



**NEW ZEALAND INSTITUTE FOR THE STUDY  
OF COMPETITION AND REGULATION INC.**

# Regulation

## Where are we going?

Prepared for the Institute of Directors (Wellington Branch)

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#### **CORPORATE MEMBERS**

Contact Energy Ltd  
Fonterra Co-operative  
Dairy Group Limited  
Meridian Energy  
Powerco  
Telecom Corporation  
of New Zealand Ltd  
Transpower New Zealand Ltd  
Vector Ltd  
Victoria University of Wellington  
Westpac Institutional Bank

# Outline

- General comment on regulation
- A quick stock take of New Zealand's state of play
- Where to from here?



# Regulation and Economic Planning

- Regulation seeks and enforces specific outcomes
- Heavy regulation beyond contract and competition law moves towards central planning
- The debate about **de-centralised** vs **centralised** administration of an economy
  - was over in the 1950/60s (most economists thought) and
  - evidence for the **de-centralised** approach were the revelations following Perestroika, and the performance of de-regulated “western” economies from the 1970s



# Competition is a major argument for a de-centralised economic system

- Competitive tensions induce variety in new products and ways of doing things
- Competitive tensions arise in different markets
  - Goods and services market
  - Ownership market
  - Labour including managerial market, and
  - Debt market
- Enhances dynamic efficiency (real economic growth), providing the (legal) rules of the game
  - Permit property rights: leading to rewards and accountability, and
  - Have certainty attached to them



# Reason to Regulate: *First Principles*

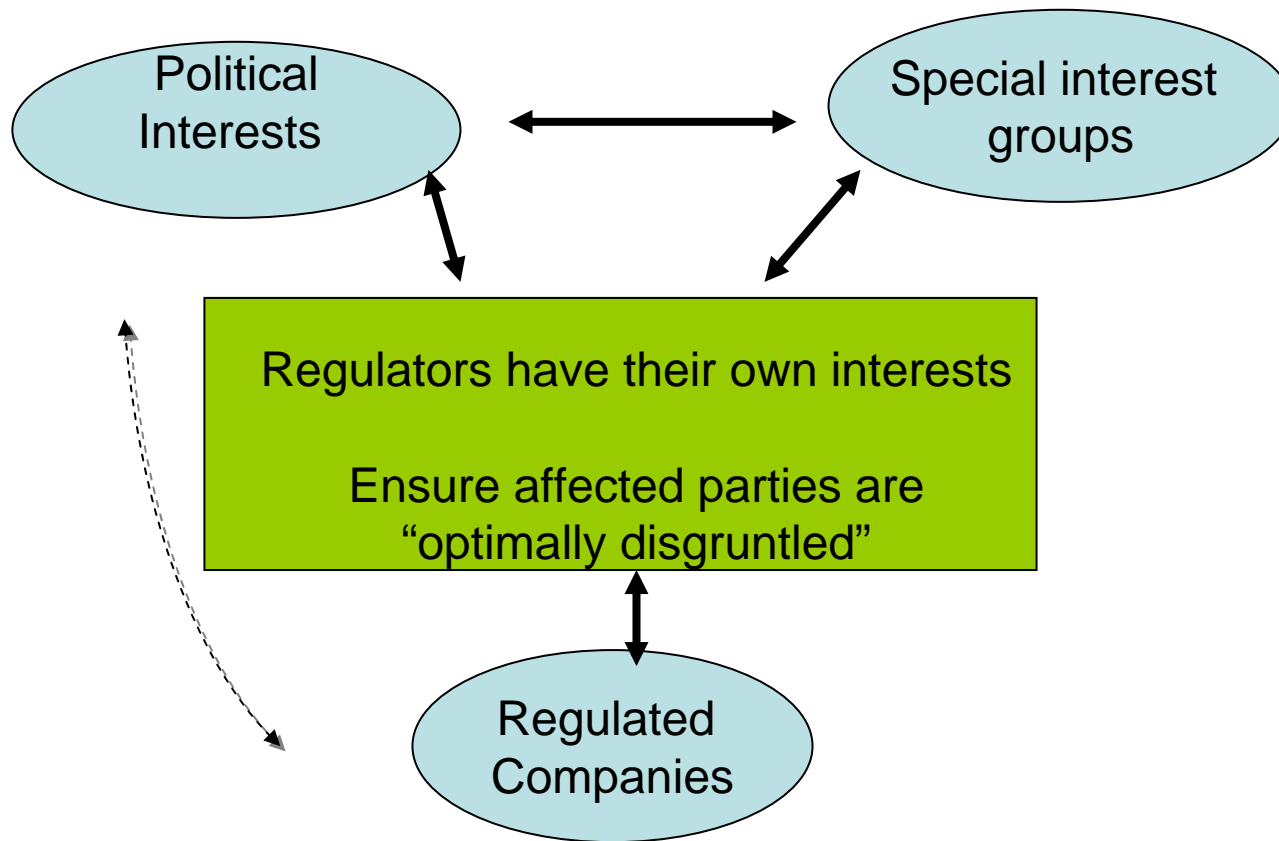
- externalities: e.g. issues to do with public goods and the environment
- getting better performance where firms have market power
- addressing hidden information problems

