

The role of the Intosai Privatisation Working Group and regulatory accountability in the UK

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POST PRIVATISATION CONTROL: THE ROLE OF THE INTOSAI PRIVATISATION WORKING GROUP

Since its inaugural meeting in 1993, the INTOSAI Privatisation Working Group has become one of the largest of INTOSAI's Committees and Groups with membership from 40 Supreme Audit Institutions (SAIs). The Working Group's 12th annual meeting in Brasilia in September 2005 is followed by a conference on International Denationalisation hosted by the Brazilian Court of Audit. Discussion of post privatisation control – by which I primarily mean economic regulation – will be a key part of both events.

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This is because successful privatisation of utilities and other businesses of strategic national importance necessitates effective regulation. The regulatory framework is, therefore, of central importance to the outcome of such privatisations. Economic regulation has taken a variety of forms and has been applied across the public and private sectors. Regulators are powerful and largely independent public bodies. All parties, especially the ultimate customers, can benefit from the spur to economy, efficiency and effectiveness that scrutiny from a SAI can bring.

A key role for the Working Group is to facilitate the exchange of information between SAIs – at our annual meetings and in between. The Working Group has published four sets of guidelines including, in 2001, guidelines on the audit of regulation.

We continue to monitor the effectiveness of the guidelines and to develop new guidance. The Working Group is currently designing a framework for a series of case studies which will illustrate key technical issues and draw on the experience of member SAIs. The first three deal with privatisation issues and the Working Group will consider the case for moving on to regulation and Public Private Partnerships.

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REGULATORY ACCOUNTABILITY IN THE UK

The United Kingdom's Better Regulation Task Force¹ defines regulation “as any measure or intervention that seeks to change the behaviour of individuals or groups”. Typically, regulation is set out in detail in laws passed by the UK Parliament (and increasingly by UK laws which transpose European Union directives). This aspect of regulatory accountability is discussed in the final section. But an important subset of regulation derives not directly from the detailed provisions of an individual law, but from the decisions, guidelines and rules established by independent regulators. The most important of these independent regulators in the UK are called economic regulators.

ECONOMIC REGULATORS

The economic regulators were established by Parliament in the wake of the privatisation programmes of the 1980s and 1990s, and were provided with statutory functions, duties and powers by Parliament. As economic regulators, their principal role is to control the abuse of monopoly power, though they may have other functions such as social regulation. Their duties are framed in such a way as to allow flexibility and discretion to regulators in the exercise of their functions.

The principal economic regulators are the Office of Gas and Electricity Markets (Ofgem), the Office of Communications (Ofcom), the Office of Water Services (Ofwat), the Office of the Rail Regulator (ORR) and the Postal Services Commission (Postcomm).

The relationship between the independent economic regulators and the Government is relatively clear. The Government sets the policy framework within which economic regulators operate but they are independent of direct Ministerial control. Independence is recognised as important and indeed one of the key benefits sought from the independent regulatory model is to shield market rules from potentially ‘captured’ politicians. The independence granted to economic regulators makes it possible for them to operate within a longer-term framework different from that dictated by shorter term political priorities.

In the UK regulatory model, however, independence is not absolute – for example regulators are appointed for a fixed term and although Ministers, in general, cannot remove regulators within this term, they have the power of appointment and reappointment. The Government can also change the legal framework within which regulators operate, by introducing new legislation subject to Parliamentary approval, although in practice this option to amend the legal framework has been used sparingly.

Furthermore, political developments such as electoral changes may mean that current priorities differ from the objectives of regulators set out in statute, which could create tensions between the regulator and Ministers. Since regulators do not operate in a vacuum, they tend to seek to minimise these tensions by maintaining open and regular discussions with Ministers and the principal Government departments.

¹ The UK Government established the Better Regulation Task Force (the Task Force) in 1997. Its terms of reference are: “to advise the Government on action to ensure that regulation and its enforcement are proportionate, accountable, consistent, transparent and targeted”.

