Why the regulators must stay

Competitive abuses must be policed, argues **Simon Carne**

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When Sir Bryan Carsberg was appointed in 1984 as the first regulator of the newly privatised British Telecommunications, it was widely accepted that he was needed to protect consumers. Without Carsberg and his staff at Oftel, there would have been little (other than self-control) to prevent BT from using, or abusing, its monopoly power to the advantage of its shareholders and the detriment of customers.

It took several years – and several regulators – before the market began to look genuinely competitive. This was after being opened up to all comers (subject to licence conditions), giving customers a real choice of telecoms providers. Now, gas and electricity are also being opened up to competition. Soon, everyone in the UK will be able to chose from an array of energy suppliers, each attempting to present its prices as a better deal than the rest.

Why, then, are the regulators not being wound up and sent home? After all, one of the first acts of the Labour government after coming to power last year was to institute a regulatory review on the back of a manifesto that promised to "promote competition wherever possible". The alternative of "tough, efficient regulation in the interests of consumers" was to be used only where competition was not possible.

Surely even a Labour government could acknowledge that unemployment among regulators is a price worth paying for competition in regulated industries. But, following its review, the government says it is committed to continuing the present regulatory regime. If anything, it wants to make this tougher by imposing a primary legislative duty on regulators to protect consumers' interests.

Has something gone wrong? Has the government lost its faith in competition? The answer to both questions is a firm "no".

The arrival of competition could not be expected to signal the end of regulation. It merely heralds the start of a new type of regulation: a transition from price control to competition policing.

If successful utility companies were to use their growing market share as a means to deter – or, worse still, destroy – their competitors, all the achievements of the past decade and a half since privatisation could be lost. A prime feature of the regulators' future role will, therefore, be to exercise powers under the new Competition Act.

These will grant the utility regulators, in parallel with the director-general of fair trading, the right to prevent anti-competitive abuse in the industries they regulate.

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Anti-competitive abuse can take many forms. For instance, established operators who find themselves faced with competition from a new entrant in a niche market may be tempted to undercut the newcomer's prices to deter customers from switching.

That is perfectly legal if the incumbent can make the price cuts through a combination of genuine efficiency savings and/or reduced profit on the product in question. But where the incumbent uses profits from other products to subsidise price reductions in more competitive markets, the price reduction might be unlawful. Economists call this "predatory pricing" – a colourful term that aptly describes the potential effect on the new entrant which becomes the target of such behaviour. And where newcomers still need to co-operate with the incumbent so as to provide a service to the domestic customer, it will be illegal for the incumbent to refuse to co-operate or to put up unnecessary barriers.

But what about the proposed new legislative requirement for regulators to protect the consumer? Anyone who expects competition to provide the necessary protection for customers has only to look across at the financial services industry, where competition is cut-throat but the scope for consumer abuse seems inexhaustible.

The possibility of mis-selling in the energy markets might become a new source of concern to the soon-to-be-combined gas and electricity regulator if companies make exaggerated claims for their products and unfair comparisons with those of their competitors. But there are other, more serious, dangers that competition can bring about if companies are tempted to cut not just costs but also corners as they fight for market share.

Regulation of the market to ensure the quality and continuity of supply might, therefore, become more important in the age of competition. The new legislative requirement seeks to make this duty explicit, although many would argue that one could not read the old legislation any other way. Certainly, the regulators have always seemed to recognise this aspect of their duties.

Moreover, it is important not to forget that, even in the newly competitive energy industries, there are still underlying monopolies (or near-monopolies) in the form of the National Grid and Transco's gas pipeline. And in telecommunications, with more than 50 per cent of households still having no alternative to BT, it is estimated that 90 per cent of all telephone calls continue to pass over the BT network at some point.

Consumers should welcome the increasing competition in these markets. But they should not expect to say goodbye to the regulators just yet – if ever.