last decade

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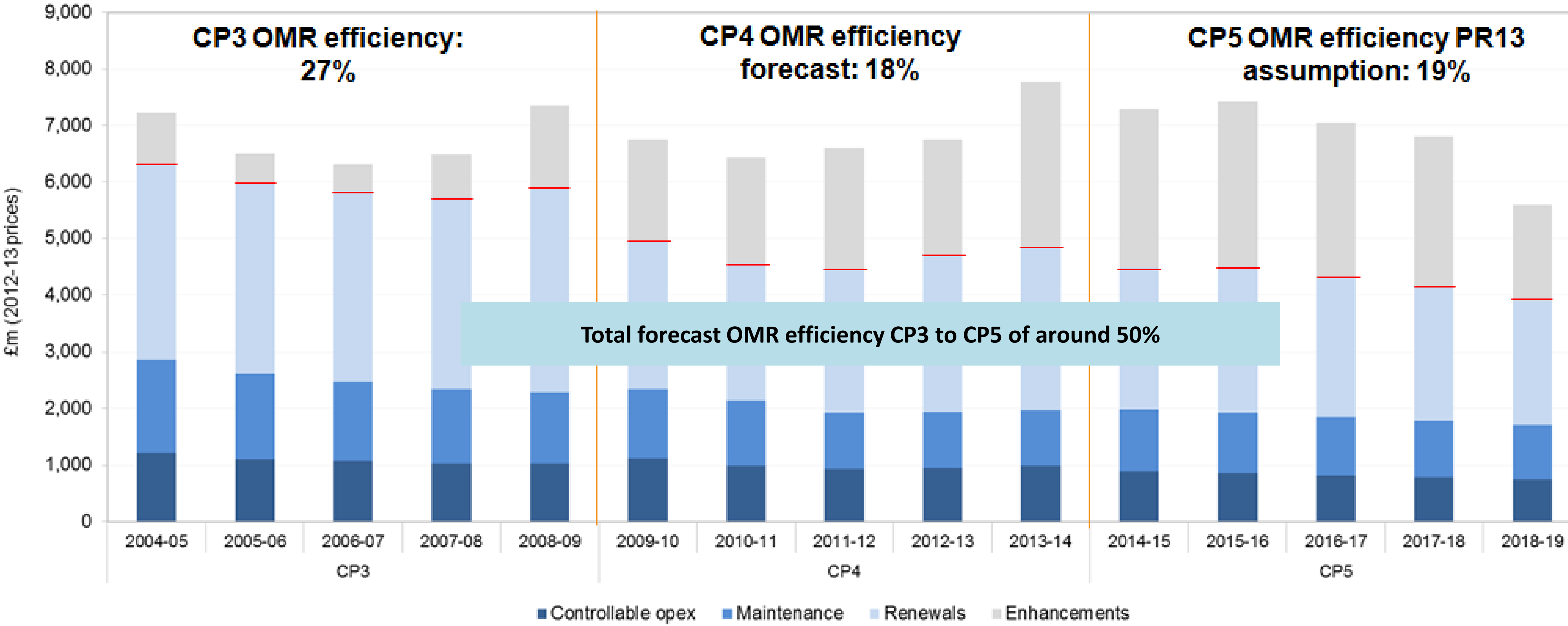
Benefits of economic regulation (3)

Rail: 40 per cent reduction in ongoing cost of infrastructure over the last decade; 18 per cent in next 5 years

- near-record punctuality and stretching targets
- sustained growth in demand and near-record levels of customer satisfaction

Reducing Network Rail's 'day-to-day' costs frees up Government resources for enhancing the network:



