Cross-sectoral cooperation between regulators The use of regulatory and competition powers; new investment in UK infrastructure, and consumer welfare

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Coherence and stability in regulatory policy
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There are great expectations in the UK for infrastructure and its role in promoting efficiency and economic growth. These expectations are matched by an ambitious forward programme of investments in renewal and expansion of network capacity and quality across sectors, backed by the government and private investors. Economic regulation and competition have a big role in helping to ensure investment is efficient, and to reconcile the interests of consumers and investors. In this context, regulatory coherence and stability – the theme of today's conference - has rarely been so important.

In this session I will discuss

- the relationship between competition and regulation, and the way regulators use their powers;
- the importance of independent regulation in ensuring efficient service delivery for consumers, particularly against a background of major investments in UK infrastructure; and
- how the regulators are working together to improve the effectiveness, consistency and efficiency of economic regulation.

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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 change 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.[2] 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.

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.

[2] See chart 1, at end.

Whatever happened to the extension of competition?

But one major expectation has not happened. Regulation has not withered on the vine in all sectors.[3]

- 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.

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

[3] As illustrated in chart 3.

confront difficult structural issues in different sectors. 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 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.

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[4] 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.[5] 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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[4] Since 2005. Source: Competition and Markets Authority: 'Baseline' annual report on concurrency (April 2014), and websites of the Office for Fair Trading and the Competition Commission.

[5] 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

Regulation and new investment

Earlier I ran through some of the notable successes of economic regulation in the past decade. We sometimes forget, or take for granted, how the system of independent economic regulation has reduced the cost of services and improved quality and choice, for consumers, while providing a stable and predictable environment for investors in which risks are understood, commitments are credible, and the cost of finance commensurately lower. This is all the more difficult where other pressures – often beyond the regulated market itself – have led to upward pressure on prices. There is a danger that we fail to learn from the way regulation has played out over the last decade, and miss an opportunity to apply the techniques and lessons to new circumstances.

This is all the more important at a time when plans for renewal and expansion of UK infrastructure are becoming more ambitious. This is in part a response by the Government to concerns that underinvestment in infrastructure may constrain future economic growth.

The World Economic Forum's 2013 global rankings for the quality of infrastructure suggest that the UK has slipped from 6th to 8th position.[6] The Treasury's National Infrastructure Plan points to evidence that this may have constrained GDP growth over the last decade.[7]

On the positive side the UK remains a world-leader in attracting private sector investment in infrastructure. A recent study ranked the UK as the No.1 place in the world for infrastructure investment.[8] Economic regulation, alongside government, has contributed to developing a stable, attractive environment for investors. It is a framework which global investors are familiar with and understand.

[6] World Economic Forum: Global Competitiveness Report 2013-2014
[7] HM Treasury: National Infrastructure Plan 2013; December 2013, chapter 2.
[8] Nambarro LLP: Nabarro Infrastructure Index - Attracting Investment

The UK Government's National Infrastructure Plan points to an infrastructure project pipeline over the next decades totalling investment of £377 billion at 2012-23 prices.[9] Around £220 bn of this is in the energy sector, and £120 bn in transport, including aviation, roads and rail (see chart 4). But there are significant programmes in other sectors too. It includes some of the biggest engineering projects of our age – such as the Thames tideway, High Speed 2, and major investments in low-carbon energy generation and transmission; as well as increasing airport capacity – though the findings of Sir Howard Davies' Airports Commission are of course not yet factored in. There are also major investments beyond the regulated networks – in the strategic roads network and in flood risk management.

The regulators are of course engaging with government and businesses in the process of considering how projects can best be scoped to deliver efficiently benefits for consumers and the wider economy; and how they can be funded in a way which protects the interests of consumers both today and into the future.

It is fair to say that a variety of instruments is developing to attract investment to the infrastructure pipeline. Sometimes they make good use of the existing regulatory regimes – as in the case of Thames Tideway, enhancing existing rail infrastructure, and airport capacity.

Sometimes the role of independent regulation perhaps has more to offer in underpinning value than has so far been the case. There is a risk of overreliance on long-term contracts and guarantees, and too little weight to ongoing, dynamic incentives to deliver services efficiently and in consumers' interests. These are the very the problems where independent regulation has a strong track record - with its toolkit of efficiency reviews and credible incentives, and scope to evolve to meet new challenges. Economic regulation will not be the answer to all problems in all circumstances.

[9] HM Treasury: National Infrastructure Plan 2013; December 2013

But it is worth considering whether enough use is being made of economic regulation in keeping the cost of investment efficient so that consumers and taxpayers pay no more than they need to; and reconciling the interests of investors and consumers, so that consumers get the best possible deal and financing costs are kept low.

