

On crossed wires? Utility regulation in the limelight

Martin Lodge and **Jon Stern** consider contemporary debates surrounding the British utility regulation model

As the UK gears up for the next general election, utility regulation has once again received considerable political attention. Whether it is on the issue of railway passenger franchises and fares, or retail energy prices, the politics of utility regulation are once again matters of live political concern. Public comment has concentrated on the behaviour of the regulated companies and regulators, as well as the viability of regulatory instruments. UK economic regulators have recently launched a network to institutionalize knowledge exchange and to highlight the benefits of contemporary utility regulation. Outside commentators and much of the political world, in contrast, continue to raise concerns regarding the accountability of regulators and the influence of the corporations running regulated industries.

In the light of these contemporary debates, it is worthwhile to reflect on the legacy of the British utility regulation since the early days of privatization. After all, it is now over 30 years since the initial privatization of British Telecom (BT). The initial thinking behind utility regulation, most of all formulated in the 1983 Littlechild Report, deserves re-examination. The Littlechild Report made the case for a competition and incentive-driven framework that was characterized by supposedly light-handed regulation, most of all based on the RPI-X (price-cap) formula. More generally, the British 'regulatory state' for utilities became associated with the rise of quasi-autonomous regulatory offices that were supposed to oversee the privatized provision of utility services, in a more predictable and transparent way than had been undertaken by ministerial departments in the age of public ownership. One key ambition was to eliminate 'politics' (or, at least, day-to-day politics) from utility regulation, and, in particular, the annual negotiations by the utilities with the government on investment and prices. A second ambition was to rely increas-

ingly on competition in the supply of these services rather than organized monopoly; a trend that can be diagnosed by the structural reforms that were witnessed in the late 1980s and 1990s in those industries that had been privatized.

The ideas underlying the Littlechild Report are now moving into their fourth decade. Such an age is usually associated with signs of mid-life crisis. Youthful enthusiasm gives way to fatalism, if not scepticism. So what kind of arguments are shaping the contemporary debates? Three different views of the legacy can be distinguished.

One is the *consolidation view*. According to this view, utility regulation in the UK has become increasingly embedded in UK institutional arrangements. While there may be regular debates about ownership, and public criticism about price rises and investment plans, this view regards the principles of competition and autonomous economic regulation as relatively firmly embedded in the UK political economy. This view would also argue that the initial ideas have shown sufficient flexibility to adapt with the times, such as in the way in which RPI-X has been evolving over time, and how the relationship between regulators and politicians have adapted. Most of all, the recent changes to UK competition law that saw the creation of the Competition and Markets Authority in April 2014 (by merging the Office of Fair Trading and the Competition Commission) further strengthened the 'concurrency' provisions in the legal relationship between competition and regulatory agencies. These concurrency provisions are seen as further developing the role of competition and markets in the wider context of economic regulation. In other words, the consolidation view regards the legacy of the past 30 years as generally successful, and probably sufficiently robust to maintain its momentum over the coming decade and beyond.

A different view can be characterized as an *existential angst* perspective. There are different strains to this argument. One strain would suggest that economic regulation of utilities is facing considerable challenges that appear to threaten the legacy of competition and incentive-based regulation. One such challenge is the growing shifting of responsibilities and public policy objectives onto supposedly economic regulators. This ever expanding jurisdiction, which it is argued, follows more a logic of political convenience than bureaucratic empire building, raises issues not just in terms of over-reach; it also raises issues about legitimacy as supposedly 'economic' regulators are ever more required to engage in value choices regarding issues of fairness, the environment, and efficiency (and others) that might be better placed in the hands of elected politicians. A different strain, keen on a 'light touch' approach towards regulation, would argue that recent interventions particularly in energy regulation, especially those justified as being based on 'behavioural economics', are highly paternalistic and erring on the wrong side of the supposed trade-offs between potential market and regulatory failure. According to this view, these challenges, and threats to the original ideas underlying utility regulation, are likely to become ever more prominent as issues such as climate change are likely to rise even further up the political and regulatory agenda.

Finally, the *fiasco view* would suggest that the initial aspirations of the utility regulation reformers have not remotely been met. Instead, utility regulation is lurching from crisis to crisis. This does not mean that these observers wish to return to the state-of-play of the pre-1983 age, rather they critically point to the effects and dynamics that occurred subsequently. Again, this view is represented by a number of different strains. For some, the key criticism of the regime has been the

power of the corporate entities that have entered the UK market. Insufficient attention, according to this view, has been paid by regulators and elected governments to the political power of these industries and investors in them. Others have argued that the regulatory instruments of the 1980s which emphasized efficiency have become ill-suited in an age that requires incentives for private investment into infrastructures. Most of all, it is suggested that utility regulation (particularly in energy) has become hyper-politicised with regular bouts of political excitement over price increases, ownership, and regulatory decisions. Thus, the supposed promise of the regulatory reforms of the 1980s – that utility regulation would become a technocratic exercise has been defeated by off-stage lobbying by various groups leading to growing boundary conflicts between electoral politics and supposedly autonomous regulatory institutions.

These three views are not meant to provide an exhaustive picture of contemporary debates regarding utility regulation in the UK; indeed, it is quite possible that protagonists of these different views would hardly agree on anything among each other. Nevertheless, the three views delineate different approaches that include competing values and priorities. They emphasize some issues, while downplaying others. Debates surrounding these views are, furthermore, not only restricted to the UK. For example, Germany has witnessed local referendums over the future of (privatized) ownership of local infrastructures over the past few years. Questions about how to attract private investment into carbon-low energy generation have been raised across EU countries and beyond. In all these countries, the problems seem to have been greatest in energy (and electricity) regulation and much less in telecoms and ICT, with rail and water somewhere in between.

What is noticeable, however, is that these different views are not in direct communication with each other. Politicians, regulators, regulated companies, and other interested parties have tricky choices to make as to how to navigate across this complex space and decide which views (and factors) they think are most crucial. However, such choices should involve more open engagement between these views – and the competing strands within them.

Furthermore, whatever one's outlook, the past 30 years have shown that economic regulation of utilities will always remain in the political limelight, given the industries' importance of social and economic life. The issues of the balance between competition and regulatory principle, between supposedly 'independent' regulation and electoral politics, between discretionary and flexible regulation on the one hand, and demands for greater consistency and 'predictability' on the other, are at the heart of utility regulation. As concerns about the trade-offs between investment needs, the recognition of social and environmental obligations, and the impact on prices become ever more prominent, it is therefore hardly surprising that utility regulation will remain at the centre of the political agenda.

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