



HOUSE OF LORDS

Industry and Regulators Committee

Corrected oral evidence: Regulators and growth

Tuesday 18 November 2025

10.05 am

Watch the meeting

Members present: Viscount Chandos (The Chair); Lord Best; Baroness Drake; Baroness Harding of Winscombe; Viscount Thurso; Viscount Trenchard; Lord Udny-Lister; Baroness Valentine.

Evidence Session No. 3

Heard in Public

Questions 27 – 40

Witnesses

[I](#)

Examination of witnesses

Witnesses: Dan Elliott, Founder and Director, Frontier Economics and Simon Wilde, Partner, Oxera

Q27 The Chair: Good morning. This is the Industry and Regulators Committee of the House of Lords conducting an inquiry into regulators and growth. This morning we are very pleased to have as witnesses Dan Elliott, founder and director of Frontier Economics, and Simon Wilde, partner at Oxera. As well as being broadcast, there will be a transcript of this session.

The Government have made it very clear that they expect regulators to support or even prioritise growth. What do you think regulators can do to achieve this, and to what extent is it their role? Mr Wilde, do you want to start?

Simon Wilde: Thank you, Lord Chandos, I am very happy to. First, it is an honour and pleasure to be here. This inquiry is very timely and I am very glad you are speaking to us having already had the perspective of some academics but also of consumers. We should not forget that regulation has been put in place for consumers and for the greater good.

It is clear that this Government are very serious about wanting regulators to promote growth and not to be a blocker for growth, as we saw in the action plan and the progress update. But it was also very heavily interwoven into the Treasury's 10-year infrastructure plan that came out in the summer, where there are some very ambitious growth objectives driven by infrastructure investment, with a clear role for regulators. So the intent is very clear.

This is not new: there was a duty that went into force for regulators in 2015, and a good question would be to what extent regulators have changed their behaviour over the last 10 years since that Act came in, and what lessons can be learned.

Perhaps my final opening remark is that regulators are very different. At Oxera we advise all types of regulators and regulated companies; I myself spent some time at Ofgem. But there are four distinct types of regulators: there are the economic regulators like Ofwat and Ofgem that we think about; there are also market regulators that are looking for appropriate market conduct, and there you have the Competition and Markets Authority at the top with a whole series of bodies. You have technical regulators around health and safety, and you have prudential regulators like the Prudential Regulation Authority, and in certain sectors that is what Ofgem is becoming. So it is quite important that we think about what type of regulation, and what roles that type of regulation has for growth.

Dan Elliott: Thank you for inviting me to speak to you. I echo pretty much everything that Simon has just said. Your question about what regulators can do to support growth obviously very much depends on which sort of regulator you are. You were talking about it as a very broad

question and the steps that might be taken, and the pitfalls will vary. Obviously, I speak from my own personal experiences, primarily in the regulation of infrastructure which, we should remember, as much as anything else is a form of consumer protection.

Directly answering the question about how regulators might help within this area, I will start by saying there is a view you hear expressed that the job of infrastructure regulators is consumer protection and it is about efficiency, and that is their contribution to growth. If you make the industries efficient, quasi-competitive or whatever, that should be the limit of what you do. That view is wrong, or it is right as far as it goes, but it is insufficient because, fairly obviously, the development of infrastructure is crucially important. There is a conflict in the role that that sort of regulator has between operating efficiency, which they seek to promote, and the dynamic efficiency which we all want to recognise.

There are many examples. The development of the energy grid is an area that is a vital input into the growth of the economy generally; this is more Simon's territory, and I am sure he can speak more eloquently about the details of that. But this is a question that, just left to itself, an economic regulator will struggle with, as it would with the third runway at Heathrow: it is too big, too strategic. If you leave them to consider a cost-benefit analysis of whether it should be done, they may not have the skills or the perspective to do that. So I can see there are real tensions. There are real contributions to be made, but it is not straightforward.

The Chair: You stressed at the beginning the role of regulators to protect consumers, and what we have seen is the sort of escalation of the language about growth. I would say it was implicit before 2015, from then it was explicit, and now it is prioritised. What do you think is the challenge to maintain confidence among consumers that their interests are being protected first and foremost, against that background?

Simon Wilde: That is a significant issue, in the sense that regulators, as we have just said, were set up to protect consumers and to address potential market failures such as network monopolies, for example, for infrastructure. It is the regulator's job to ensure those services are provided at the lowest possible cost, while still allowing fair recovery of costs and returns commensurate with private sector delivery. It is always a balancing act. In terms of legitimacy for consumers, the question is whether regulators are being asked to put their thumb on the scales in favour of regulated companies so that they invest more. I do not think that is quite what they are being asked, but it raises a legitimate question about that.

For example, again referring back to the Treasury's 10-year infrastructure strategy, there was a chapter written by the Department for Business and Trade, I believe, that I recommend people read. It is a very good articulation of the benefits, and how economic regulation might be done. That calls out the specific potential tension between what it describes as affordability and investability, and that is manifest in that. One way of reconciling that is saying, "Are you looking at this from a long-term or a

short-term perspective?" That circle needs to be squared, and it is the combined job of policymakers and regulators to very clearly articulate why they think growth is in the consumer interest.

Dan Elliott: If I may pick up on that; again, I agree entirely with what Simon said. The short-term/long-term distinction is very important. Skipping on, the problem with growth, especially when growth is characterised as growth in GDP, is that GDP is a poor measure of economic welfare; it is not an irrelevant measure, but it has its problems. As we know, you can spend money to damage the environment and then spend money to clean the environment up again, and both add to GDP. They do not necessarily add to welfare.

Simon's point about putting your thumb on the scales for investment is well put. The question is: are we looking at regulators to encourage short-term investment simply to allow more spending, because that will increase GDP in the short run, or are we asking them to think about how you can enhance productivity? Actually, the broader question is about not just productivity within their own sector but productivity more widely and the contribution that those sectors make to wider productivity. It feels to me like the first of those is in conflict with their duty to try to, if you like, protect consumers. But I can see the appeal: you spend money now, you get jobs now, et cetera, versus thinking of the long-term and thinking about productivity growth.

It is terribly important because the consumer protection aspect for water or energy bills is very significant. Unfortunately, there are substantial proportions of our population who struggle with meeting those costs. Putting your thumb on the scales and simply increasing costs and increasing bills raises issues.

More than that, though, there are issues that arise about how the regulatory systems work, timing and who pays if you are thinking about funding long-term investment and productivity. Because there is also the possibility—forgive me as an economist for being vaguely technical—that if you invest at a high marginal cost and as a result you raise prices, that the current generation of consumers pay for what is, in fact, an investment for future benefits. That could apply if it is the energy grid, in developing water resources that are needed for data centres, or for large population growth in areas where you are looking to create maybe a silicon fen or something. There are questions about how the regulatory system works, and they are right to make sure, if you like, that payment is made in the right generations as well.

Q28 Viscount Thurso: Can I come back to and follow up on that answer that you have just given? We can all be in favour of growth generically but, as you rightly point out, there are very different kinds of growth. My question really is: are the Government clear as to what they mean when they say growth? Is there clarity about what growth the Government are actually seeking, what parts of the economy they wish to grow and how?

Dan Elliott: I am not sure if I am well-placed to say that. At the moment, my sense is no, and that we are, if you like, picking important areas where we think investment is needed, but I do not yet have a sense of a broader strategic plan of how it all fits together.

