

# Agenda

## Advancing economics in business

### The General Election 2015: what next for UK infrastructure?

**On 8 May 2015, the UK woke up to a Conservative majority government—an outcome that flew in the face of opinion polls taken in the weeks and months before the General Election. Now that the dust has started to settle, what are the potential implications of this result for the UK energy, water, transport and communications sectors?**

The 2015 UK General Election result—with a Conservative majority government and a large increase in the number of seats held by the Scottish National Party (SNP) in Scotland—has a number of potential implications for businesses and communities across the UK. Some of the main changes are as follows.

- **EU referendum.** The Conservative Party manifesto<sup>1</sup> includes a commitment to hold a straight in–out referendum on the UK’s membership of the EU by the end of 2017. Were the referendum to result in the withdrawal of the UK from the EU, the political and legislative impact would be significant.
- **Greater devolution to local authorities.** The Conservatives have committed to devolving greater powers to combined local authorities with elected mayors.
- **Greater devolution to Scotland and Wales.** New powers for Scotland, based on recommendations made by the Smith Commission,<sup>2</sup> were outlined in the Queen’s Speech at the State Opening of Parliament on 27 May.<sup>3</sup> These powers primarily relate to taxation, including setting income tax rates and bands, controlling a proportion of the VAT raised in Scotland, and controlling air passenger duty. Wales is also set to receive new powers over decisions relating to transport, energy and elections.
- **Tax.** The Conservatives have pledged not to increase VAT, National Insurance contributions or income tax in this Parliament, as part of the party’s long-term economic plan.
- **Capital versus resource spend.** Over the last Parliament, the coalition government’s budget

announcements focused on capital spending, while reducing the amount of resource spend available to government departments. The new government is likely to continue this trend, creating a potential disconnect between the amount of money that is available for major investment projects and the amount that is available for day-to-day operations. The pressure on resource spend is likely to continue following the Chancellor of the Exchequer’s announcement that new rules will be introduced requiring the government, under the supervision of the Office for Budget Responsibility, to run a budget surplus in ‘normal times’.<sup>4</sup>

The election result also has potential sector-specific implications, as discussed below.

#### Energy

The initial reaction of the major UK energy companies and their investors to the election result, as reflected in movements in the shares of listed energy companies, may have been one of relief. The opposition Labour Party had proposed to freeze gas and electricity bills until 2017 and grant additional powers to Ofgem, the energy regulator for Great Britain. The Conservatives’ commitments in the energy sector, and the subsequent appointment of Amber Rudd MP (who has said that the science behind climate change is ‘completely compelling’<sup>5</sup>) as Secretary of State for Energy and Climate Change, point to a degree of policy stability.

The government’s commitment to promote competition in energy markets is unlikely to conflict with the Competition and Markets Authority’s (CMA) remit in the sector. Ofgem, which Labour proposals had proposed to replace, also looks secure for the time being.

At the same time, however:

- the government will be required to balance a number of competing agendas and there remains scope for energy and climate change policy to be revisited, particularly in the lead-up to the EU referendum;
- discussions with the SNP over increased powers for the Scottish Parliament could see some existing UK responsibilities devolved to Scotland. Electricity transmission pricing and the impact on 'Scottish security of supply' may be topics more closely followed in Scotland than elsewhere in the UK, and the results of any additional devolution of powers could increase complexity for transmission companies and for energy traders;
- the government's commitment to competition in energy markets could lead to the extension of competition into new areas, such as onshore electricity transmission. This commitment might suggest that, should the CMA find that remedies are required to ensure effective competition in energy markets, there is likely to be little resistance from the government.

## Water

As in the energy sector, the Labour Party had proposed reform in the water sector, including a new affordability scheme and greater powers for the England and Wales sector regulator, Ofwat:

The water industry, too, also requires reform. One in five people struggle to pay their water bill. Despite this, only a fraction of customers have benefited from the social tariffs offered by water companies. Under our reforms all water companies will be required to sign up to a new national affordability scheme, helping those who cannot afford to pay their water bill. And we will strengthen the powers of the regulator to change licenses, limited price rises and enforce industry standards.<sup>6</sup>

By contrast, neither the Conservative manifesto nor the Queen's Speech mentioned the water sector, and there seems little likelihood of, or appetite for, further legislative changes following the passing of the Water Act 2014. The focus in the short term is likely to be on preparing for the introduction of non-household water retail competition in England from April 2017. For companies, this will involve, first and foremost, deciding whether to continue to participate in the retail market or to seek to exit once this is open to competition.

