

## Political control of state-owned utilities in the UK





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**The UK Labour Party's proposal to nationalise core utilities has renewed debate about whether nationalisation is a good or a bad thing. Tim Tutton, Associate at the Centre for Competition Policy (University of East Anglia, UK), takes a different approach. Focusing on the issue of political control, he explores whether lessons can be learned—from both the nationalised era and the privatised era—and how any future (potential) nationalisations might be made to work more effectively than in the past**

*This article is a short version of a longer Working Paper shortly to be published by the Centre for Competition Policy (University of East Anglia).*

Political control of utilities is a problematic issue, regardless of whether the utilities in question are state-owned or privately owned—albeit that the issue has acquired a new resonance with the Labour Party's renationalisation proposals. On the one hand, these industries have high political salience. Whether it is energy, water, transport or others, politicians will typically and understandably want a serious say in what these industries should achieve. At the same time, there has been a long-term consensus, going back at least to the time of the nationalisations in the 1940s, that day-to-day political interventions will have a negative effect on operational efficiency, not least because companies have to cope with continually shifting political priorities. In addition, if the industries are in the private sector, frequent political interventions (for instance, to stop price increases) will tend to discourage investment.

Not only is the underlying problem the same regardless of ownership, but so has been the high-level political response to that problem. With both nationalisation and privatisation, government (as principal) has appointed an agent that is intended to operate with a high degree of autonomy (or 'independence')—the *theory* being that government will decide on the high-level outcomes required (the politics), but that the agent will be responsible for delivery, thus giving the utilities freedom from day-to-day political intervention. In the case of the 1940s' nationalisations, following the model set out by Herbert

Morrison in 1933,<sup>1</sup> the agents were the Boards of the public corporations. With privatisation, the sector economic regulators have been the agents.

Given that the underlying political control problem has been the same, the question posed here is what lessons can be learned from both the nationalised and privatised eras about the design of a future political control regime for state-owned utilities.

## Echoes from the past

With the nationalisations of the 1940s, problems were identified from a very early stage, as documented, for example, in Chester's official history of the nationalisations<sup>2</sup> and the second 1950 volume of *Political Quarterly*, which was devoted entirely to the question of the nationalised industries (according to the editor, 'by far the most important domestic question facing the British people at the present time').<sup>3</sup> These problems included the lack of incentives on the corporations to improve efficiency or to deliver adequate financial performance (financial deficits, and therefore the need for taxpayer support, were common), but, above all, revolved around the relationship between ministers and the Boards of the public corporations.

The way that the relationship was meant to work was set out in the various nationalisation statutes that gave ministers certain powers, including the right to appoint members of the corporation Boards, to veto major capital expenditure programmes, and, where the national interest required it, to give formal directions to a Board (for which the Minister would be answerable to Parliament). However, during the whole of the nationalised era, the power to give formal directions was hardly used. Ministers preferred to influence corporation Boards informally, allowing the ministers to intervene frequently and to avoid Parliamentary scrutiny of those interventions. As described by Vickers and Yarrow (1988), 'whereas Parliament's original intention was that ministers should provide general guidance to managements concerning enterprise objectives and should abstain from detailed interventions in operational matters, in practice the opposite had occurred: general guidance was rarely offered but specific interventions were common.'<sup>4</sup>

In the period through to the main privatisations, the political control regime for the nationalised industries did evolve. Treasury control of nationalised industry finances was tightened, and industry financial deficits were reduced. A Select Committee on Nationalised Industries was set up in 1956 and, after 1979, the select committee system was more generally revamped. Both changes improved

transparency and parliamentary scrutiny of the utilities. But the core problem of how ministers interacted with public corporation Boards was left unresolved, albeit not for lack of contemporaneous analyses of what had gone wrong and what could be done about it. Notably, the government rejected the 1976 proposals from the National Economic Development Office (NEDO) to set up 'Policy Councils' which would have, *inter alia*, provided a buffer between ministers and the industries.<sup>5</sup>

The problem of reconciling political control of utilities with their efficient operation was readdressed as part of the utility privatisations of the 1980s and 1990s. The aim, as with the NEDO proposals, was to have an organisation in between ministers and the utilities. Economic regulators would be appointed by ministers and would operate within a framework of statutory obligations (which could be changed by Parliament), but would have substantial day-to-day independence.