Viscount Thurso: Would it be a good idea if the Government were to set out some definition around the generality?

Dan Elliott: It would be. From the regulators' point of view, it would be good if they were much more specific about the nature of the growth. So if the objective is productivity outside their own sector, not short-term, then not only being specific but being clear about the areas of productivity that the regulator should concern itself with and, if necessary, providing the support needed—the analytical or information support—to actually back that up.

As an example, Ofwat is a specialist in that sector, unsurprisingly. If you are asking for the contribution that will be made, if you like, to high-tech as a result of investment in water resources, it is not necessarily so well-equipped, but it might have a better view on the environmental impact of that. So more specific guidance about what is important would be helpful because they cannot be expected to identify those by themselves.

Viscount Thurso: Simon, what is your take on that?

Simon Wilde: At the risk of us being two incredibly dull witnesses, I am in agreement in the sense that, as far as I am aware—and I may have missed something—I do not think the Government have set out exactly what they mean by growth and what growth they are looking for, either in the action plan or in the update.

It is worth looking at the regulatory harms they are thinking about, though, because they set out three particular concerns. The first is that regulation has become too complex and burdensome, and this is where the 25% target comes in: the £5 billion savings of a £22 billion regulatory burden. The second one is that the absence of knowing about certain things creates business uncertainty. I am thinking of my sector: perhaps in the absence of knowing about building out certain electricity infrastructures, you do not know about building factories, for example, or the queues. And then the third is this sense that regulators are risk-averse, they are stifling innovation and they need a pro-growth mindset, so that hints at it. But to answer your question directly, would it help to be clear? I agree, yes.

Viscount Thurso: Is there a tension—I think Dan was alluding to this—between short-term and long-term objectives in terms of growth?

Simon Wilde: Yes, and there are a number of examples in the decisions made by regulators, particularly of economic regulators—so water and electricity; I will let Dan comment on transportation. The first is the investments they approve are good old-fashioned spending: a Keynesian investment. The second is that, particularly since 2008, the UK has very

low productivity to the extent we think that is held back through a lack of infrastructure, or infrastructure not working. Perhaps there is a distinction there between investment and capital maintenance, as one or two very high-profile economists have talked about recently: is that holding back growth? And then the third is something around just confidence and whether there is something about the credibility and efficiency of UK plc as a place to do business.

Viscount Thurso: There is a lot in there, but others will probably ask those questions.

Q29 **Viscount Trenchard:** Going on from there and continuing to explore this question of the growing responsibility of regulators to achieve growth, what are the key challenges and trade-offs between the growth objective, or competitiveness and growth such as the Financial Conduct Authority has, and other objectives? Also, some regulators' objectives are sometimes primary and some are secondary, and then there are those they have regard to, which presumably is an even lower priority than a secondary objective. This sort of balance seems to me to be quite difficult for a regulator to manage. How do you think that regulators can manage these trade-offs, and in particular, the competition and consumer or environmental protection obligations that they have to meet alongside that?

Dan Elliott: A very excellent question. It very much varies, depending upon the sector we are talking about. If I may take a step back, at Frontier we have done some work at various points around the relationship between regulation broadly and growth across a number of sectors, mainly a literature review and whatever.

The evidence for a relationship between regulation and economic growth is pretty slim across the board, with the exception of addressing market failure, where it feels that there is some concrete evidence. That cuts both ways. Evidence that is slim suggests that there is slim evidence that increasing or decreasing regulation increases or decreases economic activity, in which case pinning a lot of faith on deregulation around areas that do not specifically affect market failure might be a risky thing to do. To put it another way, I would put more weight on thinking about what the potential downsides of change in regulation might be.

Our experience would be that there is evidence that addressing market failure in a variety of ways can be beneficial, but even then there are trade-offs to be made if one is thinking about a dynamic world between short-term competition and dynamic innovation, where actually you might choose to push less hard on short-term competition in order to encourage more dynamic innovation. Sorry, this is getting complicated; that might be a bit cryptic.

Simon Wilde: That is right. Our research broadly agrees with Frontier that the relationship between good regulation and high growth, or quality regulation and growth, is remarkably weak in the literature. I was surprised, to be honest. However, I would add one thing to what Dan

said. As well as market failures, when you get to a level where regulation is very bad, it definitely has a deleterious effect on growth and, for example, a lot of studies in emerging markets confirm that. But once you go above a baseline level, it becomes really quite complicated.

Just to reflect on the trade-offs point, if I take Ofgem, for example, there is a proposal out there, which there may be some consensus for, that Ofgem should really have three objectives: for consumers, for growth, and for net zero. That was contained in the industry's own recommendations, and if you interview Ofgem it can give its own views as to that.

Some of those might be complementary in the sense that there might be some investments you can make that promote growth that also benefit consumers. But with others there are big trade-offs. If you are looking at expensive clean investment versus less expensive polluting investment, there are some real contradictions. The system can be either way: you can either let the regulator make their own trade-offs—but I would suggest they are entering into political decisions there—or they need some very clear guidance on making trade-offs, where there are trade-offs. So if you can manage two or three of those without a trade-off then that is great, and the regulators should do their expert work to try to find the best solutions. But where there are trade-offs between the objectives, they need very clear political guidance.

Viscount Trenchard: Where the three objectives conflict with each other, for example in the case of Ofgem, how is a regulator going to decide on how to prioritise the conflicting demands of complying with each of those objectives? Just to broaden it slightly, you have already said a regulator's approach to growth depends on the type of regulator it is, but could you explain how you think the balance is different for regulators that are responsible for preventing harm than it is for the economic regulators?

Simon Wilde: Yes. So I have to declare a bias to almost all the remarks I have made: they really primarily relate to economic regulation, perhaps with a degree of market regulation. Regulators that prevent harm are not my area of expertise, but I have absolutely looked at them; they are one of the four categories. There it is trickier because the Factory Acts in the 19th century were put in for good reason: to protect against profit-maximising behaviour that happened to involve the employment of children in dangerous work conditions. No one would disagree with that now, although perhaps it was controversial then. So again it is a societal and political decision about to what extent citizens should be protected, and perhaps over time that can go back and forwards.

Dan Elliott: Again I agree with that; we are in agreement on most points and my area of expertise is similar to Simon's. Methodologically, the harm that the infrastructure regulators oversee—transport, water, energy—is primarily an environmental harm; not only, but the externality that we are most worried about is often an environmental one. You may think we do not get good answers, but economics is actually moderately

well set-up to address that question: the methodologies of evaluation and appraisal—a cost-benefit analysis—can address those questions. But regulators themselves are probably not best placed to decide what weight to place on things: they need guidance for how much weight must be placed on biodiversity, habitats, water pollution, air pollution and carbon prices when one is dealing with greenhouse gases. They should not be left to make judgments themselves for these sorts of things.

Economics is not as well-equipped, even if we might theoretically think it is, to deal with issues of personal harm. From experience, the answers that economists tend to come up with about the balance between economic benefit and personal harm do not tend to accord with public opinion. That is just a personal observation in the sense that public opinion would seem to place a greater value on avoiding personal harm than perhaps the economists, when trying dispassionately to come up with numbers, would do. So there is even more requirement for political guidance on those sorts of areas.