I am not attempting to answer this question today. But with this scale of investment it is in everyone's interests that we improve the understanding of what independent regulation can contribute; where it works best; and how it can evolve to get better results for the future.

Learning across sectors: the UK Competition Network and the UK Regulators' Network

These are some big challenges: ensuring we are constantly evolving best practice and applying regulatory and competition levers to the advantage of consumers; and looking ahead to the challenge of major new investments in infrastructure.

In meeting these challenges, how well have regulators learned from each other – 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 reviews of energy markets and retail banking 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.[10] There will also be a small expert panel to support and challenge our 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 "super-regulador", in the style of Spain, Estonia or the Netherlands.[11] 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.

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[10] The organisation and accountabilities of the UKRN are summarised in Chart 5.
[11] Global Competition Review: 'The painful birth of el super regulador', 17 December 2013.

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.

As individual regulators, and collectively, we are committed to learning what has worked well in economic regulation, and what could be improved, so we can meet the challenges of ensuring that the next phase of infrastructure investments are delivered efficiently and in the interests of consumers.

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; and to assess the potential gains from more fundamental changes to market structure; to assess how economic regulation can best meet the challenges of a period of renewal and expansion in national infrastructure.

UKRN, combined with transparency and dialogue, is a great opportunity to help us to see how we can improve, and evolve, economic regulation for the future.

Richard Price

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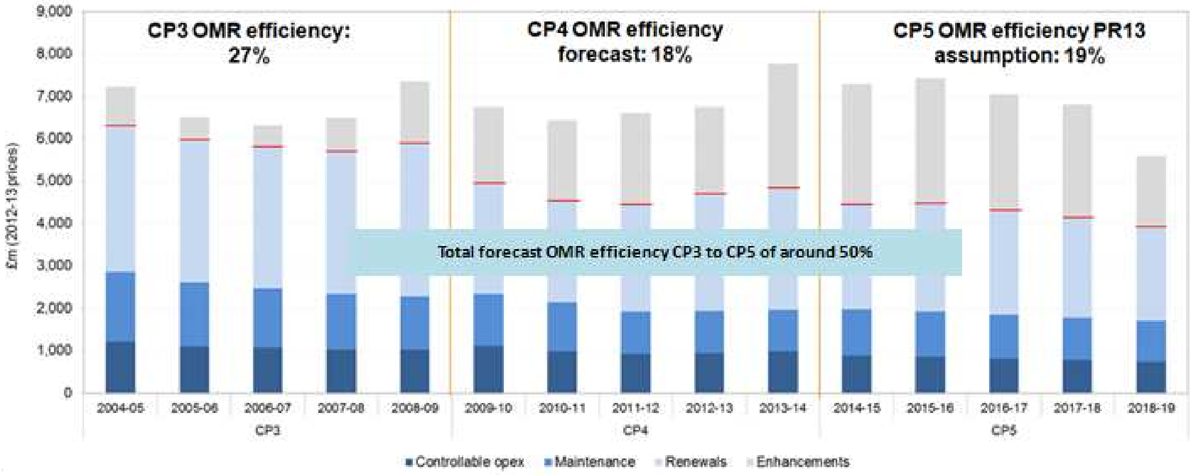
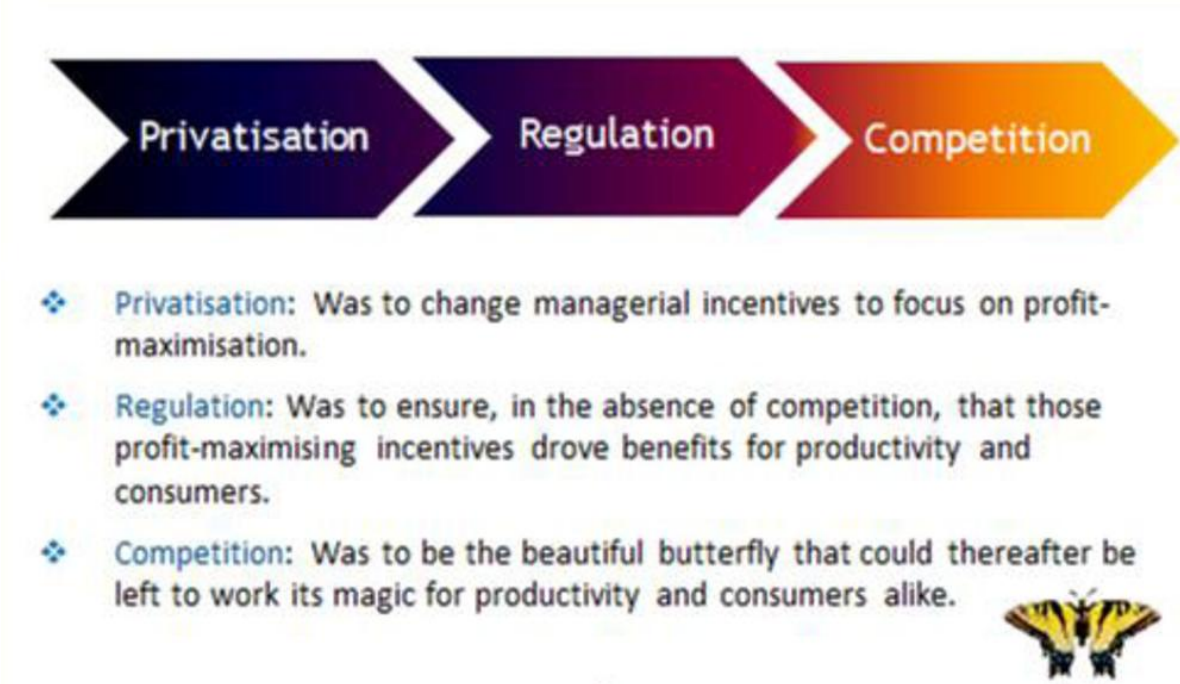
Annex: charts

