



The Role of Regulation in Facilitating Efficient Investment

Iain Osborne

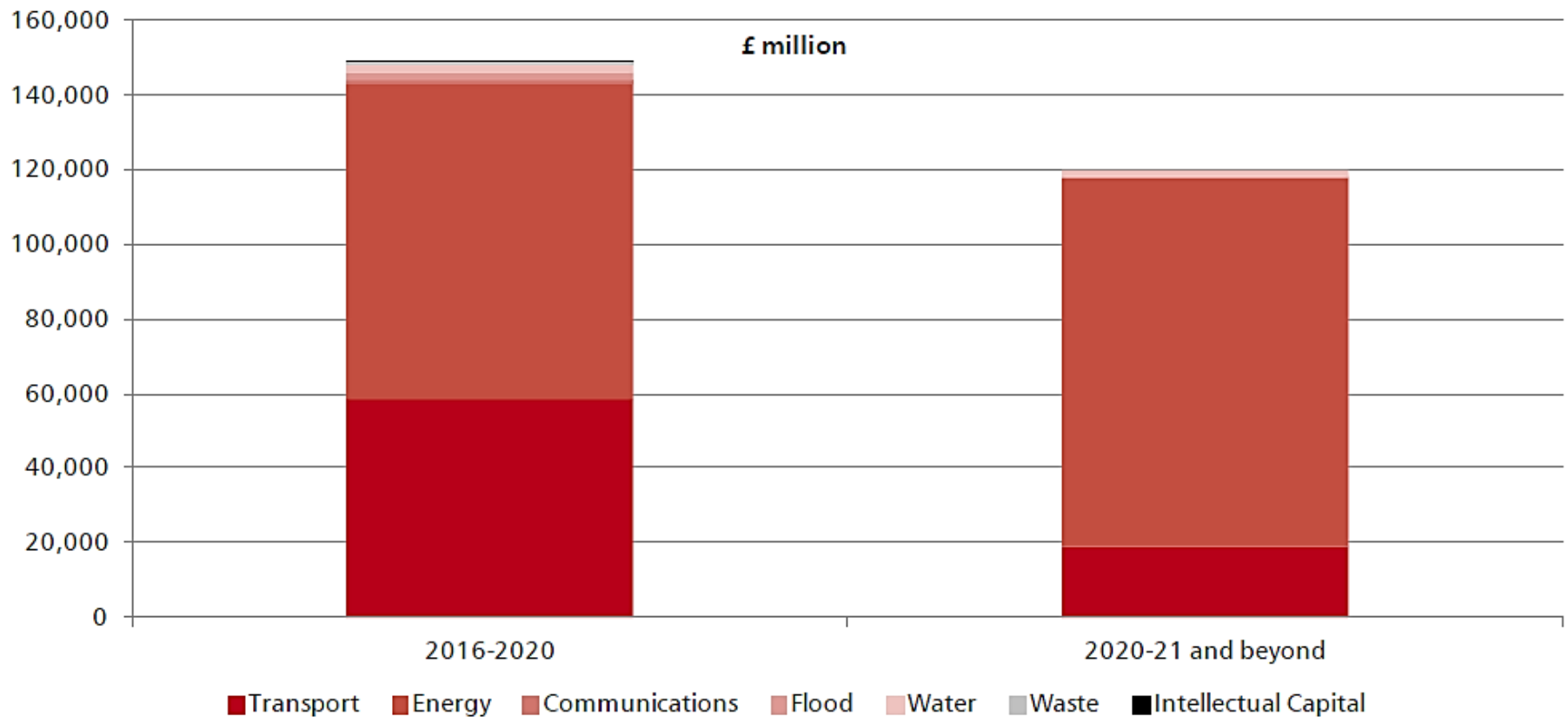
RPI Conference, 23 April 2015

Outline