Q30 Baroness Drake: Going back to your point about the dynamic world and trade-offs, whether it is between competition, innovation, consumer, long-term interests and the other interests, you say there is need for regulators to get guidance, but is guidance alone going to hack it? Do you need other structures that explicitly address these trade-offs? Because at the moment it can be random.

Dan Elliott: If we step back and think about the topics we are interested in—innovation, growth and productivity—I would probably say that the structure of an economic regulator that is primarily focused on efficiency is not, either in the structure or the mindset, necessarily well set up to deliver that sort of growth or innovation. In that sense, you might think that the requirements lie outside.

To partly explain why I say that, the business of innovation is a risky one, especially when we are talking about game-changing, big innovation. I would obviously expect all our utilities to innovate in terms of finding small or medium-sized ways to try to be better at what they do, but big, game-changing innovation involves Research and Development, spending a lot of money, taking risks, losing money and having the opportunity to make money.

Baroness Drake: A fair return?

Dan Elliott: It is complicated. You should speak to Mariana Mazzucato or somebody who is an expert in the economics of innovation on this topic, and I am sure you will, if you have not already. But it tends not to be an economics of small margins, and economic regulators are players in small margins so they will struggle with the idea that you do something, you succeed big time and you make a lot of money out of that.

Baroness Drake: Guidance alone, therefore, could not crack that problem?

Dan Elliott: Probably not.

Baroness Drake: You would have to create some other structures above that that took an oversight view?

Dan Elliott: Yes.

Simon Wilde: If I may add to that just really briefly, when I have been using “guidance”, I have been using it fairly loosely. There are many ways of that guidance being provided. For example, you could write on the face of the Act, “Here are the following duties, and they shall have this hierarchy: A, B, and C”. There are lots of reasons why that is not done because primary legislation is quite difficult to change. But it is really quite common to have the ability for that to be done through secondary legislation, which is easier to do and can be subject to a degree of scrutiny by this building. So that is one way of doing it.

The other way is perhaps providing guidance, with a capital G, through a strategy and policy statement. Those are quite well understood tools, not terribly often used. There was a draft one for the energy sector in the last 12 months, but there had not been one for a very long time. It critically set out the tripartite relationship between Ofgem, the energy ministry and another key part of the energy system. That provided welcome clarity.

Then there is a way of perhaps providing guidance with a small G, through good collaboration between the regulator and government. Of course, you need to be careful that good collaboration does not bleed into undue political interference and undermining of independence. But there are a whole series of ways of doing it.

Q31 **Baroness Harding of Winscombe:** You might have just answered the question I was about to ask, but I had a follow-up question from about two or three comments earlier. Dan, you referenced the trade-off between competition and innovation, and I just wanted to challenge that. From my experience in telecoms and digital markets, innovation comes from the threat of competition, not from the absence of it. I just wondered if you would expand a bit more on why you viewed them as a trade-off rather than actually, without competition you do not get the innovation?

Dan Elliott: That was not quite the point I was trying to make, but I absolutely understand. You are quite right that competition can be a very strong spur to innovation. The dynamic and the economics of innovation, though, are really different to the dynamic of, if you like, infrastructure. One point I was simply trying to make is that it is intrinsically riskier. For instance, in the topic of innovation we have patent law, which is a form of regulation specifically intended to attenuate competition in order to provide encouragement to invest in Research and Development. It is an example of where you actually attenuate competition in order to create more innovation, and it is a trade-off. The received wisdom is that, actually, without patent law, although you might have more competition you will have less innovation. So that is what I am driving at, to an extent.

I have been talking to my colleagues, and I stress that this specific example is not in my own personal area: in financial services, it is considered that a reasonably successful regulatory response that promoted economic growth in a particular area would have been the Spanish financial services after the 2008 crash. Now, I stress I am not an expert so I am somewhat channelling the opinion, but the decision was made to focus more on stability and sustainability of the sector than on competition. That created an environment in which the sector could flourish, with the primary benefit being seen as this crash will not happen again. In that world, our first concern is not the most rigorous competition. Again, there are trade-offs in terms of the benefits to the firms and the consumers, but in terms of promoting the growth of the sector you can see that has been very successful.

Simon Wilde: Just to add perhaps one other example of that, you have already heard from Professor Dame Julia Black, and she mentioned the UK energy retail experience where Ofgem had a policy for many years of opening the market, encouraging competition and having very low barriers to entry. There were upwards of 100 suppliers, 30 of which went bust in 2021-22 as a result of gas price gyrations from Ukraine. That led to a regulatory pivot in much the same way Dan has described happened in financial services. There was an acceptance by the regulators that they had underestimated the risks around capital adequacy and financial regulation.

But here is the thing: Ofgem had associated the number of players in the market with the level of innovation and actually, when you take a step back, you had a lot of me-too copycat companies that were not really doing anything different at all. Innovation and the role of regulators is insufficiently well understood and needs to be thought through, because if regulation affects innovation, then innovation affects productivity, and then productivity affects growth, that is clearly one of the drivers. But that first bit is insufficiently understood.

Baroness Harding of Winscombe: I think what I am hearing from you is that whether you are talking about an infrastructure sort of economic regulatory puzzle or a market regulatory puzzle where the barriers to entry may be different, you actually might take a different perspective on the trade-off between competition and its impact on innovation. Is that fair to say? I do not want to put words into your mouth.

Simon Wilde: Absolutely right. A recent example is that the Competition and Markets Authority recently approved a merger of two telecom providers, and that was seen as a key litmus test of its business friendliness, one might say. As part of that, it was at pains to explain why it thought this entity would be a stronger competitor and was going to do certain things, although it nevertheless felt the need to put in place some behavioural remedies to protect consumers during it. But there is no reason why a smaller number of competing firms cannot be more, or less, innovative. But, having spent time with the regulator and having

provided lots of inputs to regulators, there is rarely a call for evidence on that point.

Baroness Harding of Winscombe: What you are really saying is this is a very complex, subtle art, so how can Government and Parliament improve the setting of objectives and duties to provide better guidance on what regulators should prioritise, and the clarity of the role of regulators and Government, including, but not exclusively, in relation to growth?

Simon Wilde: I have some thoughts on this, having had a go at being a regulator. As we have both been saying, the regulator cannot necessarily agree what the hierarchy is. So if it is presented with a list of objectives that says, "If you can find a way of delivering these without compromise—you can find a win-win solution for affordability and investability—do both". But in the event of there being a trade-off required, then there needs to be some sort of political guidance that comes in, either that is standing through legislation or Strategic Policy Steer, or that is requested at the time.

What regulators are really good at is getting into the detail of that complicated decision. They have the industry expertise and the time; they are not subject to the short-term political pressures that the Ministers and departmental civil servants face. But as I said, they cannot decide guns versus butter; the really high-level political priorities need to be spelled out for them.

Baroness Harding of Winscombe: That is really helpful. Dan?

Dan Elliott: I am not sure if I have anything to add, actually. That was summed up pretty well.

Baroness Harding of Winscombe: Is there anything specifically you would have Parliament do, as distinct from Government, in the setting of regulators? We have discussed here multiple times the role that Select Committees should or could have in holding regulators to account. What role, if any, should Parliament have in setting those objectives?

Dan Elliott: Again, I am not sure it is my area. I am very aware that the legal framework that controls the utility regulators has allowed a very broad leeway for how the regulators have pursued their objectives over the years. In that sense my feeling is this is more a matter of guidance from Government than legislation from Parliament, if that is the question. A lot can probably be achieved without necessarily the need for primary legislation.