**OECD:** but only if regulation can improve performance



# Reason to Regulate: *Second Principles*

The Supply and Demand of Regulation arising from the State's ability to coerce



Stigler & Becker

Consumers/investors: where do they fit in?  
OECD: regulatory arrangements - political independence



# *Third Principle*

## A neglected element of regulatory design

**(less) Competance/**

**Corruption = M + D - A**

**Monopoly**

**Discretion**

**Accountability**



# How is New Zealand Regulating?

## Differently from OECD Principles, the UK and Australia

- Regulation is typically not devolved to independent institutions ( employment arrangements/political connection) e.g.
  - Telecommunications (period of appt.):
  - Electricity Commission (institutional location)
- The objective of institutions is not at all clear e.g.
  - Roothing (Is a cost-benefit analysis OK for Transit analysis?)
  - Electricity Commission (both Regulator and Service Provider)





# How is New Zealand Regulating?

- Limiting competition: e.g. health, insurance, education
- Extending regulation to activities that don't "need" it: e.g. cooperative lines Co's, state-owned entities without a profit max objective (Transpower)
- Extending the scope of regulation: e.g. the Commission extending Part IV of the Commerce Act beyond mimicking a competitive market by regulating for transfers even between firms
- Limiting the accountability of regulatory bodies vs the approach of Australia, UK and the USA that enable merit reviews.



# How is New Zealand Regulating? Electricity Lines

- The Commission set price/quality thresholds that must be breached
- On breach, the Commission could choose to control: it has assessed price control for Unison, and Vector.
- In evaluating control it suggested that it would set prices according to ODV regulation. The idea is that the prices would be those of an efficient replacement firm (entrant).



# Commission's Evaluations of Regulation Have not Been Good Practice

- ODV is a hypothetical model and its prices were not checked for reality. Prices have failed the cash flow test.
- Issues (e.g. tax/asset purchases) inserted into its hypothetical model set prices below what any standalone efficient entrant could possibly charge
- In various of its analyses it has,
  - virtually ignored the risk that ODV regulation implies for the firm (some change in 2007):
  - Placed no weight on uncertainty in the estimates of ODV;
  - insisted on a wacc with errors;
  - would not evaluate forward-looking decisions using a proper, standard, investment tool;
  - confused discounting the future with compounding the past;
  - etc



# How is New Zealand Regulating?

## Lines Companies

- Unison and the Commission reached a settlement that was not the Commission's suggested regulatory approach:
- Vector settlement unknown?

## Regulatory implementation Issues Arise Elsewhere

- e.g.
- in telecommunications
  - in RMA decision-making
  - in the presentation of data (OECD league tables)



# How is New Zealand Regulating?

## Investment has been affected

- Access, and *ex post*, regulation in telecommunications
- Transpower has (legitimately) complained of this effect of ODV regulation
- The *threat of takings* associated with scooping off “functional profits” is sufficient to reduce investment
  - Demonstrated in forestry
  - Demonstrated in cash flow analysis of lines companies
  - Demonstrated in cost-benefit analysis of gas regulation



# Where To From Here?

- The review of part IV of the Commerce Act has been stimulated in large part by the interpretations and process of the Commission
- Some proposals for change lack recognition that the form of regulation and the inputs to regulation are jointly determined and cannot be assigned to separate layers of administration;
- Some officials seem to want “The Minister” involved in price setting;
- A limited merit review arrangement is a debated possibility.



# More Generally

**The (OECD) process for regulation on first principles seems in abeyance**

**Competition rather than central planning is desirable**

**Merit review processes for many regulatory institutions would be desirable**

