

Political control of state-owned utilities: lessons from UK experience with nationalised and privatized utilities

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What this presentation is and is not about

- It is *not* about the desirability or otherwise of nationalising energy networks, the water industry or other utilities

Rather

- It *is* about, in the event of such a change, how Government might seek to control or 'regulate' the industries in question, not least against the background of control issues which arose with previous nationalisations and which have arisen post-privatisation

Starting point

- Political control of utilities is problematic, regardless of whether private or state-owned
 - Utilities are intensely politically salient
 - People care about utility outcomes a lot – politicians want to shape utility ‘outcomes’
 - Important overlaps between utilities and wider Government policies – e.g. decarbonization, universal service obligations, social policy (‘energy poverty’, ‘water poverty’) etc
 - But *day-to-day* political intervention tends to compromise utility operations and (in the case of private utilities) utility financeability
- Historically, high-level approach in the UK to resolving this conflict the same with both nationalisation and privatisation:
 - Government, as ‘principal’ appoints ‘agents’ with high degree of autonomy/‘independence’ from Government
 - Boards of public corporations in the nationalised era
 - Economic regulators in the privatized era
- Implication: history of *both* eras is relevant in trying to work out how political control should be handled with any future nationalisations

Questions posed

- How political control actually worked in the nationalised era
- What problems were identified (from a very early stage)?
- How did the control framework evolve?
- How far did the changes succeed in their aims?
- How has control worked with privatised utilities?
- What are the lessons of all of the above for any future nationalisations?

How political control was addressed with the 1940s nationalisations

- Broadly followed the blueprint of Herbert Morrison's 'Socialisation and Transport' (1933)
- Central role of the boards of the 'public corporations'
 - Emphasis on appointing the right sort of people to the boards ("on the basis of general competence, ability and public spirit for the task to be discharged")
- Corporations given high degree of autonomy, subject to high-level obligations, set out in nationalisation Acts
- Formal powers of ministers
 - Appoint members of the Board, including the Chairman
 - Approve/veto major programs of expenditure
 - Give Boards 'general directions' on issues of national interest

Problems identified (mainly at an early stage)

- Nature of the relationship between ministers and boards of public corporations
 - Not one ministerial 'direction' 1945-51
 - Ministerial preference for informal influencing of chairmen – less risk of blame, not open to MP scrutiny, resulting lack of pressure on ministers to reach publicly defensible decisions
 - Result: frequent informal interventions, as against the intended infrequent (and accountable) strategic directions, and resulting blurring of the roles of ministers and boards
- Lack of incentives to improve efficiency
 - "Efficiency was not a subject which had loomed at all large in the literature of nationalization". (Chester, 'The Nationalisation of British Industry 1945-51')
 - Presumption that nationalisation would improve efficiency, not least through consolidation/economies of scale, having right people on boards and keeping politicians away from 'administration'
 - Already an issue during the 1940s
- Lack of incentives to achieve adequate financial performance
 - Statutory obligation only to cover costs over a number of years, taken together (and where costs meant historic, rather than replacement, costs)
 - Lack of sanctions for failure to deliver even this

How did the control framework evolve?

- **Ministers and boards**
 - Select Committee on Nationalised Industries (1956) boosted MP scrutiny but not empowered to do efficiency audits
 - Plus later (1979) general revamp of the Select Committee system
 - Non-adoption of NEDO (1976) recommendation of 'Policy Councils'
- **Efficiency incentives**
 - 1948 rejection of Morrison's idea of an 'Efficiency Unit'
 - Much later, Competition Act (1980) empowered the MMC to do efficiency audits
 - Also increased competitive pressures
 - Oil and Gas Enterprise Act (1982), Energy Act (1983)
- **Financial performance**
 - Successive Treasury White Papers (1961, 1967, 1978) set financial targets for the utilities and/or constrained industry financial deficits
 - Implementation of various forms of Current Cost Accounting for utilities

Did these changes work?

- **Some successes**
 - Improved financial performance of utilities, especially after Treasury White Paper of 1978
 - Improved, if limited, efficiency incentives of the MMC's role from 1980
 - Improved Parliamentary scrutiny (and thus increased pressure on both ministers and utilities) from Select Committee on Nationalised Industries and then from general revamp of Select Committees in 1979

But

- No fundamental change in the relationship between ministers and the boards of the public corporations

Political control after privatisation: independent economic regulators

- Buffer between ministers and utilities, albeit that
 - Ministers appoint regulators
 - Regulators operate within a framework of statutory obligations which can be changed by Parliament
- Probable improvement in addressing information asymmetry (as suggested by, inter alia, NEDO in 1976 and Currie in 2014)
- Pressure on regulators to make evidence-based decisions
 - Substantial transparency about basis for regulatory decisions (albeit less so in the very early days)
 - Scope for decisions to be appealed
- Overall *potential* to offer better balance between political control of, and day-to-day political insulation for, utilities than characterized the nationalized era

Sustainability of regulatory independence (1)

- In immediate post-privatization period, regulators independent in a reasonably literal sense
- BUT
- Several factors (unusually) favourable to this
 - Government still mindful of privatisation commitments to shareholders and of possible future privatisations
 - Broad political commitment to increasing the role of competitive markets and government not particularly focused on achieving specific policy outcomes
 - Period in which politicians prepared to be more hands-off in various areas, e.g. as also with mergers, as per Enterprise Act (2002)
 - Specifically benign circumstances in some industries (e.g. low world oil prices reducing the political salience of retail energy prices, especially when combined with reducing network prices)

Sustainability of regulatory independence (2)

- Later period more complicated
 - Broad independence maintained in sectors like telecoms and water
 - Independence clearly under pressure in the energy sector from the mid 2000s
 - Higher world energy prices (and thence UK retail energy prices) made energy more politically salient
 - Climate change policy (2003 Energy White Paper, 2008 Climate Change Act, 2009 EU Renewable Energy Directive etc) driving a wedge between ministers and Ofgem: DECC targets for MW of low-carbon generation versus higher electricity prices and Ofgem's interpretation of its duty to protect the interests of consumers
 - Ministers reluctant to admit that more low-carbon generation meant higher prices and thus resisted being more explicit about what they wanted Ofgem to do
- BIS Principles for Economic Regulation as a reinterpretation of regulatory independence
 - Strategy and Policy Statements which would, in principle, embody the politics and which would ideally be changed no more frequently than once per Parliament

Takeaways for future political control of SOUs

- The history of UK utilities since the 1940s – plus a synthesis of two of the most thorough analyses of the nationalised and privatised eras (NEDO report and the BIS Principles) would imply balancing of political control and utility efficiency best achieved by
 - independent agencies interposed between ministers and utilities
 - putting the politics into transparent briefs for the agencies on how to interpret their statutory obligations
 - those briefs to be changed infrequently
- However,
 - In one form or another, variants of such ideas have been around since at least the 1970s and have been repeated since (Select Committee on Economic Regulators in 2007, as well as BIS Principles)
 - Proposals continually run up against realpolitik and human nature (especially of ministers)
 - Despite DECC's own review of Ofgem recommending the Strategy and Policy Statement solution, neither DECC nor BEIS have implemented this
- Other factors worth bearing in mind when trying to institutionalise political control of SOUs
 - Residual belief, as in 1940s, that nationalisation per se is the solution (alongside having the 'right' people in charge), thus reducing the need for other institutional change
 - For some, a point of nationalisation may be to facilitate routine political intervention in utility operations
 - Lack of capital market pressure reduces the constraints on ministers (the current political insulation mechanisms in energy owe quite a lot to having to pay attention to capital markets)