Simon Wilde: I have one really brief add on that because the role that Parliament can play as distinct to the Government, which I think was your question—and it is a really good one—is looking at whether the legislation is sufficiently clear in two areas. One is when you say growth, what do you mean? Because as has been established, growth is inherently an uncertain term. So if there is a draft Bill that says, "Pursue

growth”, a legitimate question for the legislature is, “What do you mean by growth? Or are we happy to leave it to the courts to decide?”

Secondly, what does good look like? How are we going to assess this? How do we know when a regulator is performing well? We have lots of examples of regulators being criticised right now, and some that have been abolished, but what does good look like? If you were running a project in the private sector, you would set these things out in advance and I am not sure that we have that clear understanding. Regulators are the creature of legislation, but legislation does not always specify what good looks like.

- Q32 **Lord Best:** We have talked a bit about the Government’s criticism that regulators are risk-averse, but the inconsistencies that you are describing in other contexts apply here as well. What do Government really mean by this? At the end of the day, are Government keen that there is someone else to blame, and if being risk-averse is one criticism, the opposite is, “You took a risk you should not have taken—you are to blame, not us.” Can the regulator ever win?

Dan Elliott: Over the last 20 years, we have seen a retrenchment from the idea of independent regulation. So you could frame the original concept either way: to pass the blame on to a non-ministerial government department, or the other way of viewing this was to create a body that was not subject to short-term political pressures, had clear objectives about what it was empowered to achieve and would take a long-term view. For good or ill, we have seen that unwind. It was originally set up in the 1980s as an idea, but it started to unwind in the 1990s in the specific areas you see government intervention, and I fear that is inevitable in the current climate.

If you do not mind, though, it takes me to a point that may be slightly paradoxical in all that we have discussed so far: if we are concerned with investment and growth in our areas, as we have already said, there is actually not much evidence that regulation per se is an issue, or a plus or minus. What is definitely an issue is predictability and stability of the system—the environment in which you attract investment is predictable and stable, not subject to unexpected change or political whims, et cetera. That does not mean there is not risk. There is risk to be taken, and within the framework that economic regulation works, if a company does badly its shareholders should definitely pay for it having done badly. That is not the point I am making. But stability and predictability is a key condition for regulation.

The paradox then is that perhaps banging a drum about deregulation could also create instability. Change in itself can be bad. Companies will invest on the basis of a predictable set of rules. Withdrawing regulation, changing the rules on competition, on consumer protection, et cetera, could fundamentally change the basis on which some organisation or company invested in the first place. Stability matters. So the paradox to put to you all, I am afraid, is that, yes, there is bad regulation and, yes, we should think about simplifying and streamlining regulation where it is

manifestly inefficient, badly targeted, or whatever. But I would almost say a blanket statement such as, "We must remove 25% of regulation" in itself actually creates risk, uncertainty, is vague and is subject to all the problems we know about. There is no quality measure in there; it is just a quantity measure; if we get rid of 25% of regulations, we will have achieved our objective—the right ones, the wrong ones, the good ones and the bad ones.

Simon Wilde: Can the regulator ever win? The regulator's job is to make difficult techno-economic decisions within a political framework, and to make the hard decisions based on using evidence-based analysis in a way that Government cannot do. But it will always get the decisions wrong. As we were saying, if you think about the trade-off between investability and affordability that says, "How high a return should I offer to attract the investment?" It will almost certainly fail on one side or the other, which makes assessing its performance remarkably hard. There are some regulators that feel it is their job to upset all constituencies equally, and if they have done that correctly then they have done their job well. So there is something about having this external body where difficult decisions are required.

Lord Best: Is there much prospect of government making sure that there is consistency in its approaches across the piece?

Simon Wilde: There is an opportunity, actually. The reason I keep banging on about the 10-year infrastructure strategy is not just because the deputy director of the Department for Business and Trade who wrote that section—for parliamentary convention I will not name him—has done an unbelievably good job at articulating what regulation is there for. It is that the Government are looking at regulation in the round; the Department for Environment, Food & Rural Affairs is looking at Cunliffe—I understand we are promised a White Paper before Christmas; and you have the Department for Energy Security and Net Zero review of Ofgem going on. My understanding is that appropriate departments are speaking to each other and co-ordinating behind the scenes. This feels to me a little like a once-in-a-decade opportunity to co-ordinate regulation, and there could be some real benefits.

Lord Best: Let us see.

Q33 **The Chair:** I just wanted to pick up on risk aversion. We have heard evidence quite recently that argues regulators are motivated just to increase regulation because that is what they are there for. You have been regulators and/or worked with regulators for decades. I just wondered whether you would comment on what you see the culture of regulators is.

Dan Elliott: I do not personally subscribe to the somewhat cynical idea that regulators create regulations for the sake of it. If you put talented, able and intelligent people in a place and tell them to do a job, an inevitable problem is that they will think about how they could do the job differently. They will think better, and it may be better, but differently. So

regulators will inevitably reinvent how they go about doing things; it is human nature.

Looked at from the specific perspective of the water industry, where I spent a lot of time consulting, over time it felt like Ofwat built what it would see as incentive schemes that were more and more complex and convoluted in order to achieve what it wanted to achieve. But it felt like the complexity got in the way of the simplicity of what it was ultimately trying to achieve. I will get my dates wrong now, but it may have been the 2014 price review when Ofwat decided to come up with—I forget the term—a streamlined, new, efficient methodology for the review, and when it arrived there were 200 pages for the methodology of how you had to set prices. And I totally sympathise; there is a lot going on and there are many objectives it is trying to achieve and whatever. But I think that is human nature.

I would like to see these regulators led by people with a clarity of vision, and the clarity to say, "This is what is important and this is not important", and where levels of detail are necessary and where they are not, actually adding to the quality of the decisions they are making. And that is a leadership issue.

Simon Wilde: I will try to be brief. There is always the risk of Maslow's hammer: that if you have a hammer everything looks like a nail, and if you are a regulator everything deserves a regulatory solution. That is why there is a need for good governance of regulators. I would recommend that the boards of regulators need to be packed full not of people who have been regulators but of those who will be thinking about the proportionality of the regulation that is being proposed. That challenge should be built from within.

But again, to take Ofgem as it is a regulator I know well, there has been some criticism that its budget has doubled in size over the last 10 years; it has got bigger. It may be that Ofgem itself was over-elaborating, and it will accept that there is overcomplexity in a similar way to the water sector. But by and large it has been given more and more tasks: to create a regulatory regime for Sizewell C, create a regulatory regime for carbon capture, create a regulation for this, look at this market, take on these. So I would say there has been a bit of a trend towards more and more regulation, and then departments outsourcing that to regulators.

Q34 The Chair: The Government published their action plan in March and updated it last month. You have talked about the once-in-a-generation opportunity. To what extent do you think that that plan provides a coherent strategy for ensuring that regulators drive growth?

Simon Wilde: I am the one that said there was the opportunity so let me just caveat that. I genuinely think there is the opportunity: the thinking is going on, with some really good joined-up thinking across government at very senior levels in the permanent Civil Service. And there is this overarching plan that has been put out there. That is point one.

But I would say, as point two, that we have not seen the detail, as we have just discussed, and there is a lack of transparency about what the aims and methods are. As this is implemented, it will require that scrutiny to make sure that we really see the detail. The key question I would ask is: in 10 years' time, how are we going to assess whether this was successful? And at the moment I am not seeing a framework to allow me to answer that question.

