Economic and Competition Regulation in an Independent Scotland
ECONOMIC AND COMPETITION REGULATION IN AN INDEPENDENT SCOTLAND

EXECUTIVE SUMMARY

- The Scottish Government's vision for an independent Scotland is of a thriving and successful European country, which reflects Scottish values of fairness, prosperity and social cohesion.
- Every day, people in Scotland are affected by regulation in many different ways. It will, therefore, be crucial that an independent Scotland develops an effective, efficient and easily navigated regulatory framework, which will bring significant benefits to Scotland’s economy, to businesses and to consumers.
- Independence would give us full powers for economic and competition regulation. Currently, Scotland only has overall responsibility for this in the water sector. However, our proven track record in this sector demonstrates that we can deliver an effective, innovative and world leading regulatory framework that better meets the needs of the Scottish people.
- Rather than simply replicate the full suite of UK economic regulatory bodies, an independent Scotland could simplify the regulatory landscape to one that is more appropriate for a country of Scotland's size, by bringing together these functions.
- This would allow, for the first time, economic and competition regulation in the vital sectors of energy, communications, transport, water and competition to be focused on delivering benefits for Scottish customers and the Scottish economy.
- Industry will benefit from dealing with fewer regulatory bodies and from greater stability and consistency in regulatory decisions.
- Consumers will benefit from having a more powerful regulator acting on their behalf with strong powers to ensure that markets are working efficiently in Scotland.
- The costs of regulation to industry and the public purse will be minimised, ensuring efficient government. Our initial analysis shows cost savings as compared to replicating the UK economic and competition and regulatory model in Scotland.
- The Scottish regulator would work closely with its counterparts in the rest of the UK to ensure stable markets, particularly where the continuation of joint markets is identified as beneficial to consumers north and south of the border.
- A combined regulatory body will be able to deploy resources more effectively and flexibly to the different areas of its work. It will be able to provide a single, and, therefore, stronger voice, both in Scotland and internationally on competition and consumer issues.
- Combined regulatory models of this type are successful in many other countries.
1 The Vision for Regulation

The Scottish Government’s vision for an independent Scotland is of a thriving and successful European country which reflects Scottish values of fairness, prosperity and social cohesion. As an essential part of this vision, Scotland will have a strong, stable and modern economy with a regulatory framework which meets best practice: allowing businesses to prosper while providing robust safeguards for Scotland’s people.

Every day, people in Scotland are affected by regulation in many different ways. We look to regulation to help ensure we live safer lives and are treated fairly, to protect and manage our environment, and to maintain a competitive and efficient economy. Regulation is a means to an end – a better society and a vibrant economy, not an end in itself.

The Scottish Government recognises that regulation is necessary to protect consumers, business and the environment. It is also vital that the design and delivery of regulation is effective and meets the principles of better regulation, namely that it is transparent, proportionate, consistent, accountable and targeted only where needed.

There are currently a wide range of independent UK regulatory bodies, covering both public services and private industry, which provide functions relating to:

- consumer protection (particularly in essential services and monopoly markets);
- economic regulation (such as setting prices, increasing service standards and encouraging choice);
- competition and fair trading policy (ensuring markets operate effectively);
- professional standards (for individuals, companies and public bodies); and
- technical oversight (such as ensuring safety and protecting the environment).

However, the current UK regulatory model is not the only way of delivering these functions, and many countries have adopted different regulatory frameworks that merge functions across a wide range of sectors. Some of these alternative models are discussed, in more detail, in Annex A.

An independent Scotland has the opportunity to improve on the UK regulatory model, streamlining and reinvigorating these functions to make them compatible with and reflective of our values and ambitions. The current UK framework is not focused on our distinct Scottish circumstances, and independence will allow us to deliver a more targeted regulatory framework.

Scottish consumers already contribute towards the cost of the UK regulatory bodies. The cost of running new institutions in Scotland would not be in addition to the existing cost of the UK regulators, but a replacement for them.
It will be crucial that an independent Scotland has developed a blueprint for an effective, efficient and easily navigated regulatory framework – a framework which is underpinned by a shared vision – “a country with a stable economy that works for the many and not just the few; one that knows it must create the wealth it needs to support the strong public services it values; a country that manages its vast resources responsibly, with an eye to the future; a country that has fairness at its core and allows all individuals to reach their full potential. A nation that makes its own decisions and shapes its own future.” ¹

This paper addresses economic and competition regulation. Regulation of financial services and markets will be addressed in a separate paper, which will be published later this year. Regulation in other sectors, for example in the oil and gas sector, will also be discussed in future papers.

It is also worth noting that the economic regulatory functions are closely aligned with the role of the consumer advice, advocacy and research bodies, including Citizens Advice Scotland, Consumer Focus Scotland and Passenger Focus. Further consideration is being given to the opportunities for improving consumer representation in an independent Scotland and this will be discussed in a future paper, but the initial indications are that there could also be benefits from consolidating this function in a single body to bring a greater focus and stronger voice to the regulatory landscape.

Competitive markets are, and will continue to be, an essential component of the Scottish economy. They are of vital importance in delivering goods and services cost effectively to consumers. Well-regulated competitive markets can maximise consumer welfare and boost economic growth, creating jobs and driving innovation. When markets work well, firms prosper by providing what consumers want better and more cost effectively than their competitors. However, in some instances, when left to their own devices, markets will not necessarily deliver the best outcomes for consumers, companies or Government. This is particularly the case for those markets with natural monopolies where there is a lack of competition or barriers to entry. A robust competition regime will give confidence to established businesses in Scotland, as well as to those wanting to set up here, that Scotland is a place to do business.

