

RPI-X, competition as a rivalrous discovery process, and customer engagement

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Outline

- The nature of competition
- The adoption of RPI-X in 1983
- Subsequent developments in regulation
- Negotiated settlements
- Ofgem, Ofwat and customer engagement
- WICS and the Customer Forum
- Competition in setting price controls?
- Conclusion

Plus ca change

- "Characteristically, Stephen Littlechild concludes his contribution with how he is exploring other means by which we may be able to do away with the need for price regulation by a regulatory agency of even the most natural monopoly-like element of utility services." (Jon Stern, 2003 conference)

Nature of competition

- Ten Steps to Denationalisation 1981
- “agreement that the nationalised industries should attempt to discover the goods and services that customers want and produce them efficiently”
- Austrian concept of competition as a rivalrous discovery process eg Schumpeter, Hayek, Kirzner
- And the Competition Commission 2003, 2013
- Contrast neoclassical view: equilibrium where price is equal to minimum cost of production

1983 Report revisited

- What form of regulation would give maximum scope for competition as a discovery process?
- RPI-X attractive because it gave flexibility
- I scored it highest on all but one of the criteria
- David Parker Official History of Privatisation now gives excellent account of govt deliberations
- Was reason for acceptance simpler: RPI-X wasn't Rate of Return control and wasn't ORPL??

Discovering regulation

- Now clear that in 1983 we were all engaged in a rivalrous discovery process
- What did parties want & how to provide it?
- Initially one-sided process, within Government
- Report brought in BT, and RPI-X reflected Buzby Bond: got BT 'buy in' to form of regln, Govt too
- Lengthy negotiations on X, duration, coverage - tradeoffs made – negotiated agreed outcome

Developments since 1983

- RPI-X adopted, with modifications, for all other UK privatisations, and around the world
- “But in reality, Littlechild's 1983 model of a simple control of a relatively narrow basket of prices has changed out of all recognition". (Chris Bolt, 2003 conference)
- This too has been a rivalrous discovery process – discovering what works best, rivalry between forms of regln & regulators, learning from others
- But it has been a single buyer model – the regulator buys on behalf of the whole industry

An alternative approach?

- “But do we need to stay with this method of setting X for ever, or even with this kind of price control? ... For some time I have been suggesting that it might be possible for customer groups to negotiate directly with regulated utilities as to the levels of X . More generally, they could negotiate for whatever kind of control they prefer, whether on price or earnings or revenue, and with what basis of sharing and for whatever duration. Some of this is already happening in Florida, but that is another story. “ (Littlechild 2003 conference)

Negotiated settlements

- Over the last decade further evidence of the use of negotiated settlements
 - Florida, FERC, NEB (Canada), ACCC (Australia)
 - Constructive engagement CAA in UK
- Processes more productive, less costly & risky, led to better understanding, outcomes more acceptable, often innovative
- Different philosophy of regulation: to facilitate agreement instead of taking all the decisions
- How far are such approaches now used in UK?

CAA: from constructive engagement to ?

- CAA pioneered constructive engagement
 - If airports & airlines could agree traffic forecasts, investment and service standards, CAA would embody in price control
- Generally successful & repeated, tho whether airport to be regulated now clouds the issue
- New duty to promote competition: static view
- Competition → price = cost → price control
- But Stansted deregulated (given contracts) & Gatwick allowed undertaking in lieu of control
- Some diversity reflecting some customer views

Ofgem & Ofwat: customer engagement

- Companies that engaged with customers & got support for business plans could fast-track
- Engagement necessary but not sufficient
- Customer engagement went very well
- But only 1 in each group of cos fast-tracked
- Regulators still determine almost all controls?
- Will this discourage future engagement?
- Or is this competition – lowest bid wins?

WICS & Customer Forum

- WICS, Scottish Water & Consumer Focus Scotland created Customer Forum 9 members
- Remit: research programme to ascertain & represent views of customers in price control
- Later, to seek to agree Business Plan with Scottish Water, consistent with WICS views
- Enthusiastic & effective participation by all
- Reached agreement on Business Plan
- WICS Draft Determination consistent with it

CF Inputs and Outcomes

- WICS guidance notes on opex, capex, finance
- Tramlines re SW performance gave assurance
- Deeper understanding customer preferences
- Changed SW approach: thinking, projects, explanation, more sensitive to customer needs, more open to lower price settlement
- Better outcome for customers
- Nominal price cap 1.6% 3 yrs within CPI-1.75%

Competition in setting price controls?

- Need single buyer model? Or competition via agreements between companies & customers?
- Given regulatory guidance & initial approvals, encourage companies & customers to negotiate
- Evolving recognition of “going market price”
- Price + cost of capital, efficiency, service, form
- Increasingly feasible to accept that price
- Increasingly difficult to refuse to do so
- All consistent with statutory duties cf WICS

Conclusion

- Why bother if RPI-X & variants have worked?
- Painful, costly, not best outcome for anyone
- Single buyer model of regulation is monopsony
- Further stage of customer engagement: benefits of competition to design & set price controls
- Innovation, learning (end to menu regulation??)
- And as always, as in 1983, the duty of the regulator is to promote such competition