The Chair: Within the action plan, there is this target of cutting costs by 25% across the board. Does that support—

Simon Wilde: I heard a degree of squeamishness to my left, and I share that. It is fantastic to have a clear target to focus the mind, but to my mind there is also the risk of perverse incentives. It would worry me if, at random, one in four obligations was removed. I am not sure of the ability for us to assess which are the right one in four to remove. So it is absolutely right to say that there needs to be an assumption of reducing regulation. I come back again to this point about having governance so that there is appropriate challenge to the regulators as they are doing their work and that they are applying that approach. It will be interesting how effective that is. But the general points about reducing complexity and about doing the review of regulators and tackling this risk aversion—because there is risk aversion—and being more accepting of mistakes and learning from them feel like positive steps for me.

Dan Elliott: I agree with everything you said, particularly that last part. The objectives of the action plan are sound but vague. Nothing I have said here is meant to imply that I do not think there is bad regulation. There is a lot of bad and excessive regulation, and the right process is for experts in the right field to say, "What is the function of this regulation? Can the function of this regulation be achieved by a more streamlined process?"

A lot of regulation that we see, say on the environmental side, has been set up in a very risk-averse context. It is often framed in terms of very technical solutions, "You will deal with this problem in this way" because you can measure it very precisely, whereas in fact you want a particular outcome which might say, "Actually, I would like to innovate and find a better, more effective, cheaper, quicker way of addressing this problem. But I cannot because the regulation says I must provide this ladder for these sorts of fish in this exact specification of materials" or whatever.

There is definitely scope for that, and it has come up for a lot of regulation being very risk-averse. But I would prefer a greater focus on what the purpose of this regulation is, and whether it achieves it in the most streamlined way possible, rather than the simplistic, "Let us get rid of 25% of regulations". That is not just misleading but potentially very damaging.

The Chair: You have both interpreted it as being that a 25% cut would require a reduction of regulation, whether proportionate, as opposed to saying that the regulations remain essentially unchanged, but that the

regulator operates more efficiently, whether that is through AI or whatever.

Simon Wilde: That is a very fair challenge, Chair. And one of the details that is in the action plan and picked up in the update that I have not commented on is the need for more business interaction and the need for the regulators to ask the companies they regulate and other stakeholders about the job they are doing. That feels like very good practice to me, and if there are burdensome requirements that are not needed, the idea about removing those sounds eminently sensible. In particular, there may be data that has been collected by regulators that is not used and is not necessary. So having that regular two-way dialogue about how to continuously improve regulation feels like a very good thing. I am not sure if it happens systematically in the way that it could happen.

Dan Elliott: Yes, that is right. What Simon has described is a difficult situation where you need to establish trust between your regulators and the sectors that they regulate. To an extent, and most particularly recently we have seen it in the water industry, that trust has broken down. Without pointing fingers about who is responsible, it has broken down.

I recognise this is veering slightly away from the topic of growth, but the Cunliffe review and discussion about a supervisory approach is a lot to do with trying to re-establish a process of trust, where regulator and industry can talk to each other and can accept, so there is a bit of a connect. When the industry says, "We have this technical problem and we think that this is not the solution," the response from a regulator will not reflexively be saying, "Well, they would say that, would they not, because they are trying to" whatever.

Q35 **Lord Best:** This question is about additional resources for regulators and the dilemma between regulators that say they need more to reduce regulatory burdens and speed things up, and you worrying that there is excessive regulation and that more resources might mean more regulation. How do you think this balance can be reconciled? We have been doing work on the building safety regulator, and it is quite clear that the lack of sufficient resources and staffing has been a very significant contributor to the long delays in getting approvals through. As with all these questions, regulator to regulator, things will differ. Are there some overarching lessons that you can bring to us?

Simon Wilde: Every single regulator feels that it is underresourced, and you are right, my Lord, that it depends on the individual body. Most have additional responsibilities put upon them, and therefore they have to make choices. Ofgem came into criticism by the industry for more than doubling its budget, but it has also been asked to do many more things, and there is a question about how efficient it could be.

There are three questions. First, is it efficient today, and could it be more, particularly if it dropped certain items that did not add value? The second question is around quantity versus quality. In a highly critical

report, Energy UK, the trade body, recommended loosening the Civil Service pay restrictions in order to hire better people who, by implication, command a higher market salary. Interestingly, that proposal came not from the regulator but from a highly critical industry body. The third question is: can we credibly see a surge in resources to do certain things, such as a task force that is then disbanded? We probably all have scepticism about temporary resources becoming permanent. But could you have a short-run project, where you increase resources, deliver certain things, and there is a credible commitment to those resources then going away, in the same way that private industry regularly makes investments in change management programmes? Those are my three perspectives.

Dan Elliott: Those are all very good points. It probably did not come out prominently in what I said, but I totally agree with Simon that substantial new obligations have been placed not just on regulators but also on, for example, local authorities, where resources have not necessarily moved to match the change in responsibilities. It will vary by sector. The changes proposed in water, to move to greater integration of various bodies—the environmental and economic regulators—would create a larger institution, but it is a positive step in the sense that, going back to the committee’s question around growth, we have identified a wide range of skills that need to be brought to bear to make those decisions.

Those skills do not necessarily exist within economic regulators as they currently exist. Ofwat, or Ofwat’s successor, is assisted by greater integration of environmental and economic analysis in making better decisions about big growth questions. There are probably other skills that exist within government departments, for example, analytical and certainly appraisal skills, which economic regulators may not have. It could be advantageous to have greater co-operation, if not a movement of resources, possibly on a short-term basis between the relevant departments and the regulators—you used the term “task forces”; I thought that was good—in order to address specific questions of growth.

Lord Best: In so far as extra resources are required, who should pay? Should the sector pay more in fees to the regulator, or should public funding come into the equation? It will vary regulator to regulator, but is there any mileage in that fast-lanes phenomenon, whereby bigger companies pay more and get faster approval through the system, or is it unfair to the smaller ones that cannot cope with the implied extra cost?

Simon Wilde: You covered this in other sessions. I am not sure how fast lanes would work in network regulators such as water, electricity and telecoms because they are there to reduce the risk of abuse of market power, and fast lanes are a mechanism where you might see that abuse emerge. But also I wonder whether fast lanes are required in these sectors as these regulators are funded by a levy on industry. Of course there is the natural complaining about it, but the cost of Ofgem—I would want to come back to give an exact number—might be £200 million a year. That is a lot of money, but this sector is worth £50 billion or £60

billion a year. I would characterise regular discipline and regulators benchmarking themselves against one another and sharing best practice as a subset of the governance issue. How can the board of the regulator be sure that the organisation is being run as well as possible if it does not benchmark against similar regulators overseas or in the UK?

Dan Elliott: You are suggesting—it sounds reasonable to me—that regulators should treat themselves in the same way they treat the sectors they regulate. That sounds like a very sensible proposition.

In terms of who should pay, my brain was in a slightly different place because I started off by discussing who pays for growth. That is about the actual investment, and that is a different question. In terms of who pays for the analysis, Simon's point is that, although the numbers look quite large, compared to the size of the sectors we are dealing with they are small, and the incremental effect on costs would be small. The disadvantage of publicly funding aspects of this as opposed to funding from the sector would be you increase the tendency for central government to interfere short-term in what regulators do, which I would not encourage. There are all sorts of questions, such as: could the regulators be more efficient? Could they apply the same thinking and ask, "Do we need to do it in this way? Could we do it in a more streamlined way?" That is a leadership point and should be approached regulator by regulator.