¹ Nicola Sturgeon, Deputy First Minister’s speech at Strathclyde University, December 3rd 2012
2. Opportunities for better regulation in an independent Scotland

Some of the key policy levers which determine the long run competitiveness of the Scottish economy, such as education and training, are already available to the Scottish Government. However, it has limited control over the taxation system, the overall spending envelope and key spending decisions such as welfare. One key area where the Scottish Government would gain new responsibilities would be economic regulation. We focus here on regulation but further benefits arise from the capacity to use tax and regulatory powers in an integrated way in an independent Scotland.

An independent Scotland will have the power to deliver an effective, simplified and stable regulatory framework. This will bring significant benefits to Scotland’s economy, to businesses and to consumers. For example, there are growing concerns that the current UK economic regulatory framework is not working to meet Scottish needs. There are many examples:

- In the energy sector, bills continue to rise causing increasing hardship for homes and businesses and pushing more households into fuel poverty. This is due primarily to the impact of higher gas and oil prices, but could be addressed more effectively by a regulatory approach which was tailored more explicitly towards supporting renewable and low carbon technologies and a far greater emphasis on energy efficiency.

- 43% of the households in Scotland, without mains gas, are in fuel poverty. The existing regulatory model has no mechanism which allows them to access the discounts on energy bills which are available to those on mains gas through ‘dual fuel’ tariffs.

- In the telecommunications sector, broadband coverage in rural areas remains a particular problem in Scotland. The current UK regulatory framework focuses on the most cost effective deployment rather than maximising access.

- In the postal sector, parcel delivery charges to the Scottish Highlands and Islands are unreasonably high, and the current absence of a UK regulatory approach is widely acknowledged to be detrimental to the interests of both business and consumers in Scotland.

An independent Scotland can reinvigorate the regulation of these critical infrastructure industries. In particular, there is the opportunity to re-establish public confidence in the regulatory framework by ensuring a far greater focus on the specific requirements of customers in Scotland.

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A vision for Broadband in Scotland

Scotland’s Digital Future: Infrastructure Action Plan\(^3\) outlines a commitment to a future-proofed infrastructure that will, by 2020, deliver a world-class digital vision, which will support any device, anywhere, anytime connectivity across Scotland.

Scotland’s Digital Dialogue\(^4\) is the Scottish Government’s programme for delivering this vision. Regulation is just one area that could contribute to this. Evidence gathered from international case studies highlights where regulatory actions have contributed to enhanced broadband deployment. As part of the UK, the Scottish Government has no regulatory powers in this area.

The following examples have emerged.

- In Sweden, a 99 per cent coverage obligation was a requirement of the 3G and 4G spectrum auctions. This helped deliver extensive coverage to areas characterised by low and dispersed populations. Despite the auction for 4G spectrum in the UK setting coverage targets, this will still leave significant coverage gaps in rural Scotland.
- In some smaller European countries, such as Norway, Iceland and Slovenia, the telecommunications regulators are involved in mobile sector regulation. Within Scotland, there may be a role for the regulator to allow consumers to switch between networks, to address poor network coverage in rural areas.
- In Finland, they have made access to broadband a legal right as well as setting a universal minimum service provision; 96 per cent of the country is now online.

Scotland has a challenging geographic landscape with a number of rural and remote communities to serve. In an independent Scotland, there will be a need to look at regulation differently to eliminate the digital divide and to ensure our world class digital ambitions are delivered. A strong regulator focused on the needs of Scotland’s economy, business and consumers will be needed to tackle these issues.

As evidence of what Scotland can achieve, we need look no further than the water industry where Scotland has its own economic regulator. Assisted by effective, robust and stable regulation, Scotland now has the lowest water and wastewater charges in the UK and among the highest levels of service (see box). It also has the first competitive market for businesses and public sector organisations in the world.

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\(^3\) [http://www.scotland.gov.uk/Publications/2012/01/1487](http://www.scotland.gov.uk/Publications/2012/01/1487)

\(^4\) [http://www.scotlandsdigitaldialogue.org/](http://www.scotlandsdigitaldialogue.org/)
Consumers want strong regulation that delivers the lowest possible prices and the highest service standards.

At present, Scotland has one devolved economic regulator – the Water Industry Commission for Scotland (WICS). It promotes the interests of water and wastewater customers by ensuring they receive a high-quality service and value for money, as well as facilitating competition in the industry wherever possible.

WICS is an example of how a Scottish regulator is delivering for Scotland’s consumers. WICS has helped the water industry undergo significant transformation with considerable benefits for consumers.

- The average household bill for water and sewerage services in Scotland during 2012-13 is around £50 lower than the average in England and Wales.
- Consumers in Scotland have enjoyed price freezes for the last four years. Household charges will increase by below inflation this year. This is lower than the increase announced for water bills in England and Wales.
- Scottish Water has significantly improved the level of customer service it provides and has cut its leakage by more than a third.
- Household bills are, on average, around £100 lower than they would otherwise have been without robust regulation.
- Around 40 per cent of businesses and public sector organisations are receiving lower prices and/or better customer service as a result of the introduction of retail competition in the non-household sector: a world first for Scotland.

Overall, efficient and effective regulation of the water industry in Scotland has helped to deliver the lowest average household charges in Great Britain. It has also been an important factor (along with management and staff commitment and a strong policy drive from government) in helping deliver further benefits for consumers, including stable bills, continuing customer service improvements and the delivery of a large, but efficient, investment programme.

