

*WHOSE UTILITY?*

*THE SOCIAL IMPACT OF PUBLIC UTILITY PRIVATISATION  
AND REGULATION IN BRITAIN*

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AND REGULATION IN BRITAIN***

by

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## TO HERBOIS

*We may pick a thousand sallets ere we light on such another herb*

## ABSTRACT

Privatisation of gas, electricity and water services in Britain has been predicated on an explicit belief that ordinary consumers would be amongst the major beneficiaries of the programme to restructure the utility industries. Along with the promise of reduced prices and improved standards of service, domestic users of public utility services were to be given new rights in relation to consumer sovereignty and choice. Has the delivery of the utility privatisation programme thus far, matched these expectations?

This study is the first substantive attempt to address the question of how domestic consumers have fared under the structure of public utility privatisation and regulation in Britain. As well as containing a detailed examination of the impact of the privatisation on domestic consumers generally, the study gives considerable attention to how low income households have been affected. The research is based on a comprehensive survey of primary and secondary data sources and on extensive fieldwork.

The first part of the thesis establishes the background for evaluating the consequences of privatisation. It includes a review of the history of the utility privatisation programme, which documents for the first time, the community and consumer sector campaign to influence the privatisation legislation; an analysis of the social and economic characteristics of energy and water services, which distinguish them from other commodity areas in the market economy; and a critical examination of the British model of public utility regulation.

In part two, the social consequences of utility privatisation are considered at two levels. First, major aspects of the privatisation settlement are examined - asset sales, share ownership, company profits and employment - and it is concluded that these have resulted in regressive distributional outcomes. Second, key areas of the utility companies' relationship with domestic consumers are assessed - i.e. prices, debt and disconnection, standards of service and consumer protection, and consumer representation. It is found that although the outcomes for consumers in general have

been mixed, low income consumers in particular have been adversely affected. The intervention of the independent regulatory bodies has been an instrumental factor in some areas of service provision.

The thesis concludes with a discussion of the limitations in the British model of privatisation and regulation, and argues that the paradigm of consumerism is inappropriate to the domain of public utility services.

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## ABBREVIATIONS

ACE	Association for the Conservation of Energy
AMA	Association of Metropolitan Authorities
BG	British Gas
BT	British Telecom
CBI	Confederation of British Industry
CEGB	Central Electricity Generating Board
CPRE	Council for the Protection of Rural England
CSCs	Customer Service Committees
CSUA	Competition and Service (Utilities) Act
DoE	Department of the Environment
ECC	Electricity Consumers Council
ESI	Electricity Supply Industry
FES	Family Expenditure Survey
GCC	Gas Consumers Council
GHS	General Household Survey
HoC	House of Commons
HoL	House of Lords
MMC	Monopolies and Mergers Commission
NACAB	National Association of Citizens Advice Bureaux
NAO	National Audit Office
NCC	National Consumer Council
NCVO	National Council for Voluntary Organisations
NRA	National Rivers Authority
OFFER	Office of Electricity Regulation
OFGAS	Office of Gas Supply
OFTEL	Office of Telecommunications
OFWAT	Office of Water Services
PUAF	Public Utilities Access Forum
RECs	Regional Electricity Companies
RWAs	Regional Water Authorities
WAA	Water Authorities Association
WSA	Water Services Association

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For all its individual character, research is a highly collaborative activity. By its very nature it is founded on a corpus of knowledge established by earlier and unwitting 'collaborators', and it is partially shaped and given substance by a multiplicity of, hopefully less unwitting, collaborators over the life of the research project.

This study has relied substantially on the work of those who have gone before and on the assistance and insights of colleagues in the field; without whose help I would have stood little chance of understanding the complex and rapidly changing field of public utility services in Britain. All the people with whom I have had contact in Britain over the past four years have made a contribution, in one form or another, to the end product of this research. But there are a few individuals who should be given specific mention. Brenda Boardman, Teresa Perchard, Martin Fitch, Pat Conaty, Neil Ritchie, Barbara Montoute and Diana Scott have been important influences on the research. The staff of each of the three regulatory bodies have given freely of their time and information.

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And finally to M and S - my abiding sources of inspiration and hope!

### Declaration

I hereby declare that this thesis has been composed by myself and that where the work of others has been used, that this has been explicitly cited in the text. The original material contained in this thesis has not been included in another thesis, nor has it been produced elsewhere; with the exception of some parts of an earlier draft of Chapters 6 and 7 which were published as an article entitled, 'The British experiment in privatising essential services', in *Policy Issues Forum* in November 1991.

