Regulatory independence - revisited

Brian Williamson[1], March 2017

Leo Tolstoy's book Anna Karenina begins:

> "Happy families are all alike; every unhappy family is unhappy in its own way."

To be happy, a family must be successful on each of several fronts, and failure on any one leads to unhappiness. The relationship between independent regulation and government looks increasingly unhappy, for a range of reasons.

Almost everywhere, government expectations of what network infrastructure should be widely available have run ahead of what a competitive market, and an independent regulator, are able to deliver.

In the UK, an amendment to the Digital Economy Bill in the House of Lords introduced on 21 March 2017 would allow the government to issue a strategic policy statement to Ofcom.[2] The water industry regulator Ofwat is already subject to a strategic policy statement – with a new draft statement focussing on long-term service resilience and distributional issues in relation to affordability.[3]

Independent regulation is under challenge, and it is time we talked about it. So, why is independence under challenge now, what is the point of independence anyway and what should be done?

Turning back the clock, we got to independent regulation, competition and partial or full privatisation in telecoms because state monopoly provision did not always work well. The State underinvested, and incentives were weak. It was not uncommon to wait years for a telephone, and broadband too might have been delayed had we not reformed the market.

Given that investment in infrastructure is long-term, and once made is sunk, investors will price in the risk of political intervention. This provides a rationale for independence, as the UK government put it in 2011:[4]

> "A solution to this time inconsistency problem is to design regulatory frameworks that prevent unexpected changes to the rules of the game, thus offering a credible commitment to investors. In the UK the statutory framework of independent economic regulation encapsulates a commitment by the UK Government not to intervene other than in clearly specified ways."

There are parallels here with the rationale for wanting an independent central bank – to

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[2] UK Parliament, Digital Economy Bill 2016-17 – revision in relation to strategic priorities and provision of information. March 2017.
[3] DEFRA, New Strategic Policy Statement to Ofwat - draft for consultation, March 2017.
[4] BEIS, Principles of Economic Regulation, April 2011.

overcome the time inconsistency problem politicians faced in relation to inflation. But there may be lessons too, since independent central banks have operational independence to deliver an inflation target, but have a clear institutional relationship with government who sets the target. A difference, though, is that a central bank has a single measurable target.

As competition was introduced in telecoms, and inefficiencies were removed, politicians were content to leave independent regulators alone to do their job. Substantial benefits also flowed from commercial investment in fixed and mobile network upgrades. Regulation was a happy family.

But we are seeing signs of frustration with what competition and independent regulation can deliver, set against aspirations in terms of the pace and extent of broadband delivery, and the assumed linkage between ever faster broadband and productivity and income growth.

Australia illustrates one of the ways a family can become unhappy. There was a fixation on poor relative broadband outcomes measured against the OECD league table, and frustration with lack of competition and investment, and the failure of regulation to address these concerns. The issue became politicised, with the incoming Labour government committing to fibre in 2007. Competition and a market driven approach to investment was the first casualty. By almost any measure the outcome was a failure, and Australia changed tack in 2016 with the focus now predominantly on upgrading copper.

In New Zealand, the government, fearing the regulator was not supportive of its fibre plans, set fibre prices directly leaving copper price controls as – or so it was thought – a separate matter for the regulator, the Commerce Commission. The regulator proposed a substantial copper price reduction in 2012, destabilising prospects for fibre investment, a consideration the regulator viewed as outside their scope.

The reaction was swift, with the Prime Minister John Key indicating that the Government: [5]

> "…would change the law rather than see its ultra-fast broadband network compromised by a Commerce Commission decision."

As Bronwyn Howell (2013) commented:[6]

> "It appears that the government's "grand strategy" for a fibre network was implemented as if it was a stand-alone project independent of any need to co-ordinate the integration of either the network or the requisite regulatory framework governing it into the existing industry. Meanwhile, the custodians of the regulatory framework governing the pre-fibre industry appear to have failed to appreciate the revolutionary effect of the government's strategy on their sector."

Copper prices were eventually partially restored, and fibre investment has been more successful than in Australia (fibre investment in New Zealand is proceeding in partnership with the private sector based on competitive tenders, and the elimination of infrastructure competition has not been pursued as it was in Australia). After a lengthy consultation,[7] the government is planning to return responsibility for fibre regulation to the regulator, but with the approach heavily prescribed, at least by European standards.

Given the political focus on broadband outcomes, and growing aspirations and interest

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[5] Radio NZ, *PM not ruling out legislation over broadband*, December 2012.

[6] Bronwyn Howell, *Broadband Regulation and Government Investment in Nationwide UltraFast Fibre Broadband Networks: evidence from New Zealand*, September 2013.

[7] MBIE, *Review of the Telecommunications Act 2001*, 2017.

in “ambitious” targets, there is a risk that the regulatory-government family in Europe becomes increasingly unhappy. Each in its own way, or perhaps, given the desire for a digital single market – all in the same way.

So, what should be done?

First, it is time we started talking about independence. Regulators jealously guard it, but may, along with governments, have forgotten what it is for. History should provide a sharp reminder of what could be lost if we abandon independent regulation and reliance on a market-driven approach.

Second, we need a grown-up conversation about the limits to independence. Governments have a legitimate interest in outcomes.

Third, we need a hard-headed examination of the evidence rather than a simple-minded desire to beat some league table. What are the priorities for investment, are there sound reasons for thinking a competitive market will not deliver them; and if so what package of policies is likely to be effective?

We should not abandon independence, but we should perhaps revisit it.