The significant achievements in the water industry in Scotland reflect the response to an effective combination of government policy, management incentives and economic regulation within a Scottish context. An independent Scotland with full control of its policy framework and economic regulatory and competition levers will have the scope to deliver benefits across other sectors in the economy.

In this, and other devolved areas, such as environmental regulation, Scotland has demonstrated that it can deliver an effective, innovative and world leading regulatory framework that better meets the needs of the Scottish people.
Environmental Regulation in Scotland

The better environmental regulation programme will help improve the way environmental regulations are applied in practice across Scotland. It will streamline and simplify both the legislative framework and the Scottish Environment Protection Agency’s regulation of activities which cause pollution at a local and national level.

This will bring benefits both to SEPA and to operators. A new funding and operational design mechanism will enable SEPA to move away from an activity-based to a more risk-based, flexible, joined-up, preventative and proportionate approach to environmental regulation. This move to more outcome-focused regulation will enable SEPA to target the issues that matter most and support outcomes that deliver improvements to the environment, communities and to business.

3. Economic and Competition Regulation – a worked example

Independence will enable Scotland to introduce an effective regulatory framework, which will be just as important as gaining control of other economic levers. Context matters for the design of policy; small countries are not scaled down versions of large countries.5

As an illustration of the benefits that independence for Scotland could bring to the regulatory framework, we have developed a model of how economic and competition regulation could be delivered. Along with regulation in the financial sector (which is discussed in the Macroeconomic Framework Paper published by the Fiscal Commission Working Group on 11 February 20136), the approach to economic and competition regulation is a critical area for ensuring the success of Scotland’s economy and in achieving a better deal for consumers.

Our proposal, which is set out below, delivers effective and simplified regulation in the following sectors: energy; telecommunications; postal services; water; rail; competition; and consumer protection.

The existing UK regulatory bodies for these sectors are described in more detail in Annex A.

An independent Scotland will be part of the European Union (EU). To meet EU requirements in most of these sectors, Scotland will need to establish a National Regulatory Authority (NRA), which is independent of both government and industry. This NRA will play an important role in ensuring that EU policies are taken forward, for example in the area of integrating energy and telecommunications markets across Europe. The NRA will also

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5 Implications of limited Policy Autonomy: Lessons from Selected Small Advanced Economies - David Skilling
provide Scotland with full representation in increasingly important EU and worldwide regulatory forums.

An independent Scotland will have the opportunity to streamline the number of regulatory bodies in this area to a level more appropriate for its size. Along with the obvious scope for cost savings from merging ‘back room’ functions and reducing corporate governance overheads (as discussed in more detail in Annex A), this will offer benefits of:

- a more consistent approach (more ‘joined up government’ across sectors);
- improved customer protection (from more focused regulation);
- avoiding unnecessary duplication in our markets and mergers regime;
- pooling of expertise in what are often specialised areas, where skills are in short supply.

It should be noted that staff efficiencies would be in relation to the replication of a full suite of UK economic regulatory bodies. In practice, there will be a requirement to recruit more staff than are currently employed in economic regulation in Scotland.

Annex A sets out the evidence we have gathered on the delivery and costs of economic and competition regulation in a number of other countries as well as evidence on the cost savings from recent mergers of public bodies in Scotland and from the creation of Ofcom. This evidence confirmed that merged bodies tend to achieve financial savings over the operating costs of separate bodies.

Based on the cost per population from the international comparators, it is estimated that the annual savings from creating a combined regulatory body within Scotland could be of the order of £10 million. However, it should be noted that this estimate is based on comparing the operating costs per head within a number of countries, which may not be reflective of the costs of delivering economic regulation within a Scottish context. As such, it is more likely that efficiency savings will be in the region of 10-20 per cent compared to the operating costs from creating a full suite of bodies.

Consequently, consideration has been given to integrating the required economic and competition regulatory functions into a single body, or at most two. The option analysis at Figure 1 highlights the various functional groupings which have been considered and discussed with regulatory experts across the UK, as well as with regulatory contacts in the Netherlands, Australia and New Zealand where similar models are established. The analysis considers increasingly integrating the economic and competition regulatory functions from six individual bodies, through models of combined utility (energy, water, communications) and combined transport (rail, aviation) to, ultimately, one combined economic and competition regulator.
Our discussions have demonstrated that there are two possible functional models for economic and competition regulation which could deliver our vision for an independent Scotland. Our analysis has also confirmed that, in Scotland, the role of the UK civil aviation regulator is almost entirely related to technical and safety matters and these functions could be delivered either through the existing UK body, the Civil Aviation Authority, on a joint governance or contractual basis, or through a separate Scottish civil aviation body. Were a need to arise for economic or competition regulation within the aviation sector this could be dealt with through the competition powers of the combined regulator in the same way as in other industries.

**Option 1. A combined competition and economic regulator**

This single body would bring together the roles of the Office of Fair Trading (OFT), the Competition Commission and the economic regulatory functions in the energy, telecommunications, postal services, water and rail sectors. This model recognises the close alignment of the functions carried out by the economic regulators and the competition authorities, which primarily relate to consumer protection and facilitating markets. The core skill sets of the organisations are similar and relate to the areas of competition law and economic and financial analysis. Already, most of the sector regulators hold concurrent powers in respect of both UK and EU competition rules in their respective sectors. Similarly, the sector regulators have the same power as
the OFT to make market investigation references to the Competition Commission.

Consideration has also been given as to how sector specific expertise would be maintained in this model. For example, the combined regulator would need to maintain a detailed knowledge of energy, rail and telecommunications markets. As has been demonstrated in other countries, this is achievable by maintaining a degree of sector specific focus within the combined body, for example by having a divisional structure within the organisation which brings together the technical expertise in each area but allows shared skills (such as economic analysis) to operate across divisions.