## INTRODUCTION

*One of the most important areas in which there should have been more prolonged and persistent debate and discussion in the 1980s was precisely around the question of the social effects or social consequences of free market policies - or around the issue which classical economists refer to as the question of social cost.*

Taylor (1990) p.6

*Sadly, there is no reason to expect the political process to lead to the right pattern of privatization. Unless we are luckier or more careful than we are likely to be, political pressures will tend to retain for the public sector functions where privatization would make sense, and to privatize tasks that would be better left to government.* Donahue (1989) p.13

Privatisation appears to have made its initial entry into the lexicon of political ideas with the publication of Peter Drucker's book *The Age of Discontinuity* in 1969 <sup>1</sup>, and for more than a decade it has formed a dominant *leitmotif* in the policy making of the Thatcher and Major governments. One of the most significant manifestations of privatisation policy in Britain has been the denationalisation of public enterprises <sup>2</sup>. From relatively modest beginnings during the period 1979-1983, with the divestiture of a number of state-owned firms operating in competitive markets, such as British Aerospace, Britoil, Cable & Wireless, National Freight Corporation and Amersham International, the privatisation programme reached deep into the post-war fabric of the State with the sale of the public utilities - British Telecom, British Gas, the water authorities and the electricity supply industry - from 1984 to 1991.

Privatisation policy in Britain has been driven by a diverse set of political and economic objectives, which range from the ideological (i.e. "rolling back the frontiers of the state" and "popular capitalism") to the pragmatic (e.g. generating additional public revenue).

Not all of these objectives, as we will see, have been equally important, and a number of them appear contradictory. But despite the chameleon character of the programme, where different objectives have been emphasised in line with shifting political and economic imperatives, privatisation policy has been enacted according to a more or less coherent ideological agenda, involving a substantive re-drawing of the boundaries of the State and the market in contemporary society.

The phenomenon of privatisation has not been confined to Britain, of course, with governments of varying political hues in Western countries embracing the precepts of privatisation. And the World Bank and the International Monetary Fund have encouraged developing and Eastern European countries to adopt privatisation as a major instrument of economic surgery and reform (Starr, 1989; de Oliveira & MacKerron, 1992). The internationalisation of privatisation has been documented by a number of writers including Cook & Kirkpatrick eds., 1988; Fraser, ed. 1988; Letwin, 1988; MacAvoy et al 1989; Ramanadham, ed. 1989; Ott & Hartley eds., 1991; Glennerster & Midgley, eds., 1991.

The pervasiveness of privatisation as a major item on the public policy agendas of governments throughout the world seems to suggest that the current period represents a pivotal point in the history of the modern State. In effect, we appear to be witnessing a process of transformation in the way that the State, and its constituent parts, views itself and is viewed by influential external interests and possibly, by the public at large. The post-war consensus about the explicit responsibility of the State for strategic parts of the industrial economy (such as energy policy and coal production) and for physical

infrastructure provision (e.g. transportation, telecommunications, energy and water services) has been progressively displaced by a very different set of views about the nature of the role of the State vis-a-vis industrial activity and infrastructural development.

The transfer of the water and energy utilities to the private sector illustrates, in clear relief, this pivotal shift in political and economic thinking, as these industries occupy not only a fundamental position in the economic and social development of society at large, but they also exert a direct and powerful influence on the lifestyles of every household in Britain.

The sale of the gas, electricity and water utilities to the private sector has not led, however, to a disengagement of the State from the arena of public utility services. Despite it relinquishing ownership and production functions, the State has been required to maintain a significant presence as a regulator of public utility activity. The influence of public regulation on the provision of essential services under private monopoly or quasi-monopoly conditions forms, therefore, a new and important field for policy analysis in this country.

The British Government's privatisation programme has attracted a considerable degree of academic attention; although to date, this interest has been primarily directed at the economic and, to a lesser extent, the political dimensions of the programme<sup>3</sup>. The advent of industry-specific regulatory agencies has likewise stimulated a developing literature, but here also the focus has been heavily oriented towards economic analysis.

However, the public utilities occupy too important a place in society to continue to cede almost monopoly control of the discourse on utility industry policy and regulation, to the discipline of economics.

