Utilities Policy 31 (2014) 178–183

Contents lists available at ScienceDirect

Utilities Policy

journal homepage: www.elsevier.com/locate/jup

A better deal for consumers and an attractive environment for investors: The regulators' perspective on the development and use of regulatory and competition powers☆

Richard Price [a, *], Cathryn Ross [b]

[a] Office of Rail Regulation (ORR), United Kingdom
[b] Office of Water Services (Ofwat), United Kingdom

A R T I C L E I N F O

Article history:
Received 12 August 2014
Received in revised form
29 September 2014
Accepted 29 September 2014
Available online 7 October 2014

JEL references:
L51
K23
L14

Keywords:
Incentive regulation
Competition and regulation
Investment
UK Regulators' Network

A B S T R A C T

This paper provides a perspective from two economic regulators on the way in which economic regulation in the UK has developed over time. Regulation has delivered great benefits, but its development has been at odds with expectations at the time of privatisation. In particular, effective competition has not caused regulation to ‘wither on the vine’, and be replaced with ‘normal markets’, subject to ex post interventions through competition law. This is not because of the (in)action of ‘lazy old regulators’ or because of any regulatory capture, but instead reflects the complexities of regulated sectors, their underlying economics, market structure, conduct and technology, as well as in the legislative and policy framework. Regulators can and do use competition law tools and we recognise that it is important for the health of the regime as a whole that we do. But where markets are being opened to competition the ex ante regulatory tool kit is important. And even where competition exists it may still be the case that ex ante regulatory tools provide surer, quicker benefits for consumers, and an important mechanism for securing much needed new investment. That said, it is important that we continue to make the case for economic regulation, and it is important that the regime should continue to adapt and evolve. We conclude by setting out how the formation of the UK Regulators' Network will help in doing this.

1. Introduction

There are great expectations in the UK for infrastructure and its role in delivering for customers and society, promoting efficiency and economic growth. These expectations are matched by an ambitious programme of investments in renewal and expansion of network capacity and quality across sectors, in some cases backed by the government and in others by private investors. Economic regulation and competition have a big role to play in aligning the interests of investors with the interests of customers and society. Specifically in relation to investors, economic regulation and competition help to ensure as far as possible that investment is efficient, with the right investment being made in the right place, at the right time and at efficient cost. In this context, regulatory coherence and stability has rarely been so important.

This paper provides a perspective from two economic regulators, taking into account both our sector positions and the wider environment in which we operate, including the recent creation of the UK Regulators' Network. In this paper we discuss:

- the relationship between competition and regulation, and the way regulators use their powers;
- how economic regulation has not ‘withered on the vine’ in the face of increasingly effective competition, as envisaged at the time of privatisation;
- the importance of independent regulation in helping to ensure the delivery of what customers and society need, want and can afford from regulated sectors, particularly against a background of major investments in UK infrastructure;
- how economic regulation needs to learn and evolve if it is to continue to help ensure delivery of what customers and society expect, given that regulated sectors and the environment in which they operate change over time; and
- how the regulators are working together to maximise the benefits from coordination or read across between sectors.

☆ This article belongs to the special issue: The British Utility Regulation Model in 2014 - Retrospect and Prospects: The 30th Anniversary of the ‘Littlechild Report’.

* Corresponding author.
E-mail addresses: richard.price@orr.gsi.gov.uk (R. Price), cathryn.ross@ofwat.gsi.gov.uk (C. Ross).

http://dx.doi.org/10.1016/j.jup.2014.09.012
0957-1787/© 2014 Published by Elsevier Ltd.

2. What has been the impact of economic regulation?

First, it is worth remembering that economic regulation has achieved a lot over the period since privatisation.[1] Across regulated sectors, the UK's approach to independent economic regulation has spurred efficiencies and helped to deliver a step-change in the consumer experience. Linked to this, independent regulators have facilitated massive investment programmes at relatively low costs of capital, reflecting the stability, predictability and long term view they provide. 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 delivered greatly improved infrastructure and services to customers. This necessitated a £116 billion programme of investment, which was secured through private finance with a relatively low cost of capital that reflected investors' confidence in the regulatory regime. Bills are around one-third lower as a result of Ofwat's efficiency challenge, and have been constant since 2009.
- 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 Competition and Markets Authority (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 a transformation in the global reputation and perception of Heathrow, facilitated by £11 bn of investment in world class facilities during the last decade.
- 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. 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, the appropriate counterfactuals; what represents best practice, and whether even more could have been achieved with different judgements or levers. We believe that this is an area in which both regulators and 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 –under legislation currently proposed – England's strategic road network.

3. Whatever happened to the 'withering on the vine' of economic regulation as competition law and 'normal markets' took over?

A lot has been delivered since privatisation. But one major expectation has not happened. Regulation has not withered on the vine in all sectors.[2]

- In water there have been challenges in extending competition – for example, while the new appointments regime allows for 'competition for the market' it still replaces one monopoly at the retail level with another, and the Water Supply Licensing regime introduced in the Water Act 2003 only allows the very largest business customers to switch supplier and few have done so;
- in energy markets there has been dissatisfaction with the results of market liberalisation and especially about the benefits delivered for consumers: Ofgem recently referred the whole energy market to the CMA[3];
- 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 the commissioners of NHS-funded services 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 several possible explanations.

Even recognising that there are good reasons why competition has taken hold more fully across regulated sectors, regulators have recently been challenged - by government and commentators – on why we have not made more use of our powers under competition law. There are a number of possible explanations.

[1] Though, as we note below, we believe more ex-post evaluation should be conducted to establish more precisely the value-added and what we have learnt about the effectiveness of alternative approaches to regulation.

[2] As illustrated in Chart 1.

[3] Ofgem referred the energy market to the CMA for a full competition investigation on 26 June 2014, expecting that the CMA would examine among other things the relationship between the supply businesses and generation arms of the six largest suppliers barriers to entry and expansion for suppliers; the profitability of the six largest suppliers; whether or not there is sufficient competition between the large energy suppliers; the trend of suppliers consistently setting higher prices for consumers who have not switched; and low consumer engagement that contributes to weak competitive pressure in the market. See Ofgem announcement: https://www.ofgem.gov.uk/press-releases/ofgem-refers-energy-market-full-competition-investigation.