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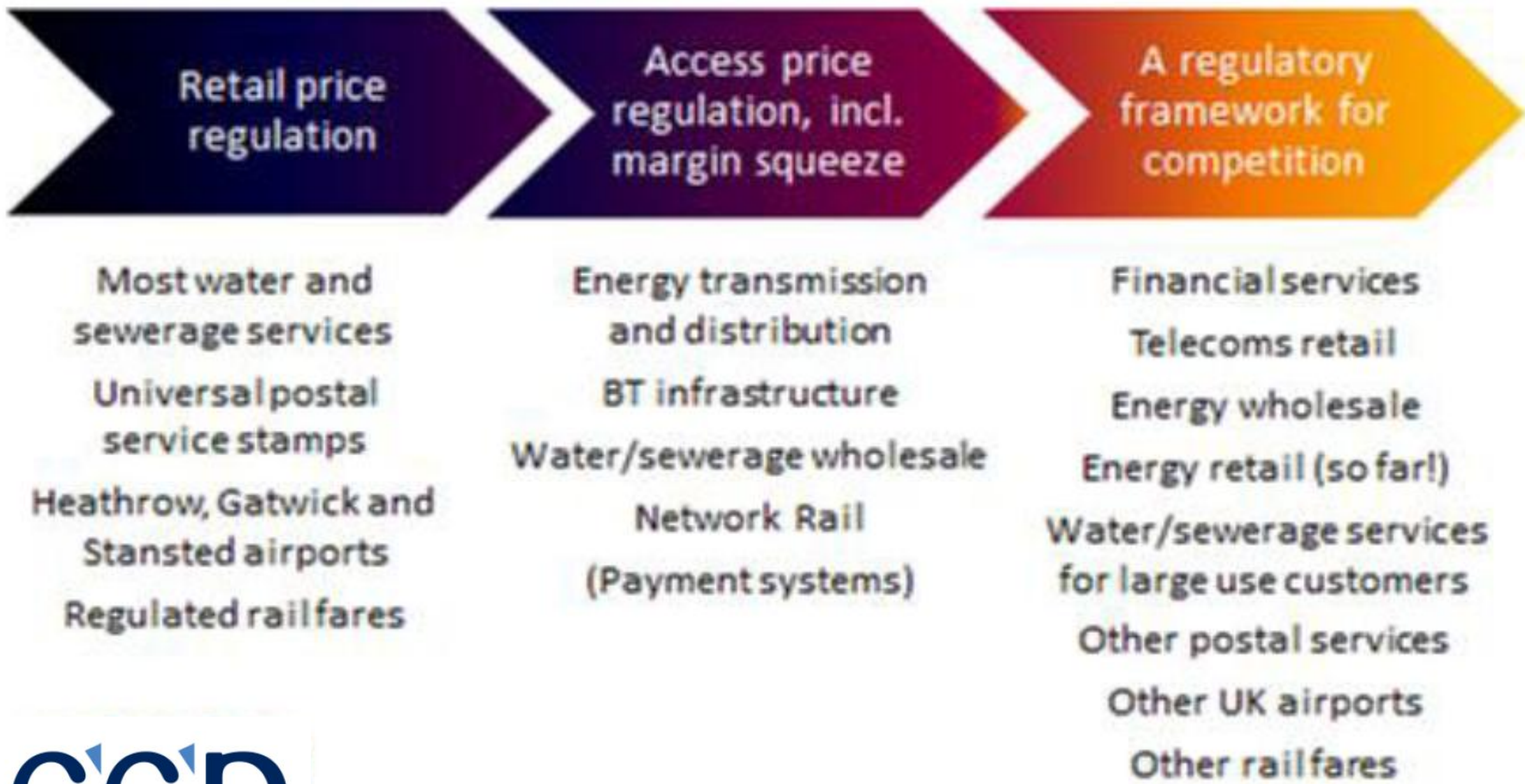
Privatisation: the expected story

- **Privatisation:** Was to change managerial incentives to focus on profit-maximisation.
- **Regulation:** Was to ensure, in the absence of competition, that those profit-maximising incentives drove benefits for productivity and consumers.
- **Competition:** Was to be the beautiful butterfly that could thereafter be left to work its magic for productivity and consumers alike.

CENTRE FOR COMPETITION POLICY

Source: Amelia Fletcher: Privatisation, economic regulation and competition in the utilities: Have we got the balance right?; Beesley Lecture Series, 14 November 2013

Regulation: a changing focus



CENTRE FOR COMPETITION POLICY

Source: Amelia Fletcher: Privatisation, economic regulation and competition in the utilities: Have we got the balance right?; Beesley Lecture Series, 14 November 2013

Why have some sectors retained price cap or other aspects of ex-ante economic regulation?

- Use of competition powers too difficult?
- Cosiness or capture?
- Regulators distracted, or focusing on the wrong things?
- Not willing to use competition powers?
- Ex ante powers / tools yield faster benefits?
- Evidence weaker on structural change?
- Role of government?

None of the above tells the whole story

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UK Competition Network (UKCN)

- UKCN includes the UK's economic regulators and the CMA
- commitment to close and regular working over competition issues
- we are working together to ensure consistent and effective use of competition powers across all sectors to
  - prevent anti-competitive behaviour, and
  - open up markets to greater competition for the benefit of UK consumers and businesses.
- Focus on:

- strategic dialogue	- enforcement cooperation
- enhancing capabilities	- sharing best practice
- advocacy	- annual concurrency report

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UK Regulators' Network : the nine UK economic regulators working together

Civil Aviation Authority

FCA
FINANCIAL CONDUCT AUTHORITY

Monitor
Independent Regulator of NHS Foundation Trusts

Ofcom

ofgem
Making a positive difference for energy consumers

OFWAT

ORR
OFFICE OF RAIL REGULATION

Utility Regulator
ELECTRICITY GAS WATER

water industry commission FOR SCOTLAND

UKRN – a new commitment to effective cooperation

UKRN is a vehicle to improve coordination across regulated sectors	– High level strategic objectives set by CEOs – Focus on consistency, efficiency and improvement of regulation – Commitment to fund and support joint working – Ambitious programme of work on areas of cross-sectoral importance
	Welcomed in Budget Report 2014: 'The government is committed to the UK's system of independent economic regulation, which is widely considered to be one of the best in the world. **The government welcomes the creation of the UK Regulators' Network (UKRN)**.'

