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George Osborne recently stated "… the UK system of independent economic regulation is widely regarded as one of the best in the world." Oh really?

The Indepen Forum brought together regulators, companies and investors to discuss the state of independent economic regulation in the UK. The debate was chaired by David Gray, chairman of Ofgem, with Andrew Haines, chief executive of the Civil Aviation Authority and James Wardlaw, partner at Campbell Luytens contributing as speakers. George Osborne, until recently Chancellor of the Exchequer, stated in the budget earlier this that "the UK system of independent economic regulation is widely regarded as one of the best in the world." The Forum considered if this was so and discussed some of the challenges faced by regulation in the UK.

Managing political and regulatory risk

Independent economic regulation continues to play a critical role in infrastructure sectors. Sector economic regulators reach into many corners of the British economy, with the UK Regulators Network (UKRN) having 13 members, including the big five (Ofcom, Ofgem, Ofwat, CAA, ORR). However, some sentiment suggests that the reputation of the UK regime in the eyes of investors is not what it was.

Deloitte's Infrastructure Investors Survey[1] in March 2016 concluded that the UK ranked alongside Iberia and Italy in terms of regulatory risk and had significantly higher risk than Benelux, France and Germany. The reasons adduced were the lack of stability and consistency in the regulatory regimes. The survey found that infrastructure investors see regulatory and political risk as linked, with regulators becoming more influenced by the political landscape and politicians seeking to influence regulators to achieve political goals.

This is an important issue since a major benefit claimed for independent regulation is that the lower the investor perception of regulatory risk, the lower cost of capital that investors will require. The panel's view was that the survey was really drawing out a message about political risk. Government intervention is a feature of regulated markets and there have

[1] https://www2.deloitte.com/uk/en/pages/infrastructure-and-capital-projects/articles/infrastructure-investors-survey.html
Deloitte's survey reported that 20% or more of respondents cited Iberia, Italy and UK as European regions of greatest regulatory risk. Less than 5% of respondents cited Benelux, France or Germany.

been significant examples of it in recent years, such as in Spanish solar and Norwegian gas transportation tariffs.

The speakers recognized that investors may not care about the distinction. A regulatory settlement will minimise the cost of capital only if investors believe it is safe from regulatory and political risk. It is ultimately in the interest of investors and customers that regulatory decisions are reasonable and defensible to stakeholders, and protected from the negative consequences of political intervention.

One speaker thought a more accurate investor view of risk would put the UK (even after Brexit), Germany, Australia, Canada, the U.S. and the Nordic Region in a similar risk category, where rates of return are broadly equivalent, with everywhere else in a higher risk category.

Changing institutional landscape

Participants commented that government and regulators have not always helped investors to understand the different types of risk that they manage by articulating their different roles. The changing institutional arrangements that have come with devolution (and perhaps now Brexit), and the creation of new institutions, such as the National Infrastructure Commission, make it challenging to maintain role clarity. One participant noted that the level of knowledge, experience and understanding in Whitehall of independent economic regulation had been "hollowed out", so that few people at the centre of government now really understand what 25 years of experience of regulated industries had taught us.

The distinctions are not easy to explain and political intervention in aspects of policymaking and regulation is legitimate, for example in transport decisions, where taxpayers' money is involved, or where there are wider public policy implications, such as, for example, acceptable noise levels in relation to airport expansion.

Innovation in economic regulation

The Forum noted that if UK regulators want to maintain or improve their reputation, it would help if they were quicker to adapt to new circumstances, to collaborate across sectors and be more transparent about their interactions with government. Even simple measures like sticking to consultation and decision publication dates would increase confidence.

Other participants had a different perspective and said that despite the critiques, they agreed that UK regulation was seen as the gold standard by investors. Given the market valuations of companies such as National Grid, this could be a cause for concern rather than for celebration. The premia in some utility share prices indicates the failure of regulation to hold them to account. It is possible for a tough regulator to be respected by investors and by customer groups provided it is understood that successful regulation is not always delivering the lowest price for customers now.

Protecting the benefits

The theme of promoting transparency between regulators and government was explored by the CMA in its energy investigation where it noted that

> "… two of Ofgem's most important decisions in recent years...were taken against a backdrop of DECC taking powers – or stating its readiness to take powers – to implement changes in primary legislation in the event that Ofgem did not act, and that the coincidence of DECC and Ofgem's actions risked creating the perception of a lack of independence on the part of Ofgem".

The CMA went on to say

> "… we therefore believe it is essential to improve the clarity of both the overarching policy objectives for the regulatory framework and to ensure that all stakeholders are given clear direction as to the implementation of these policy objectives. We believe that policy objectives should be clearly stated by DECC (following consultation with Ofgem and the industry). In turn, mechanisms should be in place in order to ensure that these objectives are reflected in the decision-making processes, and that their achievement is regularly assessed."

The Forum supported these sentiments.