1. Regulation and investment
2. Airports as an example
3. Regulation in context

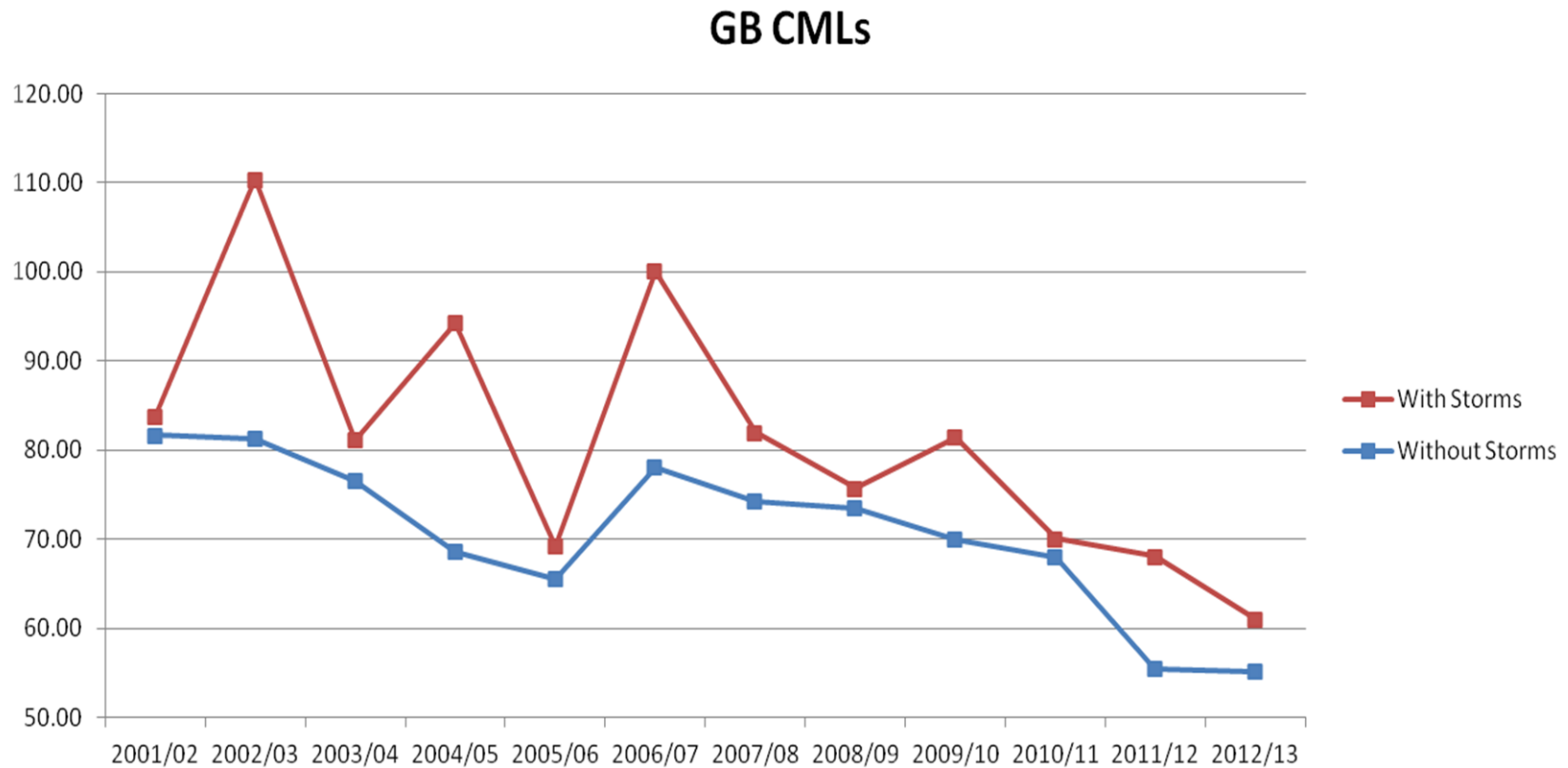
Size of the pipeline