But for me that payment is not the issue. When we are dealing with the implications of what regulators do for growth, it is a matter of how the spending they authorise impacts on short-term bills as opposed to long-term bills. That is more problematic. Should today's consumers pay more for future growth, especially when you see people struggling to pay bills? This is a paradox. It is not easy; that is the challenge. It might be dealt with more by a regulatory approach, which does not necessarily need primary legislation—it is just the way regulators focus—but it does need to be considered.

Q36 Baroness Valentine: Given we are talking about infrastructure investment, I should probably declare I am chairman of Heathrow Southern Railway. I have also been on the boards of Crossrail and High Speed 2. In the capacity of Heathrow Southern Railway, there are various interfaces with the regulators.

Before I get to my question, I want to ask about the difference between co-ordination between regulators and predictability. I am not sure whether you use predictability to encompass co-ordination. If an international investor comes in and there are various regulator interfaces, is there someone on the Government side who pulls that all together? Is that all encompassed by you both saying we need predictable regulation? I do not quite think of it as the same thing. I will come on to my question, but if you could answer that point as well, that would be helpful.

My question is about technology. How do you think wider changes in data

technology and AI are changing how companies and regulators operate? What opportunities do they provide to improve their efficiency and effectiveness? As a sub-question, are regulatory sandboxes the answer to supporting innovation? What else could or should regulators be exploring?

Simon Wilde: On your first question, co-ordination and predictability are slightly different things. In terms of predictability of decisions, regulators should use a methodology which is expected to come up with outcomes which, if not agreed with, one can at least understand how they got there. That allows a sensible degree of forward planning. Many of these assets will last 50 or even 100 years. They may go through 25-year price controls. They are incredibly vulnerable to government expropriation in one form or another, direct or indirect, and before investors act, they need to have confidence that this will not happen.

The challenge for regulators is that circumstances change. An economic reason for regulators—as well as for all the market failures and consumer protections—is the theory of incomplete contracts. You could not sit down today and write a contract that covers every possible thing that could relate to Heathrow Airport, to pick one of those areas, over the next 100 years. Instead you say, “We’ll fix what we can over five years; we’ll have some general principles, and then we will make decisions as required, but we will do those on a consistent basis, so that you can be confident that the decisions we make in 20 or 50 years’ time won’t be value destructive”. That is what I mean by predictability.

Co-ordination between them could exist, and you could still have regulators making very different approaches. However, that would be quite illogical, and there is a debate that regulators ought to adopt more consistent approaches among themselves.

To your last question about who joins the dots, there was a very sensible government initiative to set up an office for investment, as I understand it, as almost a concierge service for major international investors. That is outwith the role of regulators as such, but something about Government helping international investors feels very sensible. I will pause there before getting to your question to allow Dan the chance to come in and perhaps even answer both questions.

Dan Elliott: Thank you. I also think the most important element of consistency is the intertemporal nature of it. Simon mentioned incomplete contracts, which is a very valuable concept. A few years ago, before the pandemic, I took part in research done by the International Transport Forum on the cost of finance. The question was asked, “How is it that the UK can finance transport and other infrastructure at such a lower rate than appears to be achieved by the standard concession model that is used around the world?” There were various questions, and honestly, the primary answer was that it is due to the incomplete nature of the contracts that we have in the UK.

For instance, in the water industry, every company has an RCV, a regulatory capital value. It is not mentioned in the legislation and is not

guaranteed by law. How on earth can it be financed at such a low rate? Institutional experience is that it will be defended by the regulators and by the Competition and Markets Authority within reason, and when circumstances change, sensible decisions will be made that balance the interests of the parties concerned. That is what underpins the idea. Whereas complete contracts pass all the risk on to the investor: when it goes wrong, when something happens that none of us envisaged and the returns flick off the scale, they say, "There's nothing we can do about that, because that's what the contract says". It is very much intertemporal.

You have left me with a question about AI. I am not sure I am the person to answer this question. There is clearly vast analytical potential from AI. In the realm of innovation and regulation, I expect the ability will arise to use AI techniques to identify unseen patterns and solutions. To be slightly old-fogey-ish about this, the thing that concerns me—I have the same concern with the conventional rise in computing power over the last 30 years—is that we can do 1,000 times more analysis than we could have 30 years ago, but are we any wiser? Do we do 1,000 times more analysis because we can in lieu of thinking about what is important? Maybe it is a glib answer. I worry that AI is just that on steroids. But I am just a Luddite.

Simon Wilde: To offer a counterpoint, and perhaps reconciling the two approaches, it depends industry by industry. Certainly for the energy industry, data and AI will be transformational in many aspects. Successive Governments, the regulator and industry have come together to create something called the Energy Data Taskforce, which has been through a number of different manifestations and has the lofty aim of embedding data as a public good concept to allow open access. The architecture is there for the energy industry to enable innovation in how we engage with all our devices and how they in turn engage with the electricity system.

First, there is huge potential; secondly, steps have been taken; thirdly, I am absolutely sure there will be rigidities and frictions, and it could be done better. It is about the sixth time I have mentioned governance, but AI should be incredibly high up the list of governance priorities for the energy regulator, for the Department for Energy Security and Net Zero and industry to take advantage of it. I am probably a bit "glass half full" here in the sense that a very sensible conversation is already taking place.

Q37 Baroness Valentine: I have a follow-on question about accountability of regulators. The Government have said they will strengthen regulators' accountability, publish Key Performance Indicators and expect sponsor departments to conduct more formal performance reviews. Do departments have the right tools and information to hold regulators to account? Do the Government make enough use of other sources of information, such as company or consumer voices?

Simon Wilde: Before picking up on the specifics of your question, Baroness Valentine, on accountability in general, we have not had a wider discussion on the important point that Dan mentioned around trust. Unfortunately, there are very high levels of mistrust between regulators and companies across multiple sectors, self-evidently in water, as Dan said, but also in energy. The blame is on both sides. The reason I mention that here under accountability is: how is the regulator accountable to the industry it regulates, which pay for its services, as well as to consumers, to the Government and to Parliament? Those multiple dimensions of accountability need to be thought through. Until industry feels its voice is heard about the concerns it has with the regulator, it will be very hard to rebuild that level of trust.

Do the Government have the right tools? Going back to the Government's documents that we have alluded to this morning, the road map or update mentions using business survey and confidence data as a measurement. That is a really interesting insight. I suggest it is too blunt a tool for any one sector or regulator, and something similar could be done on a sectoral basis. But certainly, 360-degree reviews are normal in the private sector. You get reviewed by your boss, by your direct reports and by your peers. It is entirely appropriate that regulators be reviewed by their equivalents in all those different stakeholders. I am not sure that the right tools exist. It is a question for departments and regulators. Certainly, I have not seen or used such tools, but it feels like it would be a very good thing to do.