UKRN priority projects

Priority projects – high level commitment to focus on consumer concerns and investor confidence

Explaining and making best use of economic regulation

Helping raise understanding of what independent economic regulation can achieve, when it works best, and how we can improve

Cross-sector infrastructure

provide regulatory solutions to support multi-sector infrastructure investment

Consumer engagement and switching

approaches to engagement and switching across sectors

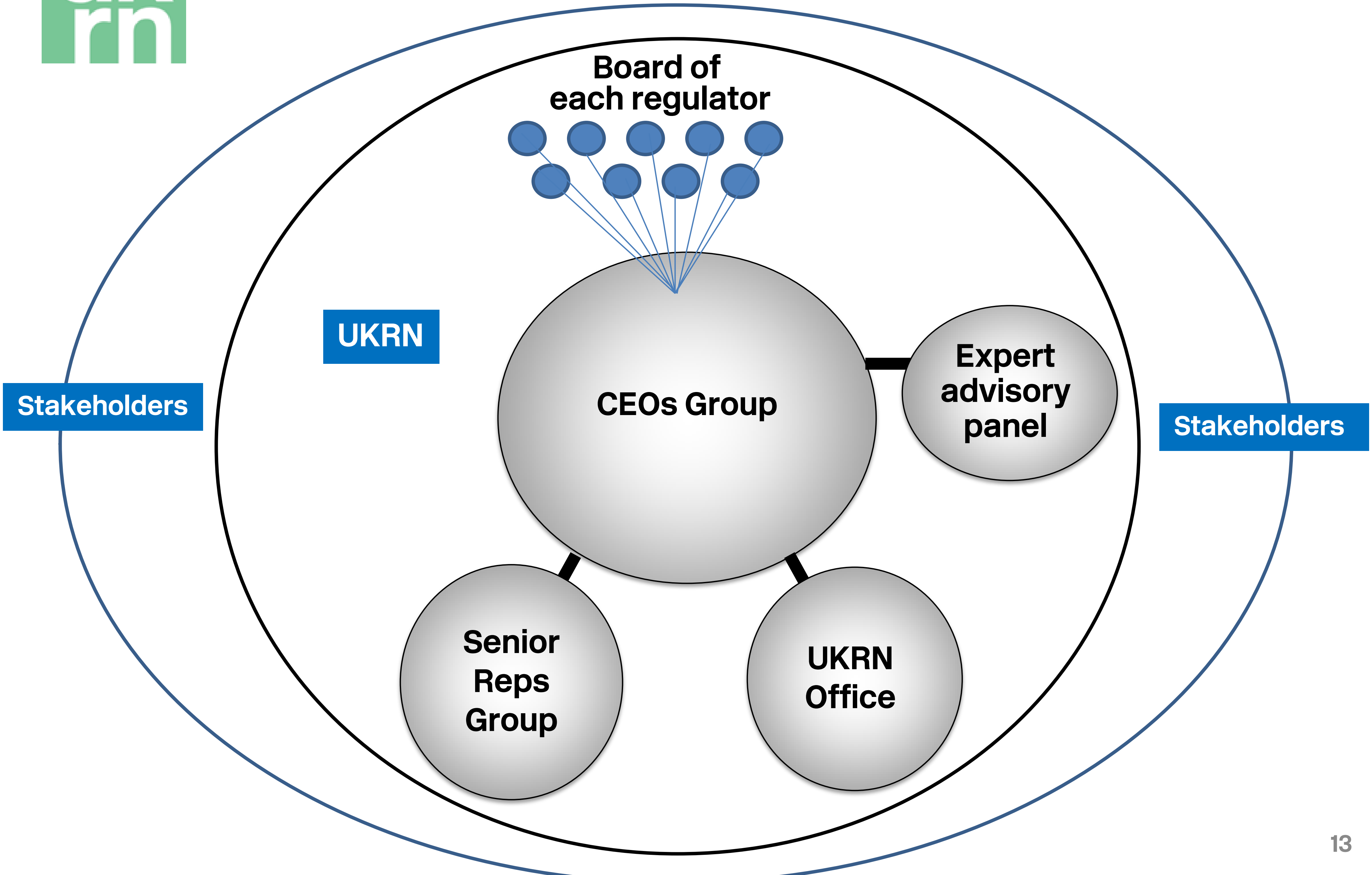
Affordability

identify affordability pressures and establish scope for possible solutions

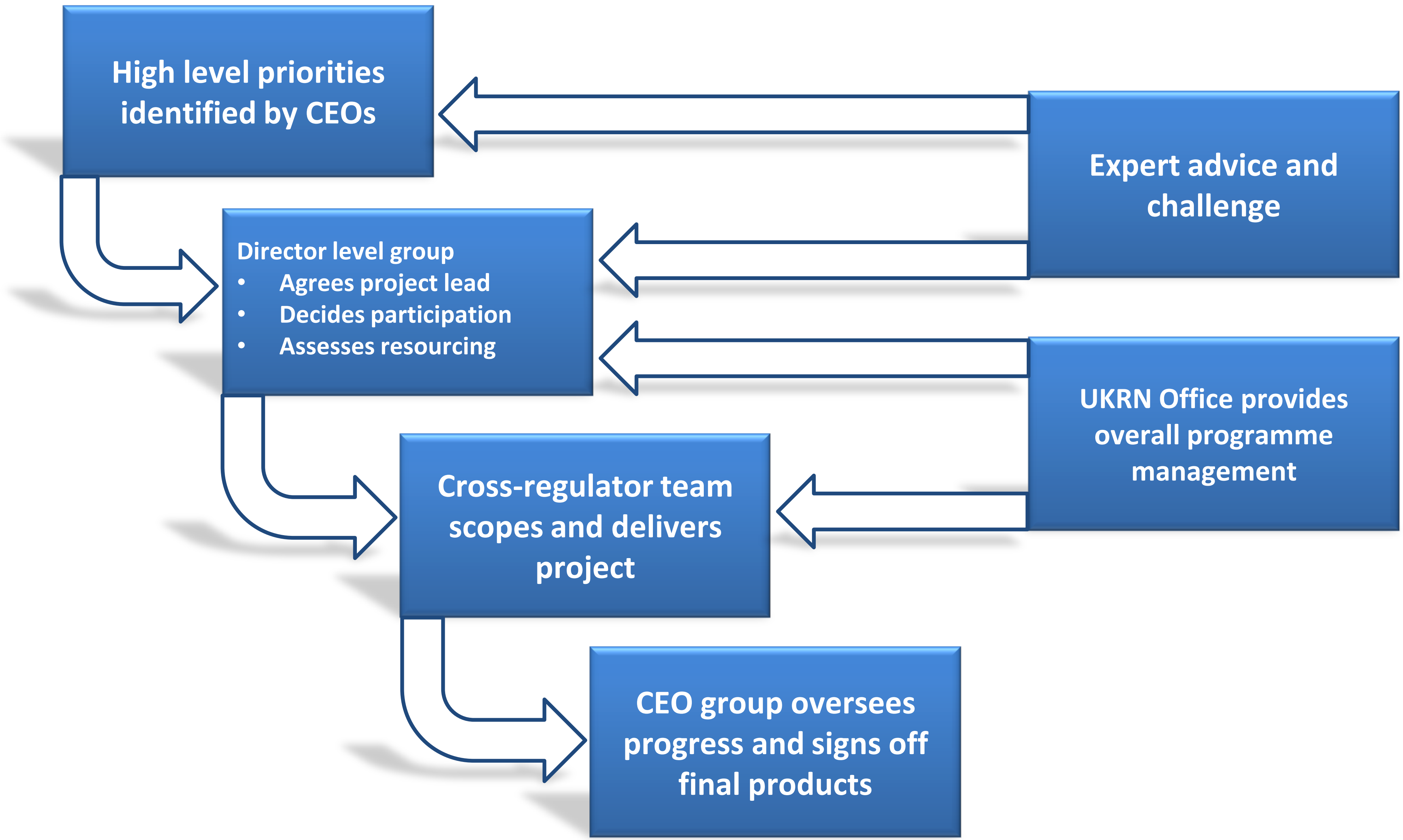
Network resilience and cybersecurity

tools and approaches to mitigate risks from cross-sector threats and dependencies

UKRN Structure



UKRN project delivery



The use of regulatory and competition powers for promoting consumer welfare

Experience across the UK's economic regulators

Richard Price [1]

The British Utility Regulation Model: beyond competition and incentive regulation? London School of Economics, 31 March 2014

It is an honour to speak at this conference marking the 30th anniversary of Stephen Littlechild's 1983 report advocating the adoption of price cap regulation and RPI-X.[2] I am going to say a few things about the relationship between competition and regulation; and about how the regulators are working together to improve the effectiveness, consistency and efficiency of economic regulation and the use of our concurrent competition powers.

The choice of competition or regulatory powers

All regulators spend time considering whether we have the right balance across the levers that we use. We think a lot about the balance between on the one hand the use of ex-ante regulatory levers - which can be complex and intrusive but often yield rapid and visible improvements for consumers; and on