The energy and water utilities make a fundamental contribution to individual and social well-being and questions concerning the distribution of utility services directly intersect with major issues of social policy. Yet, surprisingly, little analysis of the public utility phase of the privatisation programme has been undertaken from a social policy perspective. Indeed the literature on social policy and the public utilities generally, is extremely scant. Energy is better served in this respect than water, but even in the former, only two major works have been published on the subject in Britain over the last decade i.e. Bradshaw & Harris, eds. (1983) and Boardman (1991a).

Nor, up to this point, has a concerted effort been made to evaluate the impact of utility privatisation and regulation on domestic consumers in general, and on low income consumers in particular. This is likely to be a reflection of the short history of the public utilities under privatisation. But even in those studies that have attempted to assess the outcomes of the privatisation programme thus far (e.g. Bishop & Kay, 1988; Chapman, 1990; Roberts et al, 1991; Whitfield, 1992), only cursory attention has been given to the important question of how privatisation has affected ordinary consumers. The central aim of this thesis is to fill this major gap in the literature and in our understanding of how privatisation of the energy and water industries has operated in practice.

It is still too early to provide a conclusive account of how domestic consumers have fared under privatisation, but the restructuring of the public utilities has been in place sufficiently long enough to give a clear indication of the extent to which the new regime is acting either to the advantage or the disadvantage of consumers. This thesis analyses the impact of gas, electricity and water privatisation up to the end of October 1992<sup>4</sup>. While this date reflects the exigencies of the author's writing timetable, it also constitutes an appropriate point at which to reflect on the outcomes of the initial phase of the utility privatisation programme. For in each of the utility industries, there is a very real sense that the first act has drawn to a close and that there are likely to be significant changes in the plot, and possibly even the players, as the next act unfolds. The catalysts for these probable changes include the Monopolies and Mergers Commission investigation into the gas industry, the forthcoming reviews of the water and electricity price controls by the industry regulators, and the Government's review of energy policy in the wake of its controversial proposal to close many of the country's remaining coal mines.

This study focuses centrally on the impact of privatisation and regulation on primary areas of service provision for domestic consumers, namely:

- \* tariffs and systems of charging
- \* debt and disconnection practice
- \* service standards and consumer protection
- \* mechanisms for consumer representation.

It also seeks, however, to undertake an assessment of the broader distributional consequences of the sale of the public utilities (in Chapter 5). It is particularly concerned throughout to examine the way in which the new structures of ownership and regulation have affected access to energy and water services by low income households in Britain.



Because of the significant negative externalities associated with the provision of energy and water services, privatisation has been attended by considerable concern about the nature and quality of private sector 'stewardship' of the environment. Although an analysis of the environmental effects of the privatisation of the water and energy utilities is largely outside the scope of this work, the interaction between aspects of environmental policy and social policy is alluded to on a number of occasions, particularly where this is directly relevant to equity and distributional issues. The relationship between social and environmental policy is an area of increasing importance (Ferris, 1990; Ife, 1991) and is one where much more research attention is warranted in the future.

In seeking to evaluate the outcomes of the utility privatisation programme, the researcher is immediately confronted with the problem as to what constitutes the most appropriate 'frame of reference' for conducting such an evaluation. A 'before and after' approach, involving a direct comparison of the service systems of the public utilities under nationalised and subsequently, privatised regimes, would be instructive, but is made difficult due to the absence of comparable data. Juxtaposing outcomes with the objectives explicitly set for the privatisation programme is a useful way of testing the efficacy of privatisation in its own terms, and it utilises the orthodox methodology of goal-oriented evaluation. But it may not capture the full array of consequences of utility privatisation, as the field of analysis is fundamentally driven (and constrained) by the logic and rationale of the designers of privatisation policy. The application of exogenous evaluative criteria - like equity - is therefore likely to be required if the researcher is to get anywhere near tapping the depth of the 'privatisation affect', particularly in regard

to its social impact. Elements of each of these three modes of evaluation are employed, although emphasis is given in the study to the latter two approaches.

This analysis of the impact of privatisation and regulation has been informed by the use of a wide range of primary and secondary sources. Extensive use has been made of documentary material from government agencies, the regulatory bodies, the utility companies and community sector organisations. This has been complemented by interviews with key informants in the community and consumer sector, the regulatory bodies and the utility industries. Also the author has been a participant observer, over several years, in a number of the key fora set up in England and Wales to represent the interests of low income consumers of utility services, including the Public Utilities Access Forum <sup>5</sup> and the National Right to Fuel Campaign. The burgeoning literature on the economic aspects of privatisation and public utility regulation has provided an important part of the conceptual framework of the study.