The model then is one of constrained independence granted by Parliament. But how are regulators held accountable? There are four types of oversight:

- Political oversight. This derives from Ministers and Government. In the extreme, Ministers can absolve or dismiss regulators. But this is a fairly blunt, and rarely used, instrument.
- Appeals. Companies affected by regulation can appeal the content of specific decisions – for example, the level of a price control.
- Judicial review. Companies can also appeal to the courts about the process followed by a regulator – that is, the way a decision has been reached.
- The external value for money audit by the National Audit Office, acting on behalf of the public interest and reporting to Parliament.

THE NATIONAL AUDIT OFFICE'S ROLE IN ECONOMIC REGULATION

The National Audit Office's role is to give assurance to the public and Parliament on how public bodies are carrying out their tasks, and in the process to provide a stimulus to improvements in the effectiveness with which public bodies operate.

The National Audit Office contributes to the process of accountability in two main ways:

- By undertaking the annual audit of the accounts of central government and its agencies, including regulators. This audit provides Parliament with assurance that the accounts are “true and fair” and that income and expenditure complies with Parliament's intentions.
- Under Section 6 of the National Audit Act 1983, by examining the economy, efficiency and effectiveness (that is, value for money) with which audited bodies, including regulators, use their resources. In terms of regulation, the National Audit Office conducts value for money audits of the main UK regulators, (Ofgem, Ofcom, Ofwat, ORR and Postcomm) as well as the Office of Fair Trading (which covers competition policy and consumer protection outside these sectors).



The National Audit Office recognises that independent regulation as a model has many strengths and in practice has brought benefits to consumers in the UK. Nevertheless this model of regulation also brings with it some risks, primarily in terms of the exercise of discretion by the regulator: how can Parliament be sure that the regulator has used its independence and discretion effectively and in the public interest? The short answer to this question is value for money audit.

Value for money audits provide unique insight and adds an important layer of accountability over mechanisms like appeals and judicial review. The latter are concerned with the content and process of individual decisions. Value for money audit considers broader questions: such as how far regulators have achieved their objectives.

This means that in regulation we focus less on economy and efficiency than on effectiveness: not because economy and efficiency are unimportant – they are very important – but because the effectiveness of regulators is much more important in public interest terms. Regulators do not spend large sums of money. Ofgem's budget, for example, is only £36 million per annum - as at July 2005 that is some 144 million Brazilian reals, US\$63 million or 52 million euros. But regulators take decisions which have a large impact on consumers and regulated companies, and should be held accountable for the effectiveness of such decisions.

The National Audit Office therefore starts by considering how effective regulators have been in meeting their statutory duties and objectives, including a consideration of the tensions between them. The standard template for a National Audit Office examination involves three questions:

- What is the extent and scope of independent decision-making for the regulator in question, both in terms of the legal framework and in terms of the commercial and economic context of the market regulated? For example, our report on the liberalisation of Directory Enquiries (Directory Enquiries – From 192 to 118, National Audit Office, 2005) set out the legal and economic basis of the regulator’s decision to liberalise directory enquiries services, and showed how the decision was not well supported by evidence.

- How has the regulator resolved trade-offs and tensions between different aspects of its role, for example between the efficiency of the regulated market and equity of treatment for different groups within society? For example, our report on postal regulation (Opening the Post, National Audit Office, 2002) highlighted the tensions between Postcomm’s primary duty to ensure the provision of a universal service everywhere in the United Kingdom, and its secondary duty to promote competition, and how it could manage those tensions.

- Given that balanced and transparent reporting is an important element in any governance framework, how has the regulator reported its own decisions and achievements? For example, our report on new arrangements for the wholesale electricity market (The New Electricity Trading Arrangements, 2003) brought out how the energy regulator had not based its decisions in rigorous impact assessment nor undertaken robust evaluation of its own decisions.

BENEFICIARIES OF THE NATIONAL AUDIT OFFICE’S WORK

In the broadest sense, democratic society as a whole benefits from robust accountability arrangements. Within this broader picture, it is possible to identify three separate groups of beneficiaries from our work on regulation:

- **CONSUMERS** can obtain reliable, fairly priced services and are able to navigate the complexities of the markets with confidence. For example, we have produced a sequence of reports on competition in energy and telecommunications markets, which have brought to the public’s attention ways in which they can switch supplier to save money.