Pipeline capital investment 2016-17 onwards



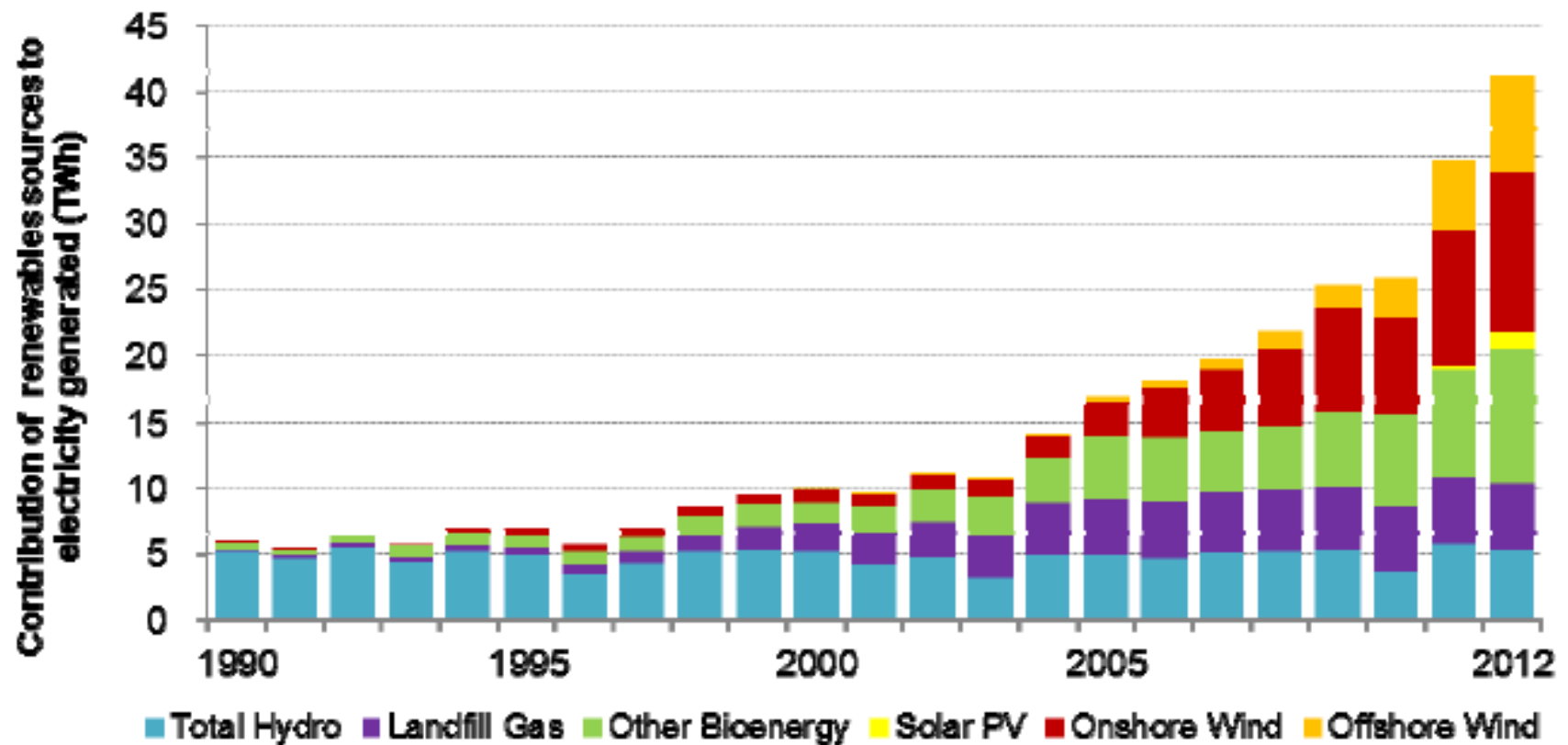
Energy

£80bn of investment in the networks since privatisation



Energy