A combined regulator would also need decision making mechanisms adequately reflecting the range of its responsibilities, both in terms of technical subject matter and in the difference between sectors that are relatively mature, and those such as energy and telecommunications that are developing rapidly. The New Zealand Commerce Commission, for example, has a designated Telecommunications Commissioner.

It is clear that some of the current UK regulatory bodies deliver functions outwith their central role as economic regulators. In telecommunications the current UK regulator, Ofcom, has wider responsibilities than economic regulation, including spectrum management and media content. Similarly, the energy regulator, Ofgem, has been given a role in administering government levy and support schemes. Further consideration is taking place as to whether these wider functions would best sit in a combined economic and competition regulator or elsewhere. For example, spectrum management has synergies with the economic regulation aspects of telecommunications (both relying on the same highly specialised skill set) and a provisional view is that it could remain in the duties of a Scottish economic regulator. Equally it could be handled directly by government (as in the Dutch model and in other countries). Media content regulation is the subject of wider discussion currently; and there is scope for either government or another agency to administer levy and support schemes.

Similarly, it is proposed that the safety functions in rail would not form part of the combined regulatory body, given the importance of maintaining a strong focus in this area and the different nature of the skill sets employed. Instead, this critical role could be delivered as part of the functions of a Health and Safety body in an independent Scotland. Further work is underway on this issue.

**Option 2. A combined utility regulator with a separate competition authority**

In this model the combined utility regulator would again cover the economic regulatory functions in energy, telecommunications, water, and rail but a separate competition authority would be maintained to carry out the functions of the OFT and the Competition Commission in Scotland.
This model recognises the synergies between the sector regulators but takes account of the difference between the regulatory powers of these organisations and the competition law powers of the OFT and the Competition Commission. In our discussions with regulatory experts there were varying views on whether competition should sit within a combined economic regulator or be separate, to ensure transparency and avoid focusing too many powers in a single body.

Where the route of appeal for regulated companies against their sector regulator’s decisions is through the Competition Authority (currently the Competition Commission) there will clearly need to be separation of roles and independence of decision making between the sector regulator and the appeal body. It is possible to achieve this within a combined regulatory body, as demonstrated by the New Zealand model, although it is important to ensure that the separation between sector regulatory decisions and competition functions is seen externally to be robust.

Under all the options being considered, we would propose that the right of appeal for regulated entities would be to an independent Competition Appeals Tribunal (CAT), ensuring transparency is maintained. Alternatively, there may be scope for the current role of the CAT to be delivered by the Court of Session in Scotland. Further work will be carried out to identify the best option, in the context of our wider programme of reform of Scottish courts and tribunals.

In either option there are considerable benefits for both businesses and consumers in Scotland:

- For the first time, economic and competition regulation in these vital sectors will be focused on delivering benefits for Scottish customers and the Scottish economy. This will contribute to the Scottish Government’s drive to build a more sustainable economy and a fairer society.
- Industry will benefit from dealing with fewer regulatory bodies and from greater stability and consistency in regulatory decisions.
- Consumers will benefit from having a more powerful regulator, acting on their behalf with strong powers to ensure that markets are working efficiently in Scotland.
- The costs of regulation to industry and the public purse will be minimised ensuring efficient government.
- Scotland will have an opportunity to influence the direction of international regulation policy, by “having a seat at the table” in key regulatory forums and being involved in negotiations at EU and global level;
- A combined regulatory body will be able to deploy resources more effectively and flexibly to the different areas of its work. It will be able to provide a single and, therefore, stronger voice, both in Scotland and internationally, on competition and consumer issues.
As has been demonstrated in the water industry, Scotland not only has the capacity to deliver these functions in a robust and orderly fashion but the ability to deliver much more. Through our regulatory expertise, bolstered by close partnership with our academic institutions (such as the UNESCO and CEPMLP centres at Dundee University), we can drive innovative regulatory approaches and share our expertise internationally.

4. Testing our proposal for a combined economic and competition regulator

The development of this approach to combining regulatory functions has been tested through discussions with the UK regulators, independent regulatory experts, consumer groups and business organisations across Scotland. We have also had discussions with governments and regulators in other countries which have illustrated the scope for bringing together these functions. In particular, Australia and New Zealand have confirmed that they are successfully delivering economic and competition regulation through merged bodies and the Netherlands are in the process of establishing this model (a detailed analysis of international comparisons is provided in Annex A).

We are, therefore, confident that this approach can, and will, work.

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<th>Combined Regulation in the Netherlands</th>
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<td>The Netherlands will be introducing a fully combined consumer, competition and regulatory body in 2013. The Netherlands Authority for Consumers and Markets (ACM) will be the merged authority created by the combination of the Netherlands Consumer Authority, the Independent Post and Telecommunications Authority of the Netherlands (OPTA), and the Netherlands Competition Authority (NMa). This new authority aims to ensure that markets work in order to protect consumer interests. To this end, the ACM will focus on three main themes: consumer protection, industry-specific regulation, and competition oversight.</td>
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<td>The Dutch Government have stated that a key driver for this consolidation is that it will increase efficiency and effectiveness of competition oversight and market regulation, as a combined regulator is able to anticipate market developments, in a flexible and integrated manner and make better use of its knowledge and expertise. Another anticipated outcome of the consolidation is cost savings.</td>
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A key theme that emerged throughout our discussions is that the regulatory principles, under which the combined body will operate, are very important. Consumers will be less concerned about how these functions are delivered, than on the outputs from this process in terms of prices, levels of service, social justice, financial inclusion, fairness and access to redress where appropriate.
This will require a body that has ‘teeth’ and is able to put in place incentives for industry that reflect the particular needs of Scotland. For example, the regulatory framework for water sets a clear role for Scottish Ministers to set high level policy objectives and for the regulator to focus on ensuring that these objectives are met in the most efficient way. This clear definition of roles has helped avoid many of the issues which have arisen in England and Wales, where regulators stray into policy space and government strays into the efficient functioning of the market.

