Regulation and the British Economy

1. Introduction

It is all too seductive to embrace a simple binary logic about the value and impact of regulation on markets and on consumers. Slow witted bureaucrats on the one hand thwarting dynamic entrepreneurs on the other. With the result that opportunities are missed. Innovation is deferred, cancelled or brought to market elsewhere.

That is a crude caricature of the debate - but it's not unrecognisable.

Where do consumers stand? Do they care?

Most UK consumer organisations - including the likes of Consumer Focus and Which? - are committed to the view that effective competition is the best way to guarantee good value and service for consumers. The hot breath of a competitor on your neck is a more effective discipline for markets than the regulators clipboard and tick box.

That was my view while I was Chair of the National Consumer Council and as a Minister for the department promoting Business and Innovation. But while that is the first principle for a free and dynamic market, it would require a heroic suspension of disbelief on my part to hold that sufficient levels of competition apply across the economy. As a former consumer champion I competition is a means to an end. Those ends are good value, responsive services which treat consumer fairly and provide sufficient margins for companies to invest, innovate and improve.

My interest in this debate is not whether or not regulation is a good thing or a bad thing, but where regulation is needed and what consumers need from it.

A short but instructive detour

We have a useful way into this debate happening now. Government is currently changing what is called the 'landscape' of consumer representation and advocacy. You may well know about the plans to merge the OFT and the Competition Commission to speed up mergers and competition cases and to devolve down aspects of the enforcement regime to local trading standards offices working in a more coordinated function.

Less well known are the changes that are happening to consumer advocacy.

In 2008 the National Consumer Council merged with two other consumer bodies called energywatch and postwatch, to form Consumer Focus. The purpose was to bring general expertise in consumer representation and consumer rights together with some deeper experience of specific markets - in this case energy and postal services. From April this year, Consumer Focus will disappear and be replaced by a new body, as yet without a name, but which is being referred to as a regulated industries unit.

The institutional arrangements and the name are not important. What is important here is the focus of the new body, because it helps to answer the questions when do consumers need the protection of active regulation and how should regulators provide that protection.

2. Where do we need active regulation of markets

This is not about general provisions for fair trading, product safety or inspection regimes. The consumer interest is important across the economy. But where it needs **active regulation** to promote and protect it is in relation to large complex markets for essential services.

These markets are characterised by imperfect competition, dominant market participants, competing public policy agendas and significant upstream or structural elements which can determine the experience of consumers in retail markets. They also tend to be markets which are essential for health/well being or participation in the wider economy/society and where there are particular consequences for vulnerable consumers.

This is not to argue for more regulators but to remind ourselves why consumers need effective regulation in certain parts of the economy. I am talking primarily about markets like energy and water supply, public transport, telephony, broadband, postal services and some financial services. And arguably not markets like grocery where there is plenty of choice, where there are options at both the high and lower end of the market and where there is point of sale clarity about what you are buying and for what price.

It just takes the most cursory glance at the newspaper to see how some of these markets and how they are regarded by consumers and policy makers.

<u>Energy</u>

The energy regulator has accused companies of 'bamboozling consumers' - *'energy companies have failed to play it straight with consumers'* Alistair Buchanan, Ofgem.

It is hard to ignore the question of whether retail prices have risen by more than the increase in wholesale costs; this in turn raises issues about the small number of major suppliers (0.5% of market share), the lack of transparency of accounts and the vertically integrated structure of the market.

<u>Rail</u>

The rail regulator wants a significant change in efficiency and value for money, because growth in the sector has 'come at a high cost to passengers and taxpayers - with industry costs up to 30% higher than other European railways ... The industry needs to deliver a step change in efficiency and provide better value for money.' Office of Rail Regulator.

<u>Civil Aviation</u>

In air travel, the Competition Commission has found 'adverse effects on competition' in the airports markets, particularly in south east England and lowland Scotland but also northeast Scotland. The Civil Aviation Authority regulates prices for three airports because...*'competition is not sufficiently developed in the provision of airport services to prevent them from* ***exploiting their market power.'***

<u>Financial Services</u>

The financial services ombudsman is growing at an astonishing rate. Almost every day I hear how consumer groups are concerned about a lack of meaningful competition, perceived lack of differentiation, difficulties in switching all of which allow businesses to escape the consequences of service under-performance, lack of innovation and poor reputation.

'the banking industry has had a high degree of rivalry, but not enough competition effectively to deliver good products and services to clients. Rather firms have taken advantage of market failures such as information asymmetry.' David Davies MP - Which? Banking Commission

'on the supply side, core markets are concentrated - the largest four banks accounts for 77% of personal current accounts and 85% of SME current accounts. On the demand side, competition between banks on current accounts is muted by difficulties of switching between providers and by lack of transparency about banking services on offer. In short consumers are often not well placed to make informed choices between effectively competing suppliers of banking services.' Independent Commission on Banking

Now I support effective competition as the greater motive force for a strong economy and for consumer welfare. But I am also a realist about the extent to which consumer benefit from effective competition and where they do not. But this is not an endorsement of our current crop of regulators or the way that regulation happens.

3. *Smart Regulation - when it is needed*

The instinct of consumer advocates is - or at least should be - against knee-jerk calls for regulation.

For three reasons.

The first is that consumers foot the bill. Even if policy makers continue to fall for the line that unnecessary regulation is 'a cost for business', that means consumers in the last analysis.

The second is that incumbents often use regulation to restrict or prevent competition. Business leaders, dare I say, often talk tough about regulation, but too many companies - and indeed entire sectors - are willing to embrace and even lobby for rules and restrictions when they think it will further their own position.

Thirdly, regulation can have a deadening effect, inhibiting business creativity and innovation.