1 Chief Executive, Office of Rail Regulation; and Chair, UK Regulators' Network.
1 Kemble Street, London, WC2B 4AN.
www.orr.gov.uk

2 Stephen Littlechild: "Regulation of British Telecommunications' Profitability – a report to the Secretary of State for Industry" (February 1983); see also Jon Stern: "What the Littlechild Report actually said", Regulation Initiative Working Paper no 55, London Business School (August 2003)

the other, the use of competition powers and structural reforms which might lead to market solutions in the longer term, and significantly reduce the scope and intrusiveness of regulation.

Which is the better solution for securing consumer welfare?

What has been the impact of economic regulation?

First, it's worth remembering that economic regulation has achieved a lot over the period since privatisation. Across regulated industries, the UK's approach to independent economic regulation has given investors certainty and confidence, helped to consumers' experiences for the better, and protected taxpayers. We have seen substantial gains for consumers in all regulated markets – whether substantially liberalised or still price-cap regulated.

- Since privatisation in 1989, the water sector has attracted £116 billion of investment, delivering greatly improved infrastructure and services to customers at no cost to taxpayers.

- Regulation of the communications sector has driven strong competition, innovation and investment, which have transformed the economy and our daily lives. Mobile and broadband services are now ubiquitous and constantly improving in terms of speed, capability and the range of services available to consumers - yet the average family in the UK is spending less now on these services than it did a decade ago, and is paying less than families in other leading developed economies.