Dan Elliott: I do not have much to add to that. Your point at the end about 360-degree review is right: all the relevant stakeholders need to be consulted in an intelligent way to gauge how well a regulator is balancing its objectives. I always worry about simplistic Key Performance Indicators, which are useful in their place, but there is potential for them to be overly focused on short-term issues or those which play well politically. They may well focus on short-term consumer protection, which is very important, but at the expense of the conditions needed to promote long-term investment, innovation, productivity and growth. There is risk, because you can see the immediate consequences on the one side, whereas the other side is more aspirational. To an extent, it is an act of faith: if you get the investment in, will growth come? I am concerned about that. Also, I have not seen the tools being used to do this.

Q38 **Lord Udney-Lister:** I want to talk about regulation. In the past, regulators have argued there needs to be more review of existing legislation if they are to innovate and be flexible. To what extent do you think legislative policy needs to be changed, and are such reviews urgent?

Dan Elliott: As I said, the existing legislation allows a great deal of leeway for infrastructure regulators in terms of how economic decisions are made. Specific areas of clarity could be addressed, but those things do not necessarily require primary legislation. An emphasis could come from Government and be provided without such a review.

Simon Wilde: I very much agree. There are two types of legislation. One is directly relevant—in the case of Ofgem, the Electricity Act, the Water Act and the Utilities Act—which is regularly updated and gives the regulator fairly broad powers in exchange for the duties that we have talked about. An awful lot can be built on the back of those powers, which empower the regulator to issue a licence and essentially write in whatever it thinks is appropriate for the achievement of the duties and exercise of its powers. It is an incredibly broad construct that, as Dan explained, has led to an entire implicit regulatory contract being written on the back of it in a way that was never envisaged when that legislation was passed. So there is great flexibility.

Secondly, bits of other legislation are also relevant, and certain things need to be done in respect of, for example, the Equalities Act.

Thirdly, if the regulator needs to take on very specific new responsibilities or new powers, that typically requires additional legislation. A very good example of this is when economic regulators step into failing companies. That right exists for financial regulators under the Financial Services Act and under the Banking Act. As I understand it, there is no equivalent piece of legislation for water and electricity. We saw a bespoke one-day Act put in place for British Steel in the recent past. There is an open question about whether regulators need more powers like that. There may be the requirement for legislation, but a lot can be achieved, as Dan said.

Lord Udney-Lister: I want to come back a little on that. You touched upon this earlier, but how can regulators change their approach to be able to regulate more flexibly? How could a more outcome-based supervisory approach work?

Dan Elliott: I have observed that they can change their approach and have done so substantially over the years. A lot of this is cultural and comes down from the top. The culture is set by the chief executive or the board of the regulatory office. Institutionally, that is how it happens. It is hard to be specific. Sorry. Simon, help me out here.

Simon Wilde: I am very happy to do so. It is a highly topical question. Sir Jon Cunliffe in the Independent Water Commission has proposed a distinct change in style and, in particular, a move towards this supervisory type of regulation. It is an interesting question. I referred to Maslow's hammer. If you ask a Bank of England regulator to look at something, he might reach into its regulatory toolkit. That has clearly happened here. It raises a whole host of issues that are relevant to this topic, including: what is supervisory regulation? Can there be an expectation it will lead to more or less growth than the current approach? I do not think we have time to get into the absolute detail here, but I will share two very brief insights.

Supervisory regulation is much more prudential based and is a way of managing financial risks. If we had a Thames Water situation under a supervisory-type relationship, it would have allowed the regulator to step

in far sooner in order to not let the companies get into quite the same financial difficulties. It might give more powers of intervention along the lines that I just referred to. That is one version.

The second aspect of supervisory regulation is that it is more bespoke to the company or bank being supervised. If you speak to the Prudential Regulatory Authority and say, "How do you regulate Lloyds Bank?", it will be able to tell you exactly how many people are doing the regulation, how many are based at the Prudential Regulatory Authority and how many are based in Lloyds Bank itself. Whether that creates a form of shadow management, I could not say, but they have a much greater situational awareness of that institution than Ofgem or Ofwat would ever have with one of their companies. Because of that, you can set much more company-specific regulatory outcomes. You could allow a unique set of cost allowances for Yorkshire Water that take into account the topography of Yorkshire, which is much harder to do when applying a top-down, econometric type regulation.

I have to get into detail here. It is potentially an important part of the investigation, because a major change is being proposed for one of our key industries. It will raise the question about whether it should be applied to other industries.

Dan Elliott: Simon, thank you for getting me back on track. I agree with what you say. There is a tension. Thinking about supervisory approach within the context of the Cunliffe report, where it is not exactly clear yet what is meant, you sense that it is more in the second than the first territory, as Simon described. There will be a dialogue between company and regulator, and people will come up with bespoke and appropriate solutions rather than a focus on top-down, benchmarked attitude of, "I don't really want to know what's going on in your area; I just know that you are more expensive than they are, so reduce your prices".

We mentioned the word "trust" before. There needs to be greater trust between sector and regulator, and a greater ability for the regulator to understand what is happening on the ground and maybe what is special. That sounds great, but the difficulty is that could go hand in hand with more intrusive, more detailed regulation, more micromanagement of what companies do, which would be the opposite of what you want to achieve, if you are trying to open up innovation and growth. The micromanagement will likely come down to people saying, "You should do it this way, because it's being done that way over there". It is still unclear how that will play out.

In the context of the water industry, it is very clear that the regulator, for whatever reason—I totally accept there is fault on both sides—had come to the point where it almost did not need to hear the detail of what was happening on the ground, and said, "We will do this on our spreadsheets from within our offices". That has gone badly wrong for a variety of reasons, and there needs to be a better understanding of the asset condition, and people need to ask, "What solutions do the engineers see, and how will we move forward?" But that is specific to that situation, and

I can see that it could go either way. The supervisory approach is presented as if it will be smoother and slightly less hands-on, but it could end up being more so.

Baroness Drake: If the system is to move to being more outcomes-based, more supervisory and more flexible, will it require far greater clarity on how a regulator prioritises and mitigates risk? Going to water, one of the risks it must have totally ignored was inward investment, for example. Will you not need much greater clarity in prioritising risks and key measures for doing that, so people know what is driving the new approach?

Dan Elliott: I would phrase it slightly differently. There definitely needs to be clarity of approach. This will be a real challenge for the water sector over the next five years, because having said we want stability and predictability, we do not know how the system will play out. The key thing will be as soon as possible to get clarity on what the terms are and how we intend to apply them.

Simon Wilde: I agree. The point that Dan just made should not be underestimated. The proposal is to effectively regulate water in a way that has not been done before, despite the 30 years of experience since privatisation. Investors and their proxies, such as credit rating agencies, say, "We do not like this uncertainty". They may have preferred a less radical change. The honest answer to the question of what supervisory regulation will look like in the water sector is, "We just don't know". The devil is likely to be in the detail. If you look around the world, it may mean using more company-specific information on costs and not having the adversarial second-guessing that goes on at the moment between the regulator and companies. That is the direction of travel in the Netherlands, for example. Or it might mean an entire shadow management, where you have to go to court to change plans, as you have in state-by-state US utility regulation. We all await to see what it looks like. But you are absolutely correct that, if the regulator ends up micromanaging more, then it will have a hierarchy or basis on which to make those decisions.

Dan Elliott: To pick up on that, I would not consider it to be an enhancement of the current system if they found themselves micromanaging more.

Simon Wilde: I am trying to be studiously neutral about Sir Jon Cunliffe.

Dan Elliott: I do not think that is the intent. That is not at all the spirit of what is written in the Cunliffe report; it is very definitely the opposite.