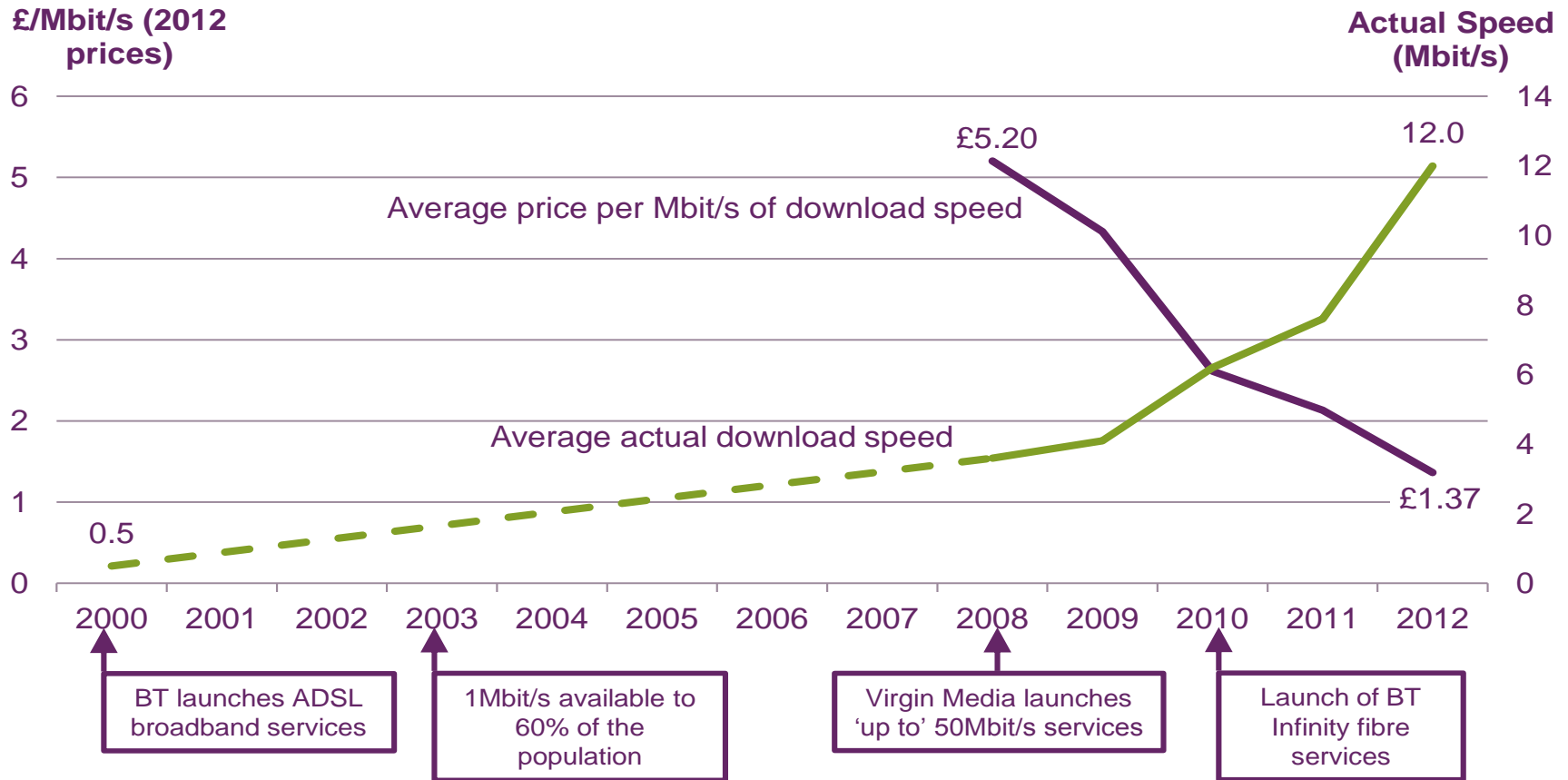
Chart 6.1.2: Electricity generated from renewable sources, 1990 to 2012



Note: Hydro bar includes shoreline wave/tidal (0.004TWh in 2012)