Our discussions also highlighted the importance of ensuring that the Board of the combined regulatory body comprises the right people: high quality individuals, and that the process for appointments to the Board is open, fair and transparent.

It was noted that the combined regulator should:

- Balance the interests of the consumer and industry;
- Ensure the efficient functioning of the relevant markets; and
- Operate within the policy framework, set by Ministers, which will take account of the public interest and promote fairness.

The consensus from all the discussions which we have held, to date, is that merging economic regulation functions benefits both businesses and consumers. It is easier for businesses to navigate, will reduce bureaucracy and will ensure more consistent regulatory policy.

5. Delivering the combined regulatory body in an independent Scotland

Our detailed analysis of the UK and international regulators is set out in Annex A. This indicates that a combined regulatory body is achievable, less bureaucratic and more cost effective.

The development of the combined regulator would take place in stages and transition arrangements would be established with the relevant UK regulatory bodies. The requirement to ensure continuity of service for business and consumers in the period up to, and immediately following, independence would be a priority. Our discussions with stakeholders have indicated that an extended transition should be avoided, but there is recognition that it will take time for an orderly transfer of functions. However, there was wide agreement that clarity of the proposed outcome from the start, in terms of a combined regulatory authority, would greatly assist the transition process and provide stability for business.

Although most of the UK economic and competition regulatory bodies already have a presence in Scotland, the skill sets available in these offices do not cover the full range of regulatory functions. In some areas, such as energy and water regulation, it is likely that the transition to a combined regulator could take place relatively quickly, whilst in others, such as rail and telecommunications, it is likely to take longer to develop the full range of
expertise. The combined regulatory model will assist through sharing of expert resources.

Within the context of the modern integrated global economy and the EU Single Market, it naturally follows that Scotland's combined regulatory body will need to work closely with its counterparts in the rest of the UK and in Europe. For example, in energy, the Scottish Government has indicated its desire to maintain the current GB market arrangements which bring benefits to customers, both north and south of the border. Joint operation of energy markets between different countries is common throughout Europe and is becoming increasingly important as the markets integrate at a European level. This will make close co-operation between regulatory authorities a necessity— as has been demonstrated in the joint governance of the Single Electricity Market in Ireland.

A key factor in determining the pace of the transition process will be the legislative timetable which will provide the combined regulatory body with its statutory powers. One option would be to create a new corporate body for water regulation and then, by staged commencement, bring all the other regulatory functions into that body. Further consideration of this process will be carried out ahead of the White Paper on Independence, which will be published later this year.

6. Our Conclusions on Regulation in an Independent Scotland

Independence will bring a real opportunity for Scotland to benefit from a more effective and efficient regulatory framework, which is far more aligned to Scottish consumers’ and Scottish businesses' needs. This distinctive approach has already been achieved by the regulator in the devolved water industry in Scotland, where bills are now lower than in England and Wales, while performance has been dramatically improved. This demonstrates what can be achieved when Scotland is able to take control of its own regulatory framework.

Customers want strong regulation that delivers the lowest possible prices and the highest service standards. Industry wants simplified regulation and stability. Building on the models developed in Scotland’s water industry and through simplified, more accountable regulatory bodies, there is an opportunity to bring significant benefits to Scotland. This will help overcome the loss of confidence of both consumers and industry in the current UK regulatory model.

Lord David Currie, Chair Designate of the UK’s new Competition and Markets Authority, which comes into force in 2014, recently stated that “the combined organisation – the CMA – will be able to redeploy resources more effectively and flexibly to the different parts of its work. It will deliver decisions in a more timely way with no diminution of quality, to the benefit of consumers and businesses. It will provide a single, and therefore, stronger voice and advocacy, both at home and internationally, on competition and consumer
issues." Our proposals for a combined economic and competition regulator will achieve all these benefits and more: it will go one step further and bring together the functions of the sectoral economic regulators as well. There are clear advantages for Scotland in this approach.

International comparisons have demonstrated that the proposed combined regulatory body is readily achievable. It will now be for the people of Scotland to decide whether the powers to deliver this vision will be forthcoming.

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Annex A

Analysis of UK and International Regulators

As part of the assessment of options for economic and competition regulation in an independent Scotland, we have looked in detail at the existing UK bodies, as well as international comparisons. This analytical note sets out the background detail on:

- UK economic and competition regulators – their functions, costs, funding and staffing
- International comparators - comparisons of countries which have combined economic regulation and competition functions or are countries of a similar population size as Scotland.
- Scope for savings within an independent Scotland – the areas where efficiency savings may be available

UK Economic Regulation and Competition Landscape

The UK currently has a number of sectoral economic regulators and competition authorities which is representative of its population size and the historical evolution of these bodies. The principal bodies in this area are:

- Competition Commission (CC) – carries out in-depth inquiries into markets, mergers and regulated industries
- Office of Fair Trading (OFT) – enforces consumer protection and competition law
- Civil Aviation Authority (CAA) – economic and safety regulator of civil aviation
- Office of Communications (Ofcom) - regulatory and competition authority for broadcasting, telecommunications and postal services
- Office of Gas and Electricity Markets (Ofgem) – regulates gas and electricity markets (it should be noted that Ofgem covers Great Britain only)
- Office of Rail Regulation (ORR) – economic and safety regulator for railways

There is some devolution of economic regulation within the energy and water sector. As noted above, Ofgem covers only the GB energy sector with responsibility for energy and water in Northern Ireland devolved to the Utility Regulator (NIAUR). Scotland also has one devolved economic regulator; the Water Industry Commission for Scotland (WICS) which is responsible for regulating the water and sewerage sector in Scotland. The equivalent economic regulator within England and Wales is The Water Services Regulation Authority (Ofwat). We consider all relevant regulators in our summary table below (Figure A1) to give an accurate picture of the UK regulatory landscape.

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8 The Financial Services Authority is the economic regulation of the financial services industry. However, it has not been included within the scope of this work. As noted earlier, proposals for financial regulation were discussed within the Fiscal Commission Working Group paper on Scotland’s macroeconomic framework.
It should also be noted that from April 2014, the CC and the competition and market functions of the OFT will merge to become the Competition and Markets Authority (CMA).

We have gathered detail on the UK regulatory landscape using publicly available information, such as annual accounts, as well as discussions with the bodies themselves.

Our discussions with each of the UK sectoral regulators and competition authorities have found that:

- safety regulation is a larger part of the work of CAA and ORR than economic regulation, particularly for CAA where it accounts for over two thirds of its work (based on staffing and costs).
- economic regulation of airports in the UK is focused on the three London airports of Heathrow, Gatwick and Stansted with little or no economic regulation being carried out within Scotland.
- eServe – which is responsible administering environmental programmes and the delivery of sustainability projects — accounts for just under a third of Ofgem’s activities.
- Ofcom has responsibility for broadcasting and content regulation and spectrum management which accounts for a significant proportion of its costs and staff numbers.

| Figure A1: Costs and staffing of UK economic regulators and competition bodies, 2011/12 |
| Operating expenditure (£m) | Staffing |
| Competition |
| CC | 21.4 | 138 |
| OFT | 62.0 | 635 |
| Economic Regulation |
| CAA | 114.6 | 969 |
| Ofcom | 161.6 | 755 |
| Ofgem | 62.0 | 585 |
| ORR | 28.7 | 283 |
| Ofwat | 19.1 | 199 |
| Devolved Regulators (Scotland and Northern Ireland) |
| WICS (Scotland) | 3.2 | 16 |
| Utility Regulator (NI) | 6.9 | 67 |
| TOTAL | 479.0 | 3,648 |

From our discussions with UK regulators, we have established that around 150 of their employees are currently based in Scotland. However, many of these staff are focused on delivery of government programmes or safety and technical regulation not economic regulation.
Another important issue is how the UK regulators and competition bodies are financed or funded. The two competition bodies are mostly funded by grant-in-aid from the UK government; although OFT does collect some fees from industry. Most of the regulatory bodies in the UK are funded by industry but this is not exclusively the case. For example, Ofcom receives a large portion of its funding from the UK Government.

We will explore, in future stages of this work, how Scottish economic regulation and competition could be funded and the extent to which there is sufficient market presence by industry to enable sufficient contributions to be made.

**International comparisons**

Our international comparisons work has focused on two main areas:

- Detailed research on, and discussions with, countries which have combined sectoral economic regulation and competition functions to some degree.
- The costs and staff required to deliver economic and competition regulation within countries of a similar population size to Scotland.

**Countries with combined sectoral economic regulation and competition functions**

Our initial scoping research found that economic regulation and competition functions are carried out differently in all countries. Historical evolution of economic regulation and competition and the different constitutional construction of countries are often significant factors in this. However, our research did identify a number of countries which have combined economic regulation and competition functions to varying degrees, such as Germany, Estonia and Luxembourg. We have considered three countries in detail at this stage of our work – Australia, Netherlands and New Zealand – as these countries have gone further than most by combining economic regulation, competition and, often, consumer functions.

**Australia**

The main economic regulator and competition body in Australia is the Australian Competition and Consumer Commission (ACCC), which was established in 1995. Its role is to promote competition, fair trading and consumer protection. The ACCC also regulates those sectors that provide national infrastructure services: these are communications, water, post and transport. Within ACCC, there is a quasi-separate body called the Australian Energy Regulator (AER) which regulates the energy sector. The AER became part of the ACCC in 2005 and shares staff, resources and facilities.

In addition, there is a separate telecommunications regulator called the Australian Communications and Media Authority (ACMA) which has national and federal state responsibilities. ACMA is responsible for all aspects of
telecommunications regulation, including technical regulation, spectrum management, consumer issues and media content regulation.

**Netherlands**

In early 2013, the Netherlands Authority for Consumers and Markets will be formed by the merger of:

- Netherlands Competition Authority (Nederlandse Mededingingsautoriteit), which oversees competition as well as regulating the energy and transport sectors
- Netherlands Independent Post and Telecommunications Authority (Onafhankelijke Post en Telecommunicatie Autoriteit) which regulates the telecommunications and postal sectors.
- Netherlands Consumer Authority (Consumerauthority or CA) which has a consumer advocacy and education role.

The Netherlands Authority for Consumers and Markets will be a single body responsible for competition, consumers and sectoral regulation. Its three main activities will be:

- general competition oversight;
- regulation of the energy, telecommunications, transport, and postal service industries;
- protection of consumer rights in the non-financial industries, and providing information to consumers about their rights and obligations.