I go back to the earlier discussion about complete and incomplete contracts, and how you come to the view that you need to be precise about every element of the analysis *ex ante*, thinking you will know how to deal with any theoretical problem before it has arisen. The difficulty with that is something will catch you out, which will not look like you ever envisaged, but the rules say you have to work in this particular way. The

incomplete “we will do the right thing” type of contract has served us very well in some respects; it has gone wrong in others. But that key element has been successful; I will put it that way.

Q39 Baroness Drake: Moving on to my question, the Government have announced plans to review every public body with a view to close, merge or bring functions back into departments. Some regulatory mergers have already been announced. What do you consider could or will be the impact of these plans on regulators and their ability to achieve their objectives? I know that is a wide universe, so you might want to make cross-cutting comments or pick out particular regulators, but give us a sense of what you feel the impact will be.

Dan Elliott: To repeat my earlier comments, I would like that process to be considered, thoughtful and not substitute action for results. That is easy to say but difficult to do. Stability and predictability over time in these arrangements is a key, but not the only, part of encouraging investment in the sector. So the decision to shake up all these bodies can be a risky and potentially damaging thing.

The situation had come to pass in the water industry where reform was required. We still do not exactly know what that reform is, and I would encourage that we get there quickly and decide what it should be. The thought worries me of merging organisations together on the pretext that they could be more efficient when there is not a clear theory of harm or of what is going wrong, or a clear vision of how the merger or change in structure will improve matters.

Baroness Drake: What you are saying is, depending on how you do it, you could actually encourage investment to be deferred.

Dan Elliott: Yes, and as I said earlier, even the promise of deregulation is a form of instability, which can discourage investment. After all, I may think, “If I hold off, I might get better terms in a few years’ time”.

Simon Wilde: Dan used an important phrase, which is, “What is the theory of harm?” What is going wrong that we are trying to remedy? The theory of harm is quite clear in the water sector, which says, “You have quality regulators who dictate what needs to be done, and you will be punished if you don’t do it. But you have a separate economic regulator that is in control of the purse strings and does or does not approve the financial investment to meet those targets”. The logic is: bring those together, and you will have more coherent, joined-up regulation. That also lets you explore things like being more company-specific or more water-basin and topography-specific.

I use that as an illustration to say, it depends on the facts of the case. The flip side is there is the proposal that some regulators get broken up. Again, the industry response to Ofgem is that, for consumer-facing activities you go to the Competition and Markets Authority, which I am not sure wants them, and if it is schemes, you go into other schemes, and you should be left with a very small network regulation. Again, the

theory of harm there is the body has become too big and sprawling, and it is not doing its job very well. So it will depend.

Fans of one thing or another can look around the world and see all these different examples. There are regulators such as Bundesnetzagentur in Germany and in the Netherlands and in Spain which are integrated, but they are separate elsewhere. That is the answer. But what is the risk? We know that all organisational transformations are difficult, and those in the public sector are particularly so. I am stating the obvious when I say that is the real risk of the regulators' eye being taken off the ball at a particularly important time. You would probably pick your moment sector by sector. Take energy, for example. We are trying to deliver Clean Power 2030 over the next five years. You can ask whether it is the right time to subject the regulators to significant structural change.

Baroness Drake: So, you risk regulators being distracted and investors putting off or deferring decisions.

Q40 The Chair: Could I wind up by picking up on your reference to regulators elsewhere in the world? We have talked a lot about failures of regulation of Ofwat in particular. Are there, whether here or abroad, case studies that we should look at and learn from?

Dan Elliott: I racked my brains on that question and put it to my colleagues, and I actually revealed my answer earlier: one particular success story, as far as we are concerned, was the shift in financial services regulation in Spain after 2008. That was a question about the balance between stability and competition.

Other than that, we have success stories in the UK, but we have rather lost our way, so it might also be worth looking at this question in a slightly different light. There were substantial successes with Ofwat; they were not unambiguous—there were pluses and minuses—but they were substantial in terms of encouraging investment, vastly improving service and environmental quality in the period 1990 to 2000. The lesson would be: we have everything into decimal points, and now we are obsessing with improving the decimal points. When you hit massive diminishing returns, things can start to go very wrong. I am not suggesting that the history of utility regulation from privatisation was an unqualified success for the first 15 years. There were public issues to do with, for instance, profits, where it was perceived the regulators had been too generous. Maybe they had, but also it unlocked the investment that was badly needed in order to renovate infrastructure. That is a lesson one might think about.

The Chair: Without making it too Ofwat focused, in the latter years, whether it was through government influence or Ofwat reading what it thought the Government wanted, the prioritisation of keeping prices down also seems in retrospect to have been a major fault.

Dan Elliott: Yes, it does. There is the specific example of storm overflows. Without going back over that topic, there are issues where the

industry would say it has identified challenges that the regulator chose not to meet. This may be a digression, but a difficulty we then faced—maybe it is the trust point—was the relationship between regulator and private company became inevitably more transactional. When a regulator says, “We want to keep prices down”, the industry says, “Well, the investors say we have not been financed to do this—that’s it; we just do what we’ve been told to do”, whereas in a more integrated or trusting environment a dialogue between all stakeholders might occur in which we say, “No, that decision is wrong: that needs to be paid for”, rather than people saying, “Hey, if you do not want to pay for it, we won’t do it”, which has come back to bite everybody.

The Chair: From your example of Spanish financial regulation post 2008, is there a conclusion or a theme that can be drawn that could be applied if not to all regulators at least to those appropriate sectors?

Dan Elliott: I am in great danger of sounding like I am banging the drum for the investors by saying, “Give the investors more money, and it will work out great”. If regulation is very focused on short-term competition and driving down of profits to the lowest sustainable level, there will not be a conducive environment for investment, innovation and growth.

Baroness Drake: Do you mean growth in the UK?

Dan Elliott: Yes, I do. If you want the investment to drive improvement in infrastructure and growth, you need to make it attractive for investors to do that. The system of regulation needs to give enough leeway—this is the judgment of the regulator—to do that while still presenting reasonable and fair controls to protect consumers. That is the trade-off.

Simon Wilde: I would agree with that. Rather than saying what is my or Oxera’s view, we have done a lot of work on investor surveys. In the water sector last year, and in the electricity this year, we asked, “What do you think about UK regulation in yours and other sectors? How is it compared to regulation elsewhere in the world? How is it compared to, say, five years ago?” Universally, the perception of UK regulatory risk and views on UK regulations have gone down over the last five years. However, in some sectors, it is still very well regarded. Moody’s, the agency which rates regulatory stability and predictability, still gave Ofgem triple A, along with only two or three other regulators around the world, including the Federal Energy Regulatory Commission in the US and the Australian Energy Regulator. This was above any continental European regulator. We should not overestimate how far we have fallen, but fallen we have, and others have picked up. The jurisdiction that was mentioned the most in Europe was Italy, a country which explicitly copied the best of UK regulation about four or five years ago and is seen as doing it very well. That is both a compliment but also a risk to the UK.

We should be honest. We are in a global competition for capital. Investors have choices. UK regulators need to be on their game and getting that balance right. But they are probably building from a stronger base than some detractors would have you believe.

The Chair: Thank you very much. You have both been extremely generous with your time and your wisdom. If we have not exhausted you and anything occurs to you, please write to us. There will be a transcript sent to you, so you will have the opportunity to correct any matters of fact. With that, I declare the session closed.