- In the first 15 years after energy privatisation, regulation led to a halving in the cost of network charges for delivering energy to consumers, and over the next 8 years will enable a 50 per cent increase in investment at a lower cost of capital. Ofgem's retail market reforms will intensify competition, and the recently announced referral of energy markets by Ofgem to the CMA will consider whether further remedies are needed to remove barriers to competition. Britain's energy system is more secure, sustainable and reliable and, at a time of rising energy costs, prices remain below the average faced by consumers across Europe

- economic regulation has supported transformation in the airport sector. It has created enormous choice and value for passengers by supporting the development of competition and the expansion of regional airports. It has underpinned £11bn of investment in world class facilities during the last decade, that have transformed the global reputation and perception of Heathrow

- In rail, regulation has driven down the day-to-day cost of rail infrastructure by 40 per cent over the last decade, with a further 19 per cent to come over the next five years, freeing up resources for investment in a better network.[3] It has set stretching targets for punctuality which have underpinned sustained growth in demand – with a doubling of passenger kilometres and a 25 per cent growth in freight volumes since privatisation in 1997; record levels of customer satisfaction; and a recent safety record among the best in Europe.

It is fair to say that more and better ex-post evaluation would help us to establish how these benefits were achieved, what represents best practice, and whether even more could have been achieved with different judgements or levers. And perhaps that is an area in which the research community could do more.

The UK model is held in high regard and copied in other countries, and is recognised as a positive model for reconciling the interests of consumers with those of investors while preserving dynamic incentives to efficiency.

[3] See chart 1, at end.

We are also seeing the extension of parts of the economic regulation toolkit and consumer empowerment to some public services, without privatisation – notably health services and –subject to government consultation – England's strategic road network.

Whatever happened to the extension of competition?

But one major expectation has not happened. Regulation has not withered on the vine in all sectors.[4]

- In water there have been challenges in extending competition – for example, in reducing the minimum inset size, an in achieving vertical separation to allow greater competition in those parts of the value chain less dependent on a monopoly network;
- in energy markets there has been dissatisfaction with the results of market liberalisation;
- in rail, the structural and financing responses to the post-Hatfield crisis have weakened incentives on the incumbent infrastructure monopolist to perform for its customers; and like the market for passenger rail services, it is prone to intervention by civil servants;
- in health – we are only starting to see the impact of a form of regulation compelling incumbent monopolists to think hard about consumer benefits first. But Monitor – and beyond Monitor the competition regime – is starting to focus minds;
- meanwhile there have been more successful, structural interventions and deregulatory moves in airports; while in communications liberalisation and technological change have transformed the market and people's everyday experiences.

[4] As illustrated in chart 3.

Why have we seen so many regulated sectors remaining with relatively little competition being introduced? There are a number of possible explanations.

First, I don't see "lazy old regulators" simply not doing the work on competition and structural issues because it's too difficult, or likely to be tough to explain and a battle to achieve. On the contrary I see regulators trying to confront difficult structural issues in different sectors. I don't see much evidence of capture or cosiness either - though of course when parts of your workforce as a regulator are embroiled in the day-to-day grind of monitoring and holding to account, you need to make sure that you give enough focus and attention to the big consumer welfare and industry structure issues and constantly challenge whether you have the right balance in the use of regulatory and competition levers.

That can be hard – and it is harder when regulators face multiple objectives or take on functions which are not central to their task, or which risk compromising their independence of government. Some see this as paralleling what we ask regulatees to do – we are 'playing to our USP' and 'growing the business'. But another way of looking at this is what the Institute for Government calls the 'Christmas tree quango' - taking on incremental function by incremental function. We need to remember that we are not 'growing businesses'. We are independent statutory bodies with duties, among other things, to improve the lot of consumers and business users. When considering our functions we need to keep clearly in mind the need to sustain and improve the integrity, focus and expertise which allows us to act firmly in consumers' interests.

Regulators have generally taken fewer cases under the 1998 Competition Act (CA98) than the competition authorities – though there have been several. If on the other hand you look at the crude numbers of market studies over the last decade[5] since 2005, the numbers initiated by sectoral regulator are around one-quarter of the numbers undertaken by the Office of Fair Trading, across all markets and the entire economy. This is proportionately not far out of line. So it is not clear that regulators have shied away from promoting competition or more fundamental structural change, compared with other sectors.

The use of regulatory measures is not always wrong-headed from the perspective of consumer outcomes: far from it. Regulatory and ex-ante levers can often get surer, quicker benefits for consumers – indeed the OFT's use of commitments and the Competition Commission's use of behavioural remedies shows that the use of ex ante solutions is not limited to regulated sectors.[6] We are constantly looking for the best tools for each problem.

It is fair to say, and perhaps obvious, that the role of government varies enormously across sectors. That variation reflects in part the different structural circumstances of each sector; in part it reflects intertwining goals of promoting economic growth, the interests of consumers, and other policy objectives. It can reflect the financial exposure of government departments, and the amounts of public money at stake in sectors such as transport and health. And sometimes it reflects different departments' stances on structural issues - from pro-competition to less so. There are very significant variations in approach between departments.