Just as we should recognise that there is effective competition and less effective competition, the same applies to regulation. It is critically important for consumers that where regulation is introduced, it is focused on consumers and delivers outcomes in an effective way.

The worst word in regulation is 'non-compliance'; the second worst is 'compliance'. The latter suggests companies doing what they're told but no more, with more than a hint that left to their own devices they'd immediately revert to inappropriate behaviour.

The best regulation is about sustained culture change, where it is needed, getting regulated businesses to internalise the objective of regulation and start to behave differently because they have accepted this is the right thing to do and have embedded it across the organisation.

Often, regulation is needed when market cannot or will not effect that change themselves. But a compliance culture doesn't seem to be delivering the right outcomes - and it is a recipe for endless skirmishes between the regulator and regulated business, as the company tries to test the boundaries of regulation and the regulator tries to anticipate this and plug any gaps.

4. Empowered consumers

It is line one, paragraph one, of many business textbooks that informed consumers, who are able to make choices, can discipline markets, reward the best and punish the poor. Part of the solution to making markets work better must lie with enabling consumers to hold businesses to account. To promote what is being called 'reputational regulation' where companies need to respond very quickly to what their customers think and say about them. Communications technologies have given the majority of consumers' unparalleled power in many markets.

The development of the internet means that consumers are able to access many suppliers, to seek out the best deals and to transact quickly and away from any sales pressure or marketing information. People in the UK now post over 100 million comments every year, sharing their experiences about services and firms and benefiting from the experience of others. Harnessing the increasing role of new technologies, enabling consumes to make fuller use of their own consumption and transaction data and developing new ways for different consumers to collaborate across the economy can be a smarter way than formal regulation to make markets work better.

But, while consumers - individually and collectively - may have grown stronger, being a consumer is harder work than ever. There are three key themes that have come to characterise most markets :

Greater choice and greater complexity

This is a more complex world for consumers, with many more decisions to be made and the constant threat of information overload. It is estimated that US consumers now receive an average of 34 gigabytes of information every day. The number of energy tariffs has risen by 70% since 2008.

Being a consumer takes more time and effort

The average person spends three hours and 12 minutes every week on seeking out consumer information and raising complaints. It takes almost an hour to read a typical consumer credit agreement. 29% of Britons say they carefully read all of the last service contract they signed. When asked why they didn't read all of it 64% said it was just too long.

High expectations of consumers' willingness and ability to engage

Business says that consumers have ever greater expectations on value and service. But there are increased expectations placed on consumers as well. Regulators expect consumers to scan markets actively and switch to better deals. Government expects people who have previously been passive users - from GP patients to students - to become more assertive.

Consumer groups are seeing worrying signs of consumer fatigue and a more resigned attitude to markets that seem unresponsive to their needs

5. Priorities for regulated sectors

Decision-making power is being put in the hands of many people, individually and increasingly collectively, and ever more consumers are exchanging experiences and learning from one another. The changing nature of markets and technology has brought issues associated with complexity and attention management. Alongside this, some of the biggest decisions affecting consumers - eg investment in energy networks - are taken at a distance by others, with little or no input from the people they most affect.

I want to share the three priorities that Consumer Focus identified for businesses, regulators and policy makers in essential markets.

Embrace simplicity

Consumers have more choices to consider, more options to review, more information to analyse and more decisions to make than ever before. The best businesses help cut through this – but many still make consumers' lives tougher not easier, through cumbersome and disjoined systems, a failure to recognise consumers' diversity and treat people as individuals, impenetrable communication and deliberately complicated design of products and services. Regulators sometimes make this worse still, by expecting consumers to shoulder a heavy burden in making markets work.

This must change. Being a consumer is not and should not be a full-time occupation, and business success should not be about stretching consumer capabilities to breaking-point.

I think we need more businesses showing greater responsibility by trading on the quality and price of their products and services, not by bamboozling consumers, regulatory approaches that seek to reduce complexity for consumers rather than add to it and a vibrant market in simplification, building on the success of approaches such as price comparison sites

Establish technology as a positive force for all

Broadband internet, mobile phones and things from home banking to price comparison sites have made a huge difference to millions of people's lives, as both consumers and citizens. Many consumers now have much greater choice, with increased customisation to meet individual needs, and the process of choosing is easier too. But not all consumers are able to take advantage of this. This isn't about shoehorning people into using the internet. An overly aggressive move to new communications technologies may turn some consumers against them, so reducing the potential benefits.

Research suggests that consumers start using new technology where they see positive benefits for them; forcing people, and penalising them if they don't use this technology, will be counter-productive. The trick is also about creating innovative, practical uses of technology. For example drawing on data held by government and regulators about company performance.

The government has said that it will '*encourage the development of innovative ways of utilising data... simply releasing data is not enough ... we will look to pump-prime or incentivise developers and intermediaries to utilise this data to create innovative applications and information*.'

This is exactly the right approach to take. There are real opportunities in terms of collective purchasing and collaborative consumption.

But consumer protection and privacy issues have to be addressed in a way that reflects the diversity of consumer needs. At present, too many consumers still see the internet as a high-risk environment, with new opportunities for mis-selling and inappropriate use of personal data.

Embed the consumer interest in the big strategic decisions

One of the paradoxes of the current situation is that while many small but important decisions have been brought closer to consumers, most of the big, strategic choices remain as distant from them as ever. Indeed, those big decisions have become bigger, with calls about investment of unparalleled size and significance being made by government, regulators and businesses in key consumer markets.

These costs will be met by consumers through higher charges for use rather than taxation. Estimates put the cumulative UK infrastructure bill at around £200 billion by 2020.

The speed with which companies renew networks and recover their investment will have an ever greater impact on consumer bills.

Consumers need regulators to question how the risk and cost be shared into the future between consumers, and private sector providers and investors?