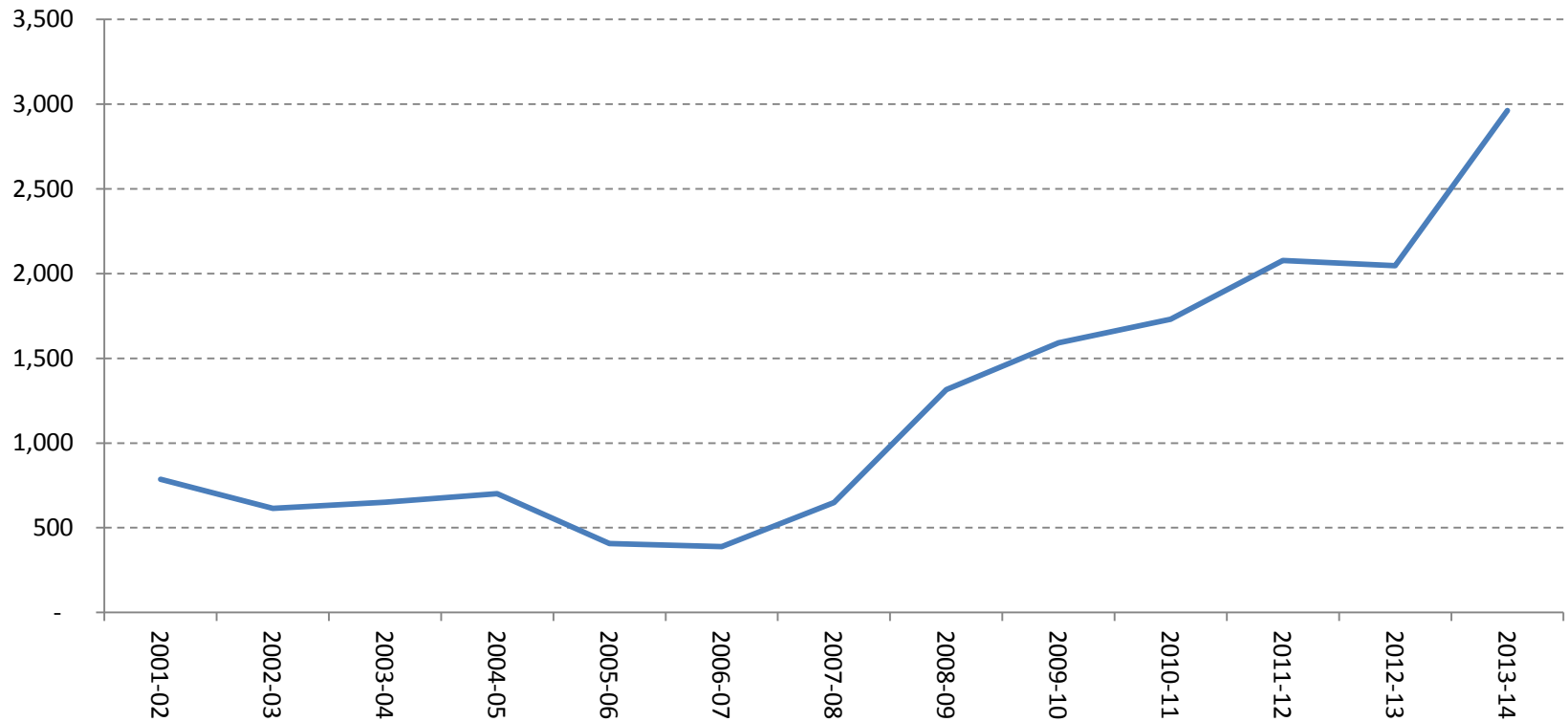
Broadband

Average residential download speeds up to 14.7Mbit/s by mid 2013



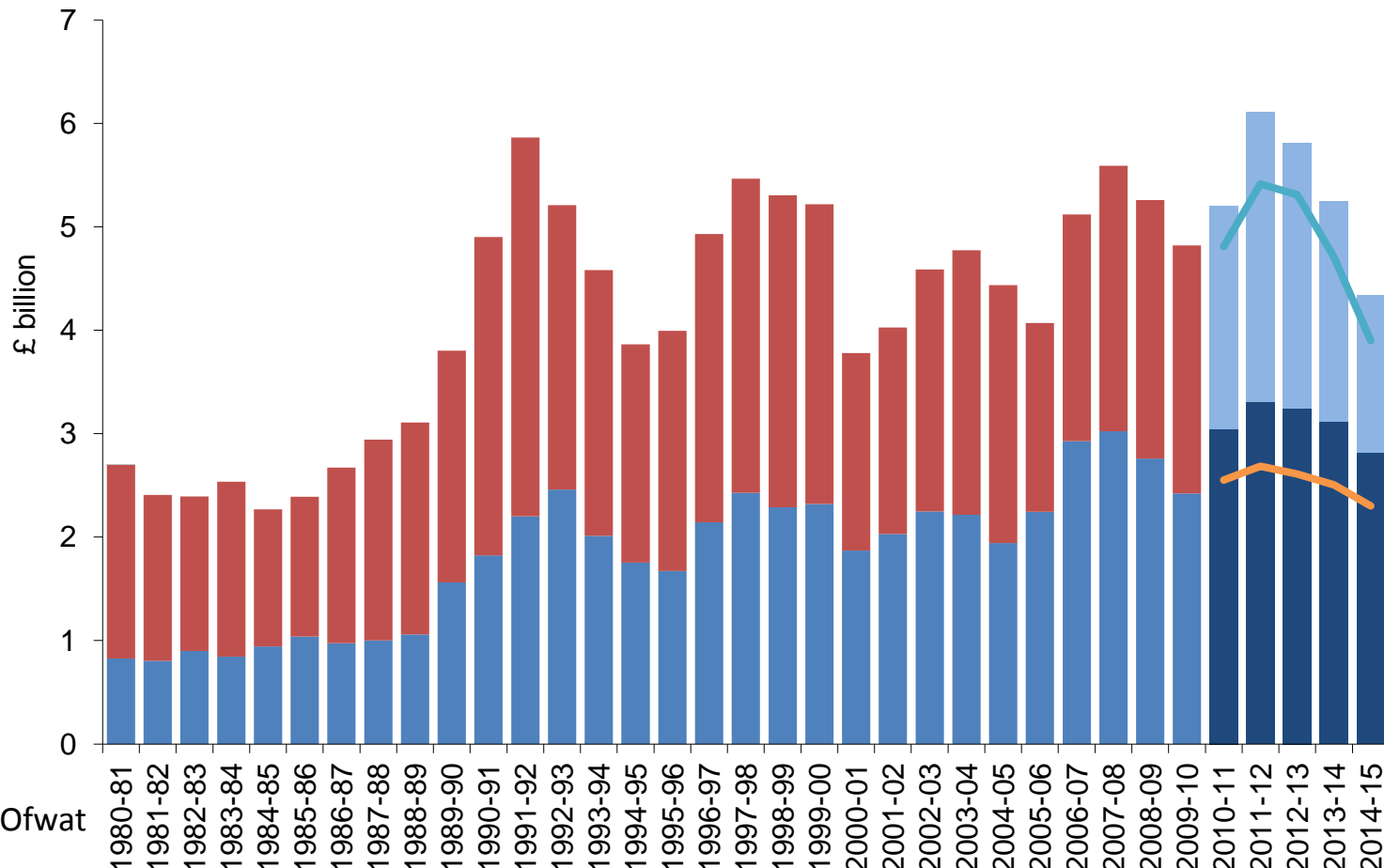
Rail

Network Rail spend on enhancements since 2001-02 (£m nominal)



Water

Annual capex doubled after privatisation, doubling RCV over 25 years



Some key lessons

- Track record of favouring investment both in competition and monopoly conditions
- Value of RAB/RCV approach, although also downsides
- Cumulative small gains add up to transformation