So there are significant differences between sectors – in approach, in market structure and in technology, as well as in the policy framework. These help to explain the variation in the extent of competition, and in the balance of competition and regulators levers used by sectoral regulators and the competition authorities.

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[5] Since 2005. Source: Competition and Markets Authority: Baseline concurrency report (forthcoming) and websites of the Office for Fair Trading and the Competition Commission.

[6] See Amelia Fletcher: Privatisation, economic regulation and competition in the utilities: Have we got the balance right?; Beesley Lecture Series, 14 November 2013; pp 9-10. http://competitionpolicy.ac.uk/publications/presentations-and-lectures

Learning across sectors: UKCN and UKRN

Have regulators learned from each other – in thinking about or understanding the relative merits of ex ante and ex post levers? How should we think about prospective consumer welfare benefits of different approaches - structural or incremental? And have we consistently explained the advantages, limits and potential developments in economic regulation?

Our feeling as regulators is that we need to do more together, to pool and share experience and expertise; and to undertake specific work on shared problems.

In promoting competition, the advent of our UK Competition Network (UKCN) and of the CMA, with additional resource from next year for deployment in sectors where regulators have concurrent powers – makes a difference to what we can do. Individually most regulators have limited numbers of CA98 cases and market studies, and consequently limited specialist capacity. We're already seeing joint work across the UKCN between the CMA and regulators – with the review of energy markets being the most high-profile example.

In parallel we have launched the UK Regulators' Network (UKRN) to work on areas of common interest. The Network consists of the UK's nine economic regulators. It mirrors the UK Competition Network, but without the CMA, to avoid potential conflicts with their regulatory appeals role. The CMA has observer status at our discussions.

The UKRN is a vehicle for co-operation that supports the separate independent regulatory frameworks of the individual regulators. It will allow regulators to work closer together on issues of cross-sectoral significance and to learn lessons across industries which help to improve regulation and the promotion of competition in order to secure better outcomes for consumers.

The three main objectives of the UKRN are to improve the consistency of economic regulation across sectors, deliver efficiency of regulation, and to improve understanding of how independent economic regulation works in the interests of consumers, markets, investment and economic performance, identifying scope to do better.

The members of UKRN are committed to working together to achieve these objectives. This commitment includes a programme of joint work on issues of cross-sectoral significance and applying lessons learned across sectors to improve the system of economic regulation.

The first areas of focus for the UKRN will include facilitating efficient multi-sector investment projects; promoting customer engagement and switching in regulated markets; assessing cross-sector resilience and cyber-security and developing a clear understanding of the overall affordability of regulated services for consumers. We will also look at our skills and labour market across the regulators to see if we can make more of our scarce expert resource.

And – for the first time – government, or investors, with cross-sectoral interests, will be able to pick up the phone and talk to a central point person who can make sure issues are addressed collectively where appropriate. Correspondingly we will be able to do more to draw lessons across sectors on how government can most effectively work with independent regulators – something which in my view has been neglected for too long.

We have resourced a small office to coordinate and drive progress, staffed by people from the regulators. Projects will also be resourced from each of the participating regulators, and Chief Executives will keep a close eye on their progress.[7] There will also be a small expert panel to support and challenge our

[7] The organisation and accountabilities of the UKRN are summarised in Chart 4.

thinking, and our work and the challenge will be transparent so people can see what we are up to.

This is not a world takeover or an attempt to create a Spanish-style "super-regulador".[8] UKRN's work will be very focussed. We will not do anything which we, as Chief Executives, are not willing to take to our Boards and consider acting on. We will focus on work we think is better done together or where we have things to learn from each other, and only where we are clear it will have practical impact.

Nor does it compromise regulatory independence or the ability of each regulator to make the best judgements for its sector. Regulators' functions and duties remain as now, with each Chief Executive on UKRN accountable separately to his or her own Board. Beyond the Chief Executives, there is no collective oversight, we are separately accountable, as now.

Conclusion

UKRN is an opportunity for us to build best practice and to identify ways to deliver greater benefits for the consumers we each serve.