- **MARKET PARTICIPANTS** are free from unnecessary regulatory burdens and can invest and enter into contracts with confidence that the regulatory regime will not lurch in an unexpected direction. For example, our report on price regulation (Pipes and Wires, National Audit Office, 2002) showed how regulated industries faced a significant burden in dealing with the demands of regulators, and recommended ways that burden could be reduced.

- **REGULATORS** use their discretion and powers wisely and appropriately, being clear about trade-offs and impacts. We aim to analyse the main decisions and tensions in regulators’ functions and report to public and Parliament on results, and encourage regulators to assess their own efficiency and effectiveness and to not over-claim their achievements. For example, our report on the water regulator’s work to protect vulnerable households from flood risks encouraged it to report these risks more fairly, fully and transparently in its annual reports.

BETTER REGULATION

Privatisation in the UK has been associated with a better deal for consumers (choice, lower price, better quality of service) and increased efficiency, but the benefits are dependent on the quality of regulation. The success of this model has led to a renewed focus on the quality of regulation as a whole. Increasingly, regulation across the whole economy is seen as a key factor in economic growth and social welfare because:

- Regulation that is badly designed and implemented restrains growth, innovation and efficiency, in particular by placing unnecessary burdens on companies;
- Bad regulation may not in fact offer the protection to individuals and communities that it was designed to deliver.

The focus on the quality of regulation has coalesced into the Better Regulation agenda in Government. Better Regulation seeks to implement measures that maximise the benefits (eg food safety, environmental improvements) for the lowest possible burden on business. Better Regulation often prefers voluntary codes and a principles-based approach to regulation because they impose lower burdens than command-and-control regulation emanating directly from Government.

As a result of the Better Regulation agenda, there is a growing understanding of:

- The nature of burdens imposed by Government;
- The types of benefit delivered by well designed, proportionate regulation; and
- The net costs imposed by regulatory burdens.

This is manifested in the widespread development and use of the tool of Regulatory Impact Assessments (RIA). RIAs identify the costs and benefits of a policy proposal and the risks of not acting. They are intended to inform the policy decision making process and communicate clearly the objectives, options, costs, benefits and risks of proposals to the public to increase the transparency of the process. The UK Government produces over 200 RIAs a year.

It may be that society fears that, so far from acting as a moderating and controlling interest on the excesses of markets, regulation itself has now got out of control.

FINAL THOUGHTS

We would like to close this paper with a speculative assertion. There is a growing interest in the UK in what is variously called regulatory quality, Better Regulation and regulatory burdens. To some extent, this interest takes on a different emphasis depending on political preferences. What is an over-burdensome regulatory approach for one commentator could for another be a reasonable and proportionate protection of society from risks.

But the growing interest may reflect more than simply politics: it may reflect a wider anxiety within developed and developing economies about how ineffective regulation acts as a significant barrier to growth and development. This feeling becomes acute when society perceives regulators acting as independent experts – experts of course being particularly mistrusted in modern discourse – and with a wide degree of discretion.

It may be that society fears that, so far from acting as a moderating and controlling interest on the excesses of markets, regulation itself has now got out of control.

While this assertion is difficult to support with evidence, this paper concludes that the National Audit Office's work reflects a desire to contribute to this debate and to ensure, ultimately, that the regulators and departments use the discretion they have in the public interest. ■

The National Audit Office is involved in evaluating the quality of the Regulatory Impact Assessments by government departments. In 2001, the National Audit Office produced a report that provided policy makers with good practice examples, and a checklist of what assessments should cover. We have since published two further reports, in 2004 and 2005, which evaluate more recent Regulatory Impact Assessments.

We have also supported two further initiatives undertaken by central government. We contributed to a review of inspection and enforcement which encouraged a more risk-based approach to inspection activities (The Hampton Review, 2005). And we are working with the Government on its programme to estimate and reduce the administrative burden imposed by Government on business (Less is More, The Better Regulation Task Force, 2005).