Aside from retail competition, the next five years may see reforms to upstream competition and the abstraction management system, including the potential for a greater level of water trading. These changes have been subject to consultation and discussion over a number of years and are by no means new policies. Indeed, the big changes over this Parliament have already been set out and there are unlikely to be significant surprises for the water companies.

What may be of more concern to environmentalists, however, is the impact of a potential withdrawal from the EU on the grounds of UK environmental legislation. EU Directives affect how water companies take water from, and discharge wastewater to, the environment (alongside their more general environmental custodianship activities). These include the Bathing Waters Directive, Habitats Directive, and Water Framework Directive. Withdrawal from the EU, or renegotiation on the impact of the Directives on the UK, may affect the standards required of water companies going forward, expenditure on environmental improvements, and the balance between capital and operating solutions.

## Transport

The returning Secretary of State for Transport, Patrick McLoughlin MP—representing some stability in a role that has been held by ten MPs in 15 years—will be trying to keep his Department out of the news. However, with a decision on a new airport runway, exposure to further public spending cuts, continuing debate on high-speed rail, threats of strikes by railway workers, and no fewer than 11 franchise awards scheduled by mid-2019, he may struggle.

The Airports Commission, set up as an independent body to assess the need for additional UK airport capacity and to recommend how this capacity can be delivered, is expected to publish its findings later this month. A decision on either Heathrow or Gatwick will have a knock-on effect for investment decisions across the transport sector—with supporting surface access schemes of varying size and complexity required at an expanded Gatwick or Heathrow airport. An immediate government response to the Commission's recommendations looks increasingly unlikely, however, with reports indicating that the government will wait until at least December 2015 before commenting on the report.<sup>7</sup>

The Conservatives' commitment to push forward with the HS2 rail programme (and HS3) is clearer, but there is further work to be done legislatively. The Hybrid Bill covering Phase 1 (London–Birmingham) of the project has been carried over into the new Parliament to allow the HS2 Bill Committee to hear all petitions made against the provisions laid out in the Bill and proposals for its amendment. Despite the significant public debate around the scheme, only 41 MPs voted against the Bill (with 452 voting in favour) when it received its Second Reading in the House of Commons on 28 April 2014, and it would take a significant U-turn now for the project to be abolished. A separate Phase 2 Bill will also need to receive Royal Assent if the scheme is to be extended beyond the West Midlands.

Elsewhere in the rail sector, train operating companies may be relieved that Labour's proposal to allow for part-nationalisation of rail services is off the table for at least the next five years. The election result might also be of interest to investors in the rolling stock operating companies, a market that Labour had proposed to overhaul.

However, the news might not all be positive for investors—the Conservative manifesto contains a commitment to freeze commuter rail fares in real terms for the whole of this Parliament, and the competition agenda remains firmly on the table. The CMA is currently undertaking a ‘policy project’ (but not a formal investigation) into the scope for increasing competition in GB passenger rail services. Whether this results in changes to the way in which open access proposals are assessed, or more fundamental changes to the structure of the passenger rail market, remains to be seen.

Local bus operators, despite accounting for 63% of passenger journeys on public transport in 2013/14,<sup>8</sup> may receive less media attention. However, the bus market could be at the sharp end of cuts to public sector budgets, as well as substantial organisational change with a potential move towards greater regulation. In line with the new government’s policy to devolve additional powers and budgets, the Buses Bill will allow combined authority areas with directly elected mayors (such as Greater Manchester) to franchise local bus services. A small number of local councils will be allowed to retain growth in business rates, which could open the door to the use of tax incremental financing to fund transport infrastructure improvements.