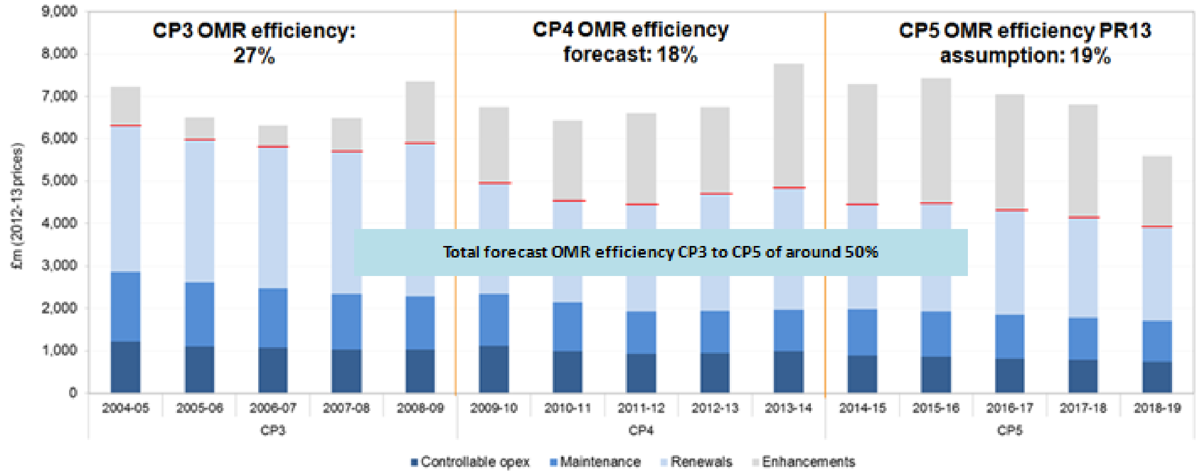
In the process we are keen to hear from researchers, consumer groups, businesses and others to help us all to get a better understanding of the effectiveness of different regulatory and competition policy levers; to evaluate regulatory practice; to assess the potential gains from more fundamental changes to market structure, and to help us to see where we can improve.

Richard Price
Chief Executive, Office of Rail Regulation, and Chair, UK Regulators' Network

[8] Global Competition Review: 'The painful birth of el super regulador', 17 December 2013.

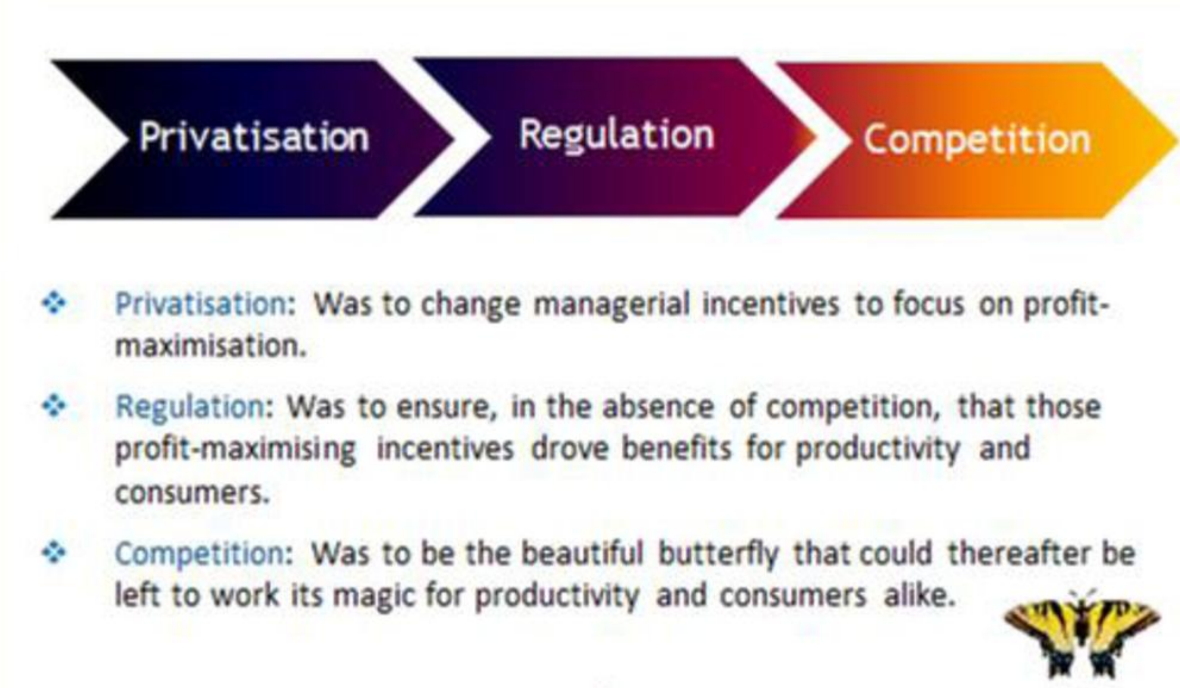
Annex: charts

Chart 1: Network Rail operating, maintenance and renewals costs; and enhancement spending, 2004-05 to 2018-19: improved efficiency frees up funding for network growth and improvement