Additional information on the research focus and the fieldwork stage of the research is contained in Annexe 2.

## Structure of the thesis

Chapter 1 establishes the context for the study by providing a summary account of the major events in the privatisation of the gas, electricity and water industries in Britain, and a detailed review of the legislative and regulatory framework, particularly in relation to consumer affairs. It also documents, for the first time, the attempts made by the community and consumer sector to influence the legislative process; using primary source material, obtained through interviews with individuals involved in the campaigns and parliamentary briefing papers. Many of the issues raised, unsuccessfully, by the community and consumer sector at the outset, were to become recurrent problems in the implementation of the new structure of utility provision and regulation.

Privatisation connotes a paradigm of utility services as 'commodities' like any other. But in Chapter 2 it is argued that this is not the case and that energy and water services have a composite of features - e.g. essentialness, inelasticity of demand, strategic importance, natural monopoly provision, and externalities - which distinguish them from other services purchased by ordinary consumers in the marketplace. The social and economic characteristics of the utility industries mean that they also intersect directly with major issues of public policy. This chapter weaves together, in an original way, theoretical and empirical material from the disciplines of welfare economics, environmental economics and social policy.

The distinguishing characteristics of utility services necessitate an overlay of strong public regulation. In the past, this was seen to be best achieved through public ownership. However, privatisation manifestly offers an alternative model of public utility management and regulation. Chapter 3 opens with a discussion of the importance of economic and social regulation in the public utility context. After briefly reviewing the alternative regulatory models, the discussion moves onto an assessment of the British model of utility regulation, based on a comparison with the system of regulation in the US and on an original analysis of the *modus operandi* of the British energy and water regulatory bodies. The chapter concludes by considering whether the problems of principal-agent theory, regulatory capture and accountability, identified in the literature on regulation, are likely to be significant factors in the regulatory framework established in Britain.

The British privatisation programme has been characterised by multiple economic and political objectives, and Chapter 4 sets the scene for the empirical analysis of the outcomes of gas, electricity and water privatisation in the chapters that follow by examining these objectives. Extensive use is made here of the literature on privatisation. The political environment in which privatisation is located cannot be fully comprehended, however, without an understanding of the ideological foundations of the programme. Consequently, the discussion on the objectives of utility privatisation is preceded by a review of the major precepts of New Right political theory, as articulated by leading New Right theorists. The chapter concludes with an assessment of whether the privatisation programme represents one part of a hegemonic project in late twentieth-century Britain.

Privatisation of the public utilities has resulted in concrete changes in the relationship between domestic consumers and utility providers. But it has also had broader distributional effects, and hence prior to considering how individual consumers have fared under gas, electricity and water privatisation, it is important to examine these macro-distributional outcomes. Chapter 5 does this through using primary and secondary source material to explore the issues of public utility assets sales, share ownership and distribution, company profits, executive salaries and employment.

Chapters 6 and 7 form the empirical core of the thesis. They directly address the question of how domestic consumers have been affected by the radical restructuring of the three utilities between 1986 and 1991, and draw on a comprehensive range of material from the regulatory bodies, the consumer and community sector and the privatised companies. The two chapters provide the first substantive evaluation of what has happened in the areas of (i) prices and tariff structures, (ii) debt and disconnection practice, (iii) service standards and consumer protection, and (iv) consumer representation, since privatisation.

The final chapter considers the major limitations in the original privatisation settlement and in the evolving model of privatised utility provision and regulation, from the perspective of domestic consumers. It suggests *inter alia* that further action is needed if domestic consumers are to benefit fully from the restructuring of the three utilities. The chapter concludes with a consideration of the paradigm of consumerism, which has underpinned the privatisation of the utilities, and suggests that a preferable alternative model could be found in the concept of social citizenship.

There is a certain poignancy, as well as historical irony, in the fact that many of the arguments that were used by a reforming Conservative Government in the middle and late 1980s to justify the wholesale privatisation of the energy industries, imitated (in their objectives, if not in their philosophical roots) many of the arguments used by the reforming Labour Government of the middle and late 1940s to support their nationalisation in the first place. While the water industry was ‘nationalised’