Fondation Paris-Dauphine

governance & regulation

DAUPHINE UNIVERSITÉ PARIS

# Regulation & Competitiveness

Conference report

**Inaugural conference of the Club of Regulators**

*Université Paris-Dauphine, 26 September 2014*

CLUB

# Regulation & Competitiveness

## Inaugural conference of the Club of Regulators
## 26 September 2014

## 1st session: Industrial competitiveness and regulation

### Economic regulation in the US

***Howard Shelanski***
***Administrator of the Office of Information and Regulatory Affairs, White House***

The US has no overarching regulatory organisation. US regulators and regulatory agencies receive guidance from courts, the White House and Congress but are generally very independent. Meetings to share best practice and exchange experience are rare.

The Office of Information and Regulatory Affairs (OIRA) reviews economically significant, politically important and legally challenging regulations to ensure that they meet certain standards and justify their social and economic costs. This provides some degree of consistency on methods, standards and objectives.

However, agencies under the control of Congress, including financial and banking, telecommunications, energy generation and distribution regulators, are not subject to OIRA review. As a result, progress and best practice adoption has been uneven across regulatory institutions in the US, although efforts are underway to improve this situation. Cooperative agreements with Mexico and Canada are highlighting the benefits of cooperation.

Economic regulation has changed fundamentally over the last twenty-five years. Initially, it focused on controlling monopolistic power. However, technological, business and market develowpments have challenged the dominance of these monopolies and pushed regulators to regulate for competition rather than against monopolies, and to focus on expanding access to markets rather than delivering direct benefits to consumers. The theory is that market price regulation will follow once competition has been established. There is ongoing debate about the need for regulation and the point at which regulators can become guardians of fair play, rather than guardians of fair pricing.

Competition helps to discipline markets and can restraint monopoly pricing, but it is extremely difficult to regulate to achieve competition, particularly when it concerns access to existing monopolistic infrastructure. Pricing must be low enough to facilitate access for new entrants but high enough to stimulate innovation and investment.

Effective regulation requires the identification of durable monopolies and feasible competition and the implementation of regulatory mechanisms that support the desired outcomes. The US, for example, tends to prefer under-regulation to over-regulation, resulting in a telecoms market that is noticeably different from the French market. It is not yet clear which approach will deliver the best services and prices in the future.

It is important that regulators recognise when to act and when to stay out of the market. It can be difficult to judge when competition is sufficient and durable, but regulators should be careful not to step away too quickly, before new entrants are sufficiently well established to resist market pressures and a return to dominance of the incumbent.

Finally, regulators must be careful to preserve the option value of innovation and ensure that their regulations do not inadvertently embed market power and monopoly. Economic thinking can provide significant benefits in non-economic areas.

## The UK Regulators' Network: Cross-sectoral cooperation and the use of regulatory and competition powers in the UK

***Richard Price***
***Chief Executive, Office of Rail Regulation***
***Chairman, UK Regulators' Network***

The UK has great expectations about the potential of infrastructure to promote efficiency and economic growth, backed by a substantial programme of government and private investment in network capacity. Economic regulation and competition will play a significant role in ensuring that investments are efficient and reconcile the needs of consumers and investors. Independent economic regulation plays an important role in maximising competitiveness.

Economic regulation in the UK has provided investors with confidence, protected taxpayers, and improved the quality of services delivered to consumers in all regulated markets. Nevertheless, enhanced ex post evaluation would facilitate the identification of best practices and areas for improvement. The UK model is recognised as a positive model for reconciling the interests of consumers and investors while preserving dynamic incentives to efficiency.

Although it was expected that regulation would gradually be replaced by competition, this has not occurred in all markets and many regulated sectors continue to have relatively little competition. This is due to a number of factors, including challenges achieving vertical separation, public and political dissatisfaction with some liberalisation outcomes, weakened incentives, political interference, structural issues, and the need to balance intrusive regulatory and competition powers. In addition, regulators have multiple objectives that can compromise their political independence or distract them from their central role. Regulators must maintain their identity as independent statutory bodies with clear duties to improve the lot of consumers and business users. Compared to competition powers, regulation can provide surer and quicker benefits for consumers.

The role of government varies widely depending on a given sector's importance to economic growth, policy objectives, levels of public investment, and individual stances on structural issues. The regulatory and competitive approach adopted reflects these factors, as well as differences between sectors in market structure, technology and policy framework.

Economic regulation has had a positive impact on cost, choice and quality of services for consumers while providing a stable and predictable environment for investors. Although other factors have created upward pressures on prices and there are concerns that a slight decline in UK infrastructure quality is having a negative impact on UK GDP growth, the UK government is committed to maintaining an attractive investment environment and delivering significant projects with benefits for consumers and the wider economy. Economic regulation is an important component in these plans.

The UKRN works on areas of common interest and engages with consumers, business groups, government and academics. It does not directly involve the competition authorities to avoid potential conflicts of interest. Collaboration offers a number of potential benefits, including shared expertise and an improved understanding of tactics used successful in other sectors. Some regulatory challenges cut across the sectors, creating opportunities to benefit from economies of scale and deliver a more efficient use of regulatory capacity. The UKRN is committed to delivering shared objectives, facilitating multi-sector investment, promoting consumer engagement and switching, assessing cross-sector resilience and cyber-security and developing a clear understanding of the overall affordability of regulated sectors. It also provides a single point of contact to ensure that issues are addressed centrally when appropriate and facilitate good working practices between regulators and government. The UKRN does not compromise the independence of its individual members or their functions and duties and accountability, but does provide opportunities to evaluate and build best practice, leverage experience to deliver better services, and enable economic regulators to best meet the challenges of substantial renewal in national infrastructure.

## BNetzA as an independent multi-sector NRA

***Dr. Annegret Groebel***
***General Director for International Affairs, Bundesnetzagentur***

The Bundesnetzagentur (BNetzA) is a multi-sector regulator that leverages professional expertise in economic, legal and technical matters to deliver on objectives laid down by the law within the context of the political agenda. The regulator is independent and cannot be overruled by any ministry or government, and is also accountable, with all decisions subject to legal review. The regulatory framework is designed to be predictable and adopts a long-term view.

BNetzA uses its regulatory instruments to promote competition, provide benefits for consumers and business users, and incentivise efficient investment. It works to deliver competitiveness by creating market conditions that encourage individual operators to become more competitive, and by improving networks in ways that should have positive knock-on effects on productivity and the wider economy. BNetzA aims to develop a competitive environment that will, ultimately, enable the market to operate as an independent, rational economic entity, free from regulation. As such, the regulator does not 'correct' prices for political reasons and seeks to minimise interference once the system is operational. The regulator must be independent, accountable, and have effective governance rules.

Network modernisation is a common challenge faced by all industry regulators, notably in energy, telecoms and transport. During the liberalisation process, economic regulation implemented sector-specific obligations, such as third-party access based on regulated cost-oriented wholesale pricing, to ensure that new entrants had an opportunity to establish themselves and promote effective competition.

In addition, a number of standard mechanisms were applied across all sectors. Sharing expertise in these common areas can generate regulatory synergies and enhance the ability to assess the cost base, regulated asset base and the cost of capital in different sectors. This supports a key regulatory function, namely the ability to make informed judgements about reasonable mechanisms. These decisions, once taken, must be enforced as delays will always act in favour of the incumbent.

From its origins as the telecoms and post regulator, BNetzA now encompasses energy, railways, energy and gas development and grid expansion planning and permits. BNetzA leverages common principles and experience in these sectors to deliver regulatory consistency, operational synergies, reduced administrative costs, and support for cross-network convergence, for example in the creation of smart grids and responses to cyber-security issues.

# 2nd session

## The OECD Network of Economic Regulators

***Faisal Naru***
***Senior Economic Advisor, Regulatory Policy Division, Public Governance and Territorial Development Directorate, OECD***

The OECD established the Network of Economic Regulators (NER) to support regulators after the financial crisis, which resulted in part from regulatory failures. There are an increasing number of often contradictory demands on regulators, as well as a number of cross-sectoral issues that affect all regulators. The NER brings together more than 70 regulators from OECD and non-OECD countries to share experiences, undertake analyses and provide guidance.

A key outcome of the NER is the development of the OECD's Best Practice Principles on the Governance of Regulators, which highlights seven practical principles that should underpin effective regulation. These principles are already being used to review and reconstruct existing national regulatory structures.

The NER also considers regulatory performance, specifically the capacity of regulators to add value, affect markets, and demonstrate their utility. The Performance Assessment Framework for Economic Regulators (PAFER) has been developed to assess the mechanisms used to evaluate regulators. Upcoming events hosted by the NER will examine these issues, as well as questions of regulatory behaviour, independence and behavioural economics. All members of the Club of Regulators are welcome to attend and participate.

***How does the OECD define 'independence'?***

**Faisal Naru:** The OECD does not use a simple definition because independence is affected by various aspects of functioning, especially the independence of political decision-making vis-à-vis economic decision-making. It is possible for a regulator to be part of a ministry but retain significant independence so, rather than using a simple test, the OECD considers various components including the principles of decision-making, de-politicisation of economic regulation and decisions, and the composition of the leadership board.

***Could you describe how multi-sector regulation can promote collaboration, for example with reference to smart grids?***

**Annegret Groebel**: The creation of a smart grid can be incentivised through cost regulation and facilitated through access to information. For example, the regulator can provide a financial incentive by temporarily allowing costs to be included in the regulatory asset base until they are amortised or generating profits, or it can reduce investment costs by increasing access to existing infrastructure, or it can impose symmetric obligations to ensure that both costs and access are distributed equitably. For example, BNetzA has mapped passive infrastructure capacity and shares that information with operators, enabling them to reduce costs and increase efficiency by using existing ducts for new fibre. This approach also has a competitive effect by increasing the number of actors on the market and increasing sustainable infrastructure competition. It is easier for a multi-sector regulator to access this kind of information and provide this kind of service.

***What steps should the Club of Regulators take to ensure its success?***

**Richard Price**: First, take advantage of being together to share best practice. Second, make sure that investors and government understand the system of economic regulation and that active interference does not always speed progress. Third, leverage shared experiences to better represent and protect the interests of consumers.

**Howard Shelanski**: Sustain this effort. For example, adopting a resolution or bylaw that requires that every agency reports on the Club's progress in its annual report will ensure that all parties continue to participate. This is essential for ongoing progress.

**Faisal Naru**: Identify key issues of mutual interest and identify outcomes that you can work towards. This will sustain interest and can be used to demonstrate that the Club adds value.

**Annegret Groebel**: Keep other informed. Sharing information helps to ensure regulatory consistency between sectors or justify differences between them, which can be useful in the context of legal challenges. Finding a way to rotate people between sectors can also be useful in terms of sharing experience, improving decision making and safeguarding against regulatory capture.

***When considering costs and benefits, how important is it to take account of the size of the market? How can the fixed costs of regulation be offset for small markets?***

**Howard Shelanski:** We do not insist that quantifiable benefits offset quantifiable costs as costs are usually easier to quantify and it is not a precise science. Exceptions or longer compliance periods can be used to reduce the impact of regulation on small markets or small firms.

**Eric Brousseau** : Our thanks are due to the audience, the speakers and the sponsors of this session. The members of the Club will now sign the convention.

*Chaire Gouvernance et Régulation*
*Fondation Paris-Dauphine*
*Place du Maréchal de Lattre de Tassigny - 75116 Paris (France)*
*http://chairgovreg.fondation-dauphine.fr*