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



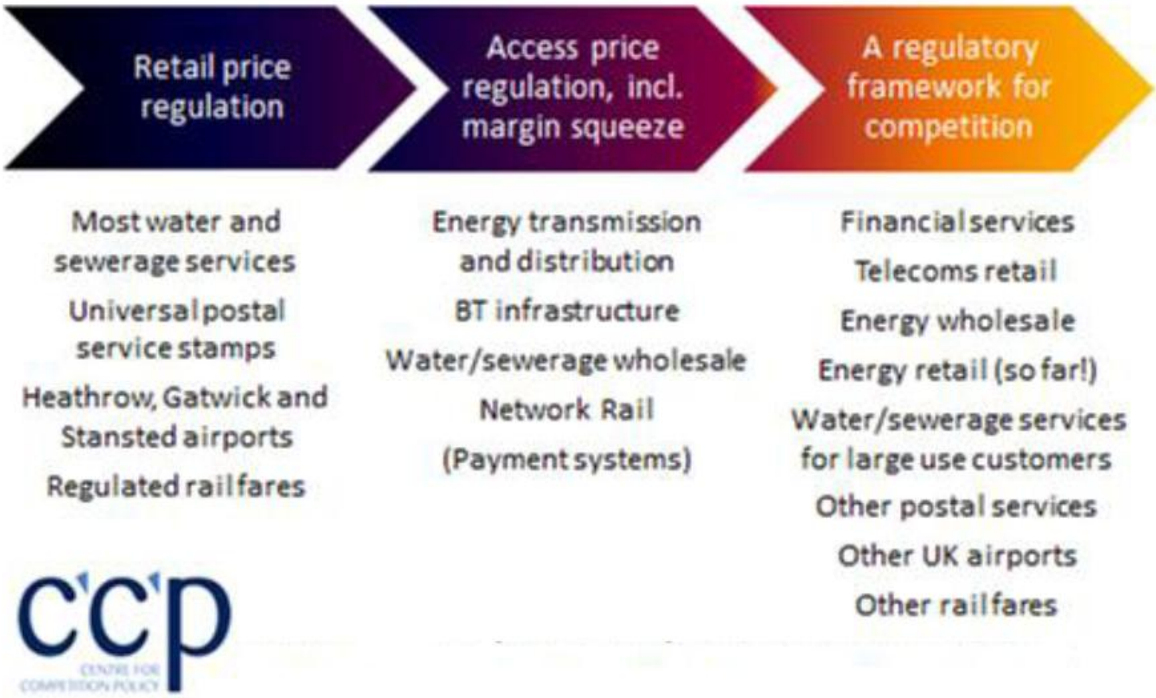
Source: Office of Rail Regulation

Chart 2: Privatisation: the expected story



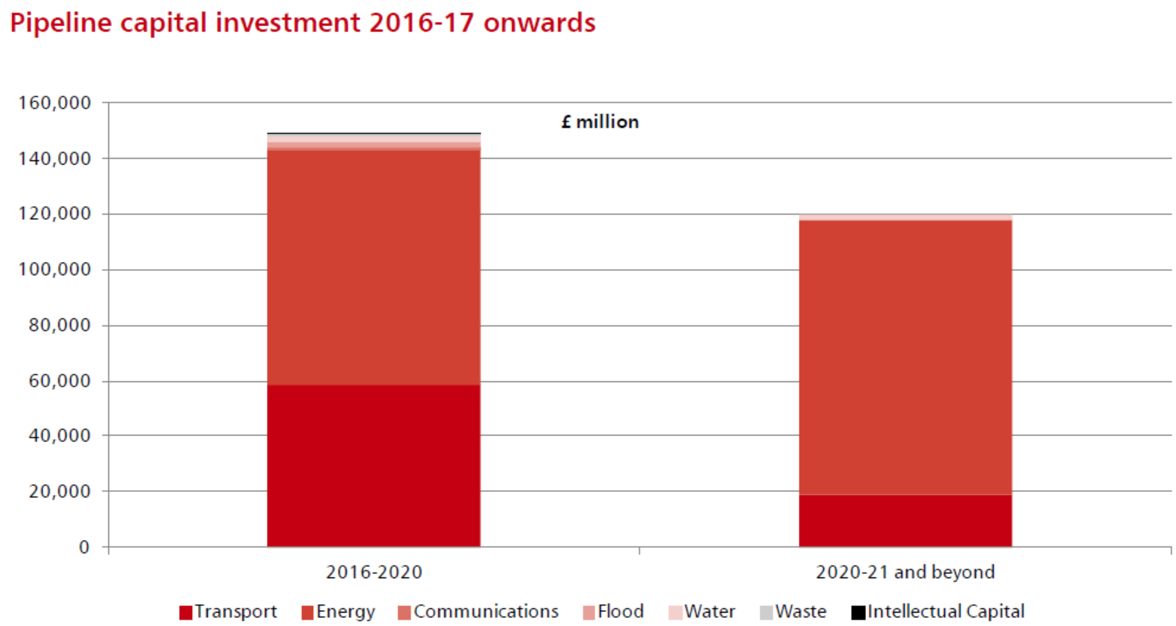
Source: Amelia Fletcher: Privatisation, economic regulation and competition in the utilities: Have we got the balance right?; Beesley Lecture Series, 14 November 2013

