Regulatory decisions and incentives in a predicted recession

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Article #2 of the NSW WEN fortnightly blog series in partnership with the NSW Economics Society of Australia and the National WEN.

The Australia regulatory frameworks share at their core the objective of regulating for the long term interests of customers. This involves considering the effect of regulatory decisions on encouraging competition, achieving economic efficiency and promoting economy-wide productivity. It can also involve balancing what are at times competing objectives – providing appropriate returns to shareholders and community expectations that prices should be fairly stable over time.

How the performance of the regulator is judged can depend on which of the above objectives are considered most important. But what is a regulator to do when its decisions are being made and will take effect in a period of time when the global economy is forecast to go into recession?[1]

At the centre of the answer is the customer. A regulator's view of how customers will behave as we enter, endure and emerge from this predicted recession is key, but uncertain. Due to this uncertainty, the tools at a regulator's disposal is central to ensuring the right incentives are in place to encourage efficient market behaviour by the regulated entity.

But first, let's think about customer behaviour in a recession. Though recessions differ in their causes, depth and duration, and whom they affect the most, it's possible to anticipate consumer behaviour by understanding three things:

1. How previous recessions have altered customer behaviour.

2. How the predicted recession compares with previous ones.

3. The journey customers have taken to present, which will condition their response to the recession.

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[1] Or as the IMF's April 11 release put it: *Growth Slowdown, Precarious Recovery:* https://www.theguardian.com/business/grogonomics/2019/apr/11/imf-outlook-for-global-economy-goes-from-bright-to-precarious

Recessions fall into two broad categories: most are brief and short-lived, and result in short-term changes in customer behaviour. In rare cases, recessions are deep and enduring, as was the Great Depression. Such recessions shape the mind-set of whole cohorts of customers and have a long-term impact on behaviour. Deep recessions can also change the regulatory landscape, affecting both companies and consumption. This predicted recession resulting from worldwide restrictions on the mobility of people and supply chain disruptions may have features of both types of downturns.

It is important that we consider the role of regulated prices and their sensitivity (or lack thereof?) to demand, both in contributing to the efforts to curb the recession and to recovery.

So, to loop back, how does a regulator set prices and strive to incentivise efficient market behaviour by a utility ahead of a predicted recession? The regulator is to consider the social impact of regulated prices through the lens of what customers can afford to pay. The challenge for the regulator is to take into account the social impacts while also ensuring that regulated prices provide a commercially sound basis for the current and future provision of services.