

# Government and 'independent' regulation': how things have evolved since privatisation

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# To be covered

- Why the issue is topical now
- Context
  - independence from what/whom?
  - the purpose of independence
  - the changing meaning of independence
- What has driven the evolution of relations between government and regulators?
- Where are we now?
- Where might we be heading?

# Why independence an issue now

- Long-term conflict between government and Ofgem, especially related to government decarbonisation goals and latterly over price controls
- Various government reviews of role of regulators (notably, Ofgem and Ofwat)
- More recent political interventions
  - Greg Clark's 'admonishments' to Ofgem (June - November 2017) and '4 Principles' for the energy sector (November 2018)
  - Michael Gove's 'A water industry that works for everyone' (March 2018)

# Independence from what?

- In the US (and elsewhere), traditional concern has often been independence from the regulated and other third parties ('regulatory capture')
- In the UK, main concern has been with the relationship between regulators and government
  - DTI review of utility regulation in 1998
  - Introduction of Social and Environmental Guidance in the Utilities Act 2000 and the Water Act 2003
  - House of Lords Select Committee on Regulators (2007)
  - Government reviews of the role of Ofwat (2011) and Ofgem (2011)
  - BIS Principles for Economic Regulation (2011)

# What is independence for (it is not an end in itself)?

- Meet international requirements
  - e.g. EU Third Energy Package
- Help accumulate specialist expertise in government
  - more difficult in mainstream civil service
- Provide a receptacle for blame for unpopular government policies or for particular outcomes
- Boost credibility that regulators' actions will not be driven by day-to-day politics
  - underpinned original privatisation IPOs
  - facilitates ongoing investment in regulated industries (especially in networks)
- Arguably, a better balance between predictability and flexibility than the (mainly long-term contractual) alternative means of achieving similar objectives (and as embodied in long-term government contracts with low-carbon generators)

# What does independence mean?

- Dimensions of independence
- What it does not mean
- What it did mean
- What it seems to mean now

# At least two dimensions of independence

- **Breadth.** Size of area over which regulator has discretion
  - i.e., where the boundary is set between ‘regulation’ and ‘policy’
- **Depth.** Extent of regulator’s discretion within the area designated as regulation
- Both of these dimensions at issue in the recent history of UK government – regulator relations
  - although independence debate has tended to be more concerned with the second dimension

# Independence has never meant autonomy

- Regulators are agents of parliament
- Regulators are appointed by government
- Regulators operate within a framework of statutory obligations which can be (and, in most cases, have been) amended by parliament
- Regulatory independence has **always** involved a rather specialist meaning of independence

# What it meant in the immediate post-privatisation period

- Regulators broadly left to interpret (often very high-level) statutory obligations
  - Own interviews confirming little political ‘interference’ in the 1990’s in gas and electricity regulation
- Effective core of the brief around
  - Prevention of abuse of monopoly power
  - Promotion of competition where feasible (more relevant in energy and telecoms than some of the other utilities)
  - Some high-level, industry specific obligations

# What it sort of means now: the BIS Principles

- BIS Principles for Economic Regulation
  - Acceptance that politicians are going to want to have their say about how regulation works and what it is trying to achieve
    - Explicit that governments will want particular outcomes from regulators and that those desired outcomes will change, not least with a change of government
  - Recognition that effectiveness of a regulator (especially re investment) depends on regulator being perceived as independent of government, at least in a day-to-day sense
  - Recommendation of Strategy and Policy Statements (with same principle applying to the CMA's Strategic Steer) to reconcile these two objectives
- Independence in effect re-defined in terms of
  - **frequency** with which the government's brief to a regulator is changed (not normally more than once per parliament)
  - **transparency** of that brief – implication that more informal, covert instruction/pressure is more damaging to the perception of independence

# In practice

- Strategy and Policy Statement in water
- Strategic Steer for the CMA
- ORR 'package'
  - Railways Act 2005 High Level Output Specification
  - Statement of Funds Available
  - Revised Statutory Guidance
- Ofgem
  - BEIS have given up on Strategy and Policy Statements
  - Ofgem currently using the SoS's 'Four Principles' in lieu

# Energy as case study in the shrinkage of regulatory independence

- BEIS (with 'Electricity Market Reform') took full control of funding of lower carbon generation via long-term contracts (CfDs) with a government entity, thus shrinking the **scope** of Ofgem's mandate
- Ofgem now implements retail price caps, legislated by government (against Ofgem's wishes)
- Ofgem's only area of more or less being left to get on with it: setting price controls for networks

# Why did it happen?

- Post-privatisation, Offer/Ofgas/Ofgem effectively charged with controlling network prices and promoting competition in wholesale and retail markets (the sort of simple brief advocated by the House of Lords Select Committee on Economic Regulators in 2007)
- From the mid noughties, rising (internationally driven) wholesale energy prices made retail energy prices more politically salient
  - Government increasingly unwilling to leave these prices to the market
- Again from the mid-noughties, climate change policy required electricity consumers to subsidise relatively expensive low-carbon generation
  - Government focused on **volume** of low-carbon generation, not the **economics**
  - Clash with Ofgem's interpretation of its primary duty to consumers (until that duty refined by successive changes in the Energy Act)
- Ofgem (run largely by market-oriented economists) viscerally opposed to government policy – making a reduction in regulatory independence inevitable
  - Albeit that changes have mainly been achieved in a fairly transparent way (after informal pressure failed) – arguably, an improvement on how government influence on utilities worked in the nationalised era

# Why independence more of an issue in energy than in, for example, telecoms?

## Energy

- Relatively large part of consumer expenditure
- Prices rising over a number of years
- Government policy to decarbonise electricity and to make (not obviously willing) consumers pay for this
- Conflict between government policy and regulator's obligation to protect consumers (as that would commonly be understood)

## Telecoms

- Smaller part of consumer expenditure
- Prices falling over a number of years
- Urban consumers willing to pay for faster broadband
- Government largely funding rural broadband from taxation, rather than from consumers
- No conflict between government policy and regulatory obligation to protect consumers

# In sum, where are we now? (1)

- Some sectors, like telecoms, where regulatory and government agendas sort of aligned and regulator seems to be broadly left to get on with it
  - Although the rollout-out of fibre optic cable has analogies (emphasis on volume, rather than economics) with the expansion of low-carbon generation

# Where are we now? (2)

- Broadly not inconsistent with the BIS Principles
- Most regulators have relatively transparent guidance on how they interpret their statutory obligations
  - S&P Statement in water
  - DfT package of guidance to ORR
  - Strategic Steer for the CMA
  - (Probably the least helpful) the Four Principles in energy

# Where we may be going (in a privatised world)

- Politics is not going to go away
  - The 1990's (and a bit thereafter) was an unusual period in terms of politicians' willingness to be reasonably hands-off in the utility space
  - We are now 'back to normal' in terms of the politics of utilities
- Probably, best than can be hoped for is
  - Degree of transparency in the Principal – Agent relationship between government and regulators
  - Government intervention being at discrete intervals

# In a renationalised world?

- Could be a continuing role for ‘independent’ regulators, as with
  - Water in Scotland (where WICS’s effectiveness may have been, in part at least, due to the availability of privatised England and Wales benchmarks)
  - Rail
- Labour plans for the water industry would, however, seem to point back to a world of multi-stakeholders Boards as the Government’s agents
  - Possibly with a more explicit brief on the ‘public interest’ than was the case with the 1940’s nationalisations