Overall, the focus for the transport sector over the next five years is on new capacity, with large enhancement projects already under way in the rail and roads sectors (including electrification, Crossrail, and the A14 Cambridge to Huntingdon improvement scheme), and a much-anticipated decision on new airport capacity.

## Communications

The new government’s broadband objectives are clear: to extend the superfast broadband network (defined as speeds of 24Mbps or more) to as many premises as possible, while ensuring a minimum 2Mbps for all. The current ambition is to provide superfast broadband to at least 95% of premises in the UK by 2017, and to explore options to achieve near-

universal superfast broadband coverage by 2018. The challenge for the government will be in securing value for money in the deployment of the network without adversely affecting competition and deterring access-seekers. Given the incumbent BT’s cost advantages, the trade-off is unlikely to be an easy one. However, achieving universal coverage will require innovative solutions from the industry, and the door may be opened to smaller network providers and locally funded schemes as the network is extended to the final 5% of premises.

The new government moved quickly to sell off a further 15% stake in Royal Mail, and is expected to complete the sale of its remaining 15% stake later in the financial year 2015/16. Having been criticised in the previous coalition government for undervaluing Royal Mail in the sale of the first tranche of shares in 2013, the new government will come under pressure to show that this latest sale represents value for money for taxpayers.

Another organisation that looks set for change over this Parliament is the BBC, as negotiations begin over the renewal of its Royal Charter from 2017. Having recently referred to the licence fee as ‘regressive’, and having chaired the select committee that called for the abolition of the BBC Trust in February 2015,<sup>9</sup> the new Secretary of State for Culture, Media and Sport (John Whittingdale MP) is expected to consider a restructuring of the BBC’s funding and regulatory oversight.

## Thinking ahead

As ever in politics, it is unsafe to project short-term stability too far into the future and, in particular, an ‘out’ decision in the anticipated EU referendum would have far-reaching implications for UK businesses. The referendum aside, this Parliament could oversee a genuine shift of power towards local governments and devolved administrations, and the new government is likely to face critical decisions over airport capacity, energy policy, and the future of the BBC, to name but a few examples.

<sup>1</sup> Conservative Party (2015), 'Strong leadership. A clear economic plan. A brighter, more secure future. The Conservative Party Manifesto 2015', available at: <https://www.conservatives.com/Manifesto>.

<sup>2</sup> The Smith Commission (2014), 'Report of the Smith Commission for further devolution of powers to the Scottish Parliament', 27 November, available at: [https://www.smith-commission.scot/wp-content/uploads/2014/11/The\\_Smith\\_Commission\\_Report-1.pdf](https://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf).

<sup>3</sup> Cabinet Office and Her Majesty The Queen (2015), 'Her Majesty's most gracious speech to both Houses of Parliament at the State Opening of Parliament 2015', 27 May, available at: <https://www.gov.uk/government/speeches/queens-speech-2015>.

<sup>4</sup> HM Treasury and The Rt Hon George Osborne MP (2015), 'Annual Mansion House speech by Chancellor of the Exchequer, RT Hon George Osborne MP', 10 June, available at: <https://www.gov.uk/government/speeches/mansion-house-2015-speech-by-the-chancellor-of-the-exchequer>.

<sup>5</sup> Shankleman, J. (2014), 'Amber Rudd: "I'm a Thatcherite when it comes to climate change"', *BusinessGreen*, 23 September, available at: <http://www.businessgreen.com/bg/interview/2371516/amber-rudd-im-a-thatcherite-when-it-comes-to-climate-change>.

<sup>6</sup> Labour Party (2015), 'Britain can be better: The Labour Party Manifesto 2015', April, p. 26, available at: <http://www.labour.org.uk/manifesto>.

<sup>7</sup> Pickard, J. (2015), 'Decision on UK runway faces more delay', *Financial Times*, 9 June.

<sup>8</sup> Department for Transport (2015), 'Transport Statistics for Great Britain 2014', national statistics, available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/389592/tsgb-2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/389592/tsgb-2014.pdf).

<sup>9</sup> House of Commons Culture, Media and Sport Committee (2015), 'Future of the BBC', Fourth Report of Session 2014–15, 26 February.