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: Projected infrastructure investment, by sector, 2012-13 prices



Source: HM Treasury: National Infrastructure Plan 2013; December 2013

Chart 5: UK Regulation Network – organisation

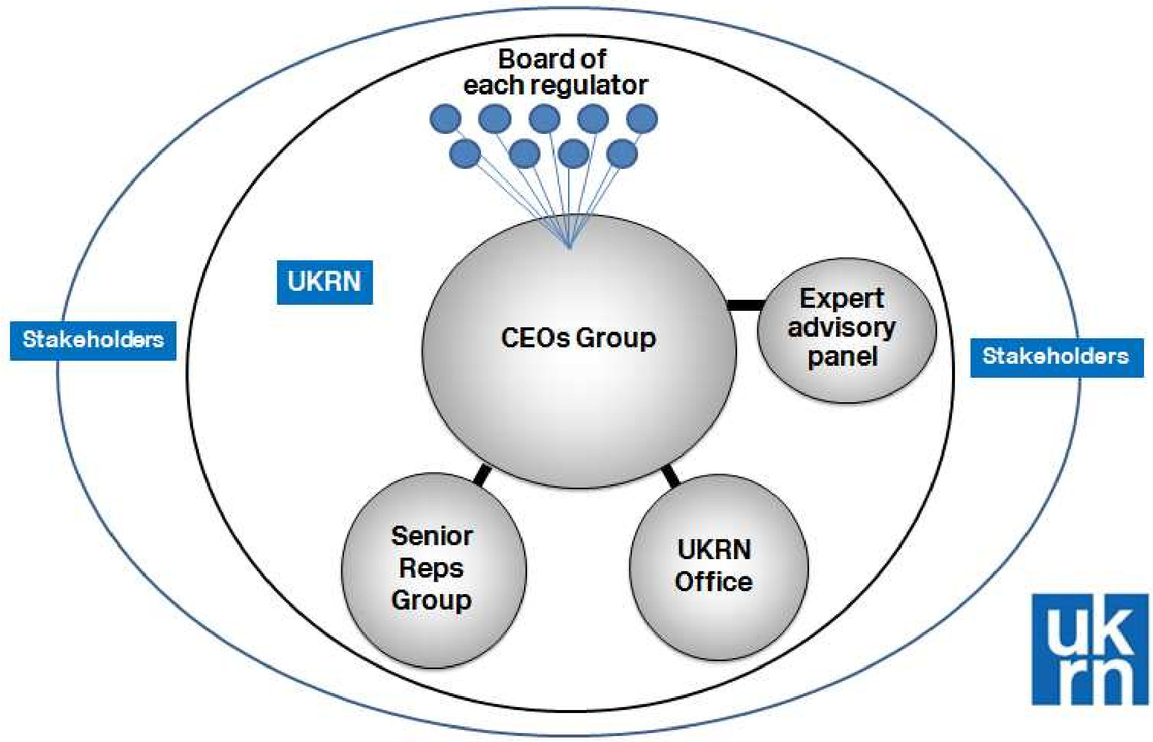


Chart 6: UK Regulators' Network: Project governance and delivery