## Degrees of independence

In the event, this framework survived reasonably unscathed through the early post-privatisation period, arguably achieving Morrison's objective of politics determining the high-level outcomes expected of utilities, while giving those utilities substantial insulation from continuing political intervention. Interviews by the author with two of the energy regulators in this period confirmed the lack of significant ministerial intrusions on their independence.

Independence in this period was assisted by a number of factors, including a general (and historically quite unusual) willingness of government to delegate decision-making in politically salient areas, a willingness also manifested in the delegation, introduced in the Enterprise Act 2002, of most decision-making on company mergers to competition authorities. There were also industry-specific factors: for example, low world oil prices meant less political salience for UK retail energy prices.

However, it is also true that, during the mid-2000s, and even leaving aside the rail industry (which is a somewhat special case because of the government's role in its financing), this model came under strain. This was especially the case in the energy industry, where the government's desire to boost the volume of (then expensive) renewable electricity generation clashed with the regulator Ofgem's interpretation of its primary duty to protect the interests of electricity consumers. As in the days of nationalisation, part of the problem was the then government's reluctance to admit

its role in potentially unpopular policies—specifically, its unwillingness to admit that more renewable generation would lead to higher electricity prices.

Nonetheless, despite the stresses and strains in the government–Ofgem relationship (which, by and large, have not been replicated, at least to the same extent, with other regulators), the outcome was, in most ways, one that re-established a more transparent way for ministers to influence the regulator. This continued to largely insulate the industry itself from day-to-day political intervention: the 2010 Energy Act changed Ofgem’s primary obligations to make it clear that decarbonisation ranked alongside affordability for consumers (just as later legislation paved the way for price caps on energy suppliers); Ofgem continued to have broad freedom in setting the prices that could be charged by the monopoly energy networks; and the process for subsidising new renewable generation was largely delegated to a mixture of market processes and non-ministerial bodies.

More generally, in its Principles for Economic Regulation,<sup>6</sup> the then Department for Business, Innovation and Skills (BIS) set out a more structured way (“Strategy and Policy Statements”) in which government could transparently set out what it wanted an economic regulator to achieve, with the intention that such instructions would be more specific than the high-level statutory duties and would be changed infrequently (ideally, no more than once per Parliament). In principle, this would leave a regulator with day-to-day independence from political intervention. The economic regulator of the water industry in England and Wales (Ofwat) now has such a Statement, and the Competition and Markets Authority

effectively has one in the form of a ‘Strategic Steer’ from government. Ofgem does *not* have a Statement despite the use of one being a recommendation of the then Department of Energy & Climate Change, following its own 2011 review of the role of Ofgem.<sup>7</sup>

## What if?

So, what lessons can be learned from both the nationalised and privatised eras for how to reconcile political control and operational efficiency of any (potentially) renationalised entities? The following, at least, would look to be desirable:

- an independent agency (whether or not it is called a regulator) interposed between relevant ministers and relevant utilities;
- a transparent ministerial brief to the agency on how it should interpret its (inevitably high-level) statutory obligations, including guidance on how to make trade-offs between conflicting political objectives;
- that brief not to change too frequently.

However, although such institutional arrangements could encourage an appropriate transparency, scrutiny and separation between politics and utility operations, they would not guarantee such outcomes, especially when politically unpopular decisions are involved.

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<sup>1</sup> Morrison, H. (1933), *Socialisation and Transport*, Constable.

<sup>2</sup> Chester, N. (1975), ‘The Nationalisation of British Industry 1945-51’, HMSO.

<sup>3</sup> *Political Quarterly* (1950), 20:2.

<sup>4</sup> Vickers, J. and Yarrow, G. (1988), *Privatization: an economic analysis*, MIT Press, p. 128.

<sup>5</sup> National Economic Development Office (1976), ‘A Study of the UK Nationalised Industries’, HMSO.

<sup>6</sup> Department for Business, Innovation and Skills (2011), ‘Principles for Economic Regulation’, April, <https://bit.ly/37ybwLc>.

<sup>7</sup> Department of Energy and Climate Change (2011), ‘Ofgem Review: Final Report’, July, <https://bit.ly/2D5WrSL>, p. 24.