**New Zealand**

The Commerce Commission (ComCom) is New Zealand’s combined economic regulator, competition and consumer authority, established under the Commerce Act 1986. As well as overseeing and promoting competition, it also undertakes economic regulation within a number of sectors: telecommunications, dairy, electricity, gas pipelines and aviation.

In addition to the Commerce Commission, the Electricity Authority undertakes some economic regulation of the New Zealand electricity industry; although a significant proportion of its work is related to contracting service providers to operate the New Zealand electricity system and market. The Electricity Authority also has responsibility for promoting the benefits of comparing and switching retailers.

We will continue to develop our international comparators work to further our knowledge and to identify potential pitfalls and lessons to be learned. This will be likely to involve further discussions with officials in Australia, the Netherlands and New Zealand as well as detailed research on Estonia – which merged its sectoral economic regulators and competition authority in 2008 – and Latvia – Europe’s first multi-sectoral regulator.
Countries of a similar population size to Scotland

As part of the analysis on the options for economic and competition regulation within an independent Scotland, we have considered countries which are of a similar population size to Scotland.

The countries selected were: Croatia, Finland and Ireland. Although these three countries do not have combined economic regulation and competition bodies, they do provide useful benchmarks on the scale of costs and staffing requirements needed to provide these functions in countries with a similar population size to Scotland.

Figure A2 provides an overview of the operating expenditure and staff numbers across economic regulation and competition bodies in each of the comparator countries.

To take account of differences in population size and structure of bodies within each country, we have also estimated the cost per capita and staff numbers per million population to allow meaningful comparisons to be drawn between countries. This shows that:

- Netherlands and New Zealand have the lowest operating expenditure per capita.
- All three of the comparator countries with combined economic and regulatory bodies have lower staffing requirements (as measured by staff per million population).

Overall, the evidence from this limited comparison shows that in general the operating expenditure per head and staffing requirements tend to be lower in those countries with combined regulatory bodies.

<table>
<thead>
<tr>
<th>Country</th>
<th>Population, millions</th>
<th>Operating expenditure, £ million</th>
<th>Staff numbers</th>
<th>Opex per head, £</th>
<th>Staff per million population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>22.6</td>
<td>115.2</td>
<td>876</td>
<td>5.09</td>
<td>39</td>
</tr>
<tr>
<td>Netherlands</td>
<td>16.7</td>
<td>61.9</td>
<td>561</td>
<td>3.71</td>
<td>34</td>
</tr>
<tr>
<td>New Zealand</td>
<td>4.4</td>
<td>17.4</td>
<td>183</td>
<td>3.95</td>
<td>42</td>
</tr>
<tr>
<td>Croatia</td>
<td>4.4</td>
<td>18.0</td>
<td>299</td>
<td>4.09</td>
<td>68</td>
</tr>
<tr>
<td>Finland</td>
<td>5.4</td>
<td>41.5</td>
<td>361</td>
<td>7.70</td>
<td>67</td>
</tr>
<tr>
<td>Ireland</td>
<td>4.5</td>
<td>34.5</td>
<td>237</td>
<td>7.68</td>
<td>53</td>
</tr>
</tbody>
</table>
| UK economic regulation and competition  
  (Source: Annual reports; SG calculations) | 63.0                 | 479.0                            | 3,648         | 7.60             | 58                           |

9 For those countries with combined economic regulation and competition functions, only the combined body has been included within the estimates presented in Figure A1.

10 This includes all the bodies outlined in Figure A2. As such, this includes a number of functions that would be outwith the scope of combined economic and competition regulator.
Scope for savings within an independent Scotland

To date, our work has focused on the areas where there may be scope for efficiencies from combining regulatory bodies, rather than replicating the UK model.

There is some existing evidence on the scope and scale of efficiency savings that can be realised from merging public bodies or creating one public body to undertake the functions of a number of other bodies. Although these may not be strictly applicable given the unique situation of creating an economic regulation and competition body within a newly independent Scotland, these are explored further below as they still provide useful insight into where savings may occur.

Ofcom, the regulatory body for the communications sector, was created in 2003 following the consolidation of five other regulatory bodies (Office of Telecommunications, Broadcasting Standards Commission, Independent Television Commission, Radio Communications Agency and Radio Authority) and the addition of some new functions. The drivers for the creation of Ofcom were the ability to respond to a rapidly changing marketplace, removing overlap of existing regulation and the incorporation of EU obligations. There are a number of useful insights to be gained.

Firstly, wider lessons learned from the creation of Ofcom were:

- **Reducing burdens on business** through the communications industry only having one body to deal with instead of five, and the creation of a new regulatory regime where both business and consumers will see flexibility.
- **Improving regulatory outcomes** through a comprehensive, coherent and joined-up approach to regulation. The new framework helped to promote greater clarity and certainty and regulation that was not only light-touch and flexible but also robust and responsive.
- **Achieving efficiency savings** through lower day-to-day running costs and the creation of a lean and efficient organisation.

Secondly, the National Audit Office produced a cost profile for Ofcom, which compared current costs to the projected cost of the five previous regulators if they had continued to exist. After taking account of inflation, the costs of taking on new responsibilities and VAT liabilities, Ofcom’s costs are estimated to have been between 10 and 13 per cent lower than the combined estimated costs of its predecessors. These reductions in Ofcom’s costs were also found by House of Commons Public Accounts Committee report into Ofcom in 2011; although it notes that some of the savings may relate to general efficiencies rather than specific merger savings. It also found that Ofcom has managed to streamline back office functions and has fewer staff than the five previous regulators in this sector.