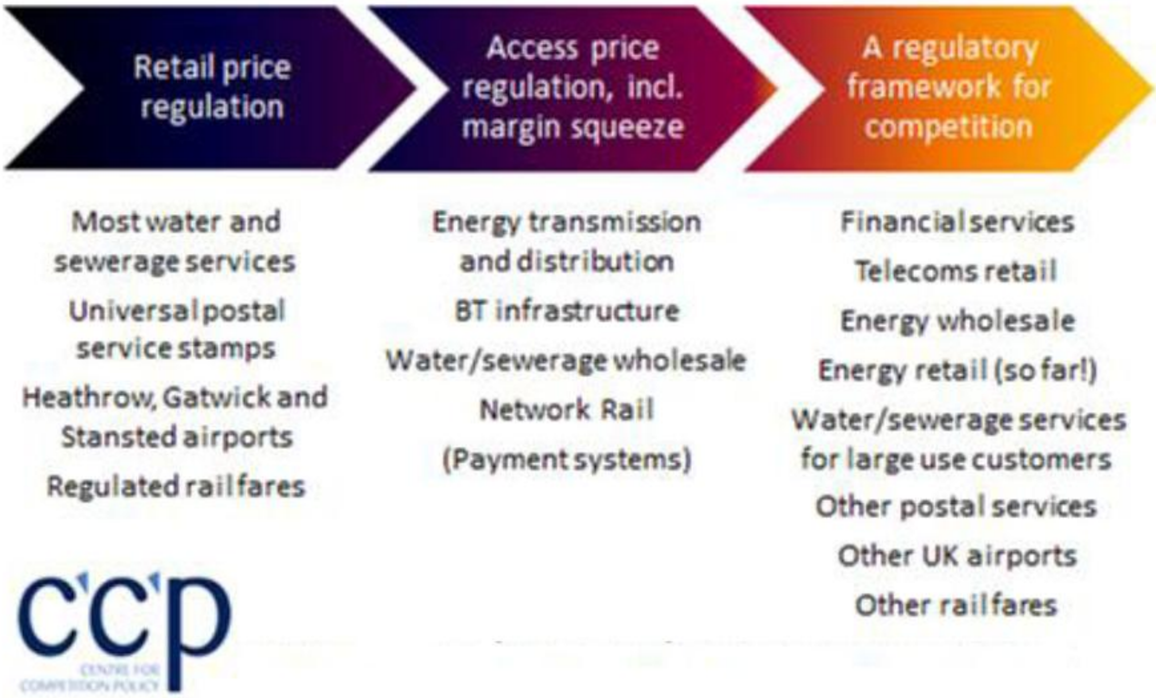
Source: Office of Rail Regulation

Chart 2: Privatisation: the expected story



Source: Amelia Fletcher: Privatisation, economic regulation and competition in the utilities: Have we got the balance right?; Beesley Lecture Series, 14 November 2013

Chart 3: Regulation: a changing focus



Source: Amelia Fletcher: Privatisation, economic regulation and competition in the utilities: Have we got the balance right?; Beesley Lecture Series, 14 November 2013

Chart 4: UK Regulation Network – organisation

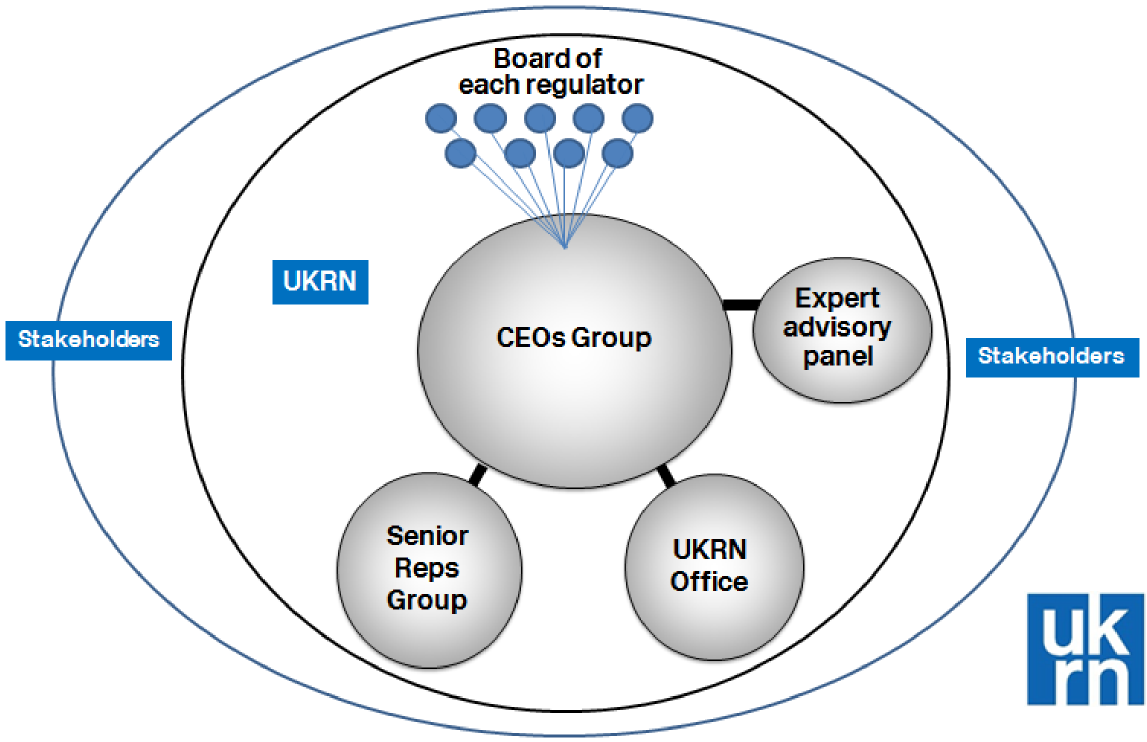


Chart 5: UK Regulators' Network: Project governance and delivery