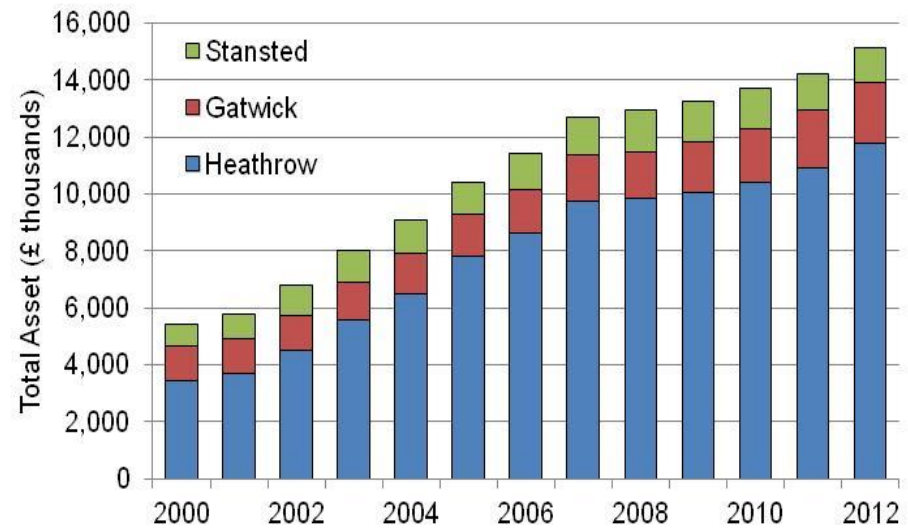
2. Aviation

- Saved passengers £2.1bn in airport charges from 1988/89 to 2013/14
- Encouraged investment of £10bn in regulated airports between 2000 and 2012
- Contributed to higher commercial revenues at regulated airports, which helped lower airport charges
- Contributed to lower operating expenditure at regulated airports
- Improved service quality and raised passenger satisfaction at airports
- Reduced average flight delay from 130 seconds in 2003 to one second in 2013
- Lowered lower the cost per flight-hour for en-route services from €634 in 2002 to €399 in 2011.
- Going forward, CAA will further the interests of users by:
 - only imposing economic regulation where it is warranted
 - ensuring prices are appropriate
 - ensuring continuity of service
 - ensuring reasonable levels of service by regulated airports and NATS



Strong investment story

- Heathrow, Gatwick and Stansted have undertaken significant investment in airport infrastructure. Notable investments include:
 - Heathrow Terminal 5, built at a cost of £4 billion to house the majority of BA's flights and opening in 2008.
 - Heathrow Terminal 2, built at a cost of £2.5 billion to consolidate the 23 airlines of the Star Alliance and opening in 2014.
 - Gatwick's various improvement to the South and North terminals, which has included improvements to the forecourts, landside concourse, security processes, baggage system and departure lounge.
- Increased investments has resulted in improvements in passenger service quality and airline operational efficiency.
- Total assets at Heathrow, Gatwick and Stansted have increased by around 280% between 2000 and 2012, rising from £5.4 billion to £15.1 billion in nominal terms.



Regulating new runway expansion: the challenges



- High gearing and/or the investment is a large proportion of existing RAB (x2 - x3)
- Not possible to forward-sell capacity. Airline balance sheets not up to it; and legal issues.
- Payback over a period that is a significant proportion of the lifetime of aviation so far – not easy to predict the future!
- Costs for this kind of project often escalate

Principles for regulating runway expansion



- Risks should be allocated to the bodies best placed to manage each specific risk
 - Maintain incentives for efficient delivery
 - Allocation to passengers is a last resort
- Commercial negotiations between the airport and its airlines should be encouraged
 - Pricing of risk less likely to be distorted by regulatory gaming or information asymmetries
 - But need to remain alert to effects of market power
- Runway capacity can be paid for both before and/or after it is operational
 - Smooth the price shock and reduce risk

Pre-requisites for successful regulation of runway expansion

- Clarity of purpose. This is already in place in the Civil Aviation Act 2012
- Institutional credibility. This is down to us!
- Ministerial commitment.

3. Regulation in context

- Regulation is part of a policy and industrial project.
- Do consumers and society accept the importance of investment and of profit?
- Who is trusted?
- Who has permission to lead?