The UK Government is currently in the process of merging the CC and the competition and market functions of the OFT into one competition body, the

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11 Taken from The creation of Ofcom: Wider lessons for public sector mergers of regulatory authorities, National Audit Office, 2006

12 Ofcom: the effectiveness of converged regulation, House of Commons Public Accounts Committee, 2011
Competition and Markets Authority (CMA). According to the impact assessment accompanying the proposed merger\textsuperscript{13}, potential savings will arise from having just one Board and a reduction in the number of senior and back office staff. In terms of governance, only one Chief Executive and one Chairman and fewer Board members will be required. Similarly, in terms of senior staff, there are a number of duplicated roles within the two bodies, such as Chief Economist, Chief of Legal and Director of Corporate Services, as well as duplication of roles below senior level that can be streamlined. Within the merged competition body, there will be a requirement for fewer back office support functions, such as HR, IT and finance, compared with the staffing requirement in these areas across two bodies.

In 2012, Audit Scotland reported its findings on the lessons to be learned from public body mergers. Although this report refers to the Scottish Government’s stated aim of simplifying Scotland’s public body landscape, it outlines a number of areas where financial savings from merging bodies may occur. The most important of these for the establishment of a combined economic regulation and competition body in Scotland are:

- **Reduction in staff numbers**, including a reduction in staffing related costs such as IT equipment and office space.
- **Shared support services**, including corporate services such as finance, IT and HR.
- **Streamlined processes**, including improved organisational delivery and reducing duplication of effort.

As part of the Scottish Parliament’s inquiry into the Audit Scotland report, the Scottish Government published updated information on the costs and savings of a number of recent Scottish public body mergers. Figure A3 outlines the net savings for the mergers which resulted in the creation of a new public body. Although for some mergers, the net financial savings can be small, the evidence to date does confirm that public bodies established through merger are able to deliver savings and cost reductions whilst delivering high quality services.

\textsuperscript{13} A competition regime for growth: A consultation on options for reform – Impact Assessment, BIS, 2012
It should be noted that with a Combined Economic and Competition Regulator, any staff efficiencies are in relation to replication of a full suite of UK regulators. In fact, there will be a requirement to recruit more staff than are currently employed in economic regulation in Scotland.

**Figure A3: Estimated net savings Scottish public body mergers**
Source: Submission from Scottish Government to Scottish Parliament inquiry on Learning the lessons of public body mergers; Scottish Draft Budget 2013-14; Creative Scotland Corporate Plan 2011-2014
Note: For Healthcare Improvement Scotland, some of the savings represent the overall efficiency savings being achieved by the body

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Skills Development Scotland</td>
<td>• Scottish University for Industry</td>
<td>176.4</td>
<td>38.9</td>
</tr>
<tr>
<td></td>
<td>• Careers Scotland</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Skills functions from Enterprise bodies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creative Scotland</td>
<td>• Scottish Arts Council</td>
<td>50.4</td>
<td>3.5</td>
</tr>
<tr>
<td></td>
<td>• Scottish Screen</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education Scotland</td>
<td>• Her Majesty’s Inspectorate of Education</td>
<td>24.7</td>
<td>6.7</td>
</tr>
<tr>
<td></td>
<td>• Learning &amp; Teaching Scotland</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Scottish Government’s Continuing Professional Development and Positive Behaviours teams</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Healthcare Improvement Scotland</td>
<td>• NHS Quality Improvement Scotland</td>
<td>16.6</td>
<td>3.2</td>
</tr>
<tr>
<td></td>
<td>• Regulation of independent healthcare services functions from the Care Commission</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Finally, a number of reports from the National Audit Office\(^{14}\) have found that the cost reductions from shared services, such as finance, IT, procurement, facilities management and estates management, can be as much as 20 per cent. This is based on evidence from case studies undertaken by the NAO, UK Government departments and the private sector.

Overall, the evidence gathered to date on the scope and scale of efficiency savings which may be realised from creating a combined economic and competition regulator in an independent Scotland suggests that:

- Merged bodies tend to achieve financial savings over the operating costs of separate bodies.
- In addition to savings from lower staff numbers and reduced governance, a reduction in duplication of effort and a streamlined clear

\(^{14}\) Improving corporate functions: using shared services, National Audit Office, 2007; Efficiency and reform in government corporate functions through shared service centres, National Audit Office, 2012
and consistent approach to organisational delivery are other clear benefits to mergers.

- Fewer bodies reduces the burdens on business and consumers by reducing the number of bodies with which they need to interact.

The operating costs and staffing implications of a combined economic and competition regulator will be refined following decisions on the scope of its functions, including whether sectoral economic regulation and competition are to be combined within one body. However, early indicative estimates based on the international delivery of these functions suggest that the potential magnitude of financial savings could be of the order of £10 million\(^{15}\). However, it should be noted that this estimate is based on comparing the operating costs per head within a number of countries, which may not be reflective of the costs of delivering economic regulation within a Scottish context.

It is more likely that the financial savings will be in line with the savings realised within combined public bodies in a UK and Scottish context. Evidence suggests that these efficiency savings accrue from streamlined back office functions, reduced governance and the need to recruit a lower number of specialist staff. These savings are more likely to be in the region of 10-20 per cent of the annual operating costs when compared with the running costs of creating a full suite of sectoral and competition regulators within an independent Scotland.

\(^{15}\) This calculation is based on comparisons of cost per capita from the international comparisons presented in Figure A2 applied to Scotland’s population, which is currently estimated as 5.25 million.