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# *Institutional Change in UK Regulation*

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# Outline

- Institutions – the big picture
- Core objectives of economic regulation
- Sectoral issues
- UK regulatory strengths and weaknesses
- Lessons from Telecoms
- Lessons from Negotiated Settlements
- Lessons from Consumer Advocacy

# Institutions (Rodrik, 2008)

- Institutional arrangements should:
- Provide Security of Property Rights
- Ensure enforceability of Contracts
- Stimulate Entrepreneurship
- Foster integration into world economy
- Maintain macroeconomic stability
- Manage risk-taking by financial intermediaries
- Supply social insurance and safety nets
- Enhance voice and accountability

# Institutions

- Relevant implications of Rodrik list:
- Property right and contract protection core
- Strong bias towards entrepreneurship
- Investment arrangements have macro impact
- Systemic risks need to be ‘regulated’
- Voice and accountability good in themselves

# Optimal Institutional Arrangements (Rodrik, 2004)

- *History matters* but is not decisive.
- *Proximity (of distance and culture) matters* but in ways that are poorly understood.
- *Luck and human agency* important in successful reform.
- Institutional quality difficult to define but ***substance triumphs over form*** (e.g. property rights protection in China vs Russia).
- Optimal arrangements may involve ***partial (rather than full) implementation of ideas*** from elsewhere (e.g. special economic zones in Mauritius).
- ***Change stimulated by individual reforms*** but sustained by clear end point of consistently high quality arrangements.

# Optimal Institutional Arrangements

- Relevant implications:
- Good to build on positive history
- Good to draw ideas from ‘neighbours’
- Good to experiment
- Need to understand core idea in changes
- Optimal (second best) arrangements may be messy
- Appropriate ‘Ideal’ model endpoint very helpful

# Relevant starting points for UK regulated industries

- Number of firms
- Market structure
- Role of Competition Authority
- Potential for competition and contracting
- Regulatory history, experience and technical skills
- Scope for technological progress
- External pressures, e.g. on environment

# Learning from elsewhere

- Need to take starting points in UK and other sector/country into account
- Legal arrangements in other jurisdiction important (policy may be second best in UK even if best somewhere else)
- Bias towards experimentation (to encourage entrepreneurship and ‘discovery’)
- Experiments can be in limited areas (e.g. auctions for offshore transmission)
- Need to test change against path to ‘ideal’ endpoint (e.g. may put off competitive market)

# Strengths of UK regulatory system

- Strong protection of property rights and contracts (with occasional lapses).
- Strong regulatory powers (mostly).
- Willingness to experiment.
- Bias towards competition, entrepreneurship and market incentives and mechanisms.
- Lots of transferability of ideas between UK regulators.
- Good experience of 'big bang' *and* incremental changes.
- Generally good performance since 1984.

# Weaknesses of UK regulatory system

- Tendency to be unwilling to learn from overseas.
- Lack of transferability of UK system *to* other countries.
- Increasing complexity over time.
- Narrow view of competitive ideal as private for profit activity with lots of churn.
- Tendency to keep doing things past sell-by date.
- Politically vulnerable to new initiatives (not all bad).

# New ideas: Telecoms

- Core questions:
  - ‘End of Regulation’ vs ‘Regulation forever’
  - Regulation for innovative investment
- Core lessons (Hausman and Sidak, 2007; Pollitt, 2009):
  - Competition and consumer choice important
  - Strategic withdrawal of regulation possible
- Transferability:
  - Limitations: consumer role and rate of innovation
  - Facilitation: climate change concern

# New ideas: Negotiated Settlements

- Core questions:
  - Is creation of buy side for network services possible?
  - What facilitates sensible/timely negotiation?
- Core Lessons (e.g. Doucet and Littlechild, 2006, Littlechild et al., 2008):
  - Appropriate forum necessary
  - Strong regulatory threat and decisions on key issues
- Transferability:
  - Clear in electricity and gas transmission
  - Market structure changes likely to be necessary in distribution

# New ideas: Consumer Advocate

- Core questions:
  - Is there a cheaper way to negotiate price plans?
  - Is a dedicated office the best way to deal with consumers?
- Core Lessons (e.g. Littlechild, 2007):
  - Democratic accountability is a powerful enforcer
  - Costs of regulation can be reduced
- Transferability:
  - Works well in US legal system
  - Could a modified system be implemented in UK via Consumer Focus or Ombudsman system?
  - Would a transfer of powers weaken regulatory agencies?

# Conclusions

- Should be open to regulatory innovations that enhance:
  - Property right and contract protection (broadly!)
  - Entrepreneurship
  - Macroeconomic stability
  - Management of systemic risks
  - Voice and accountability
- The UK has a good record of institutional innovation in this area (and in general).
- The regulatory system for utilities is facing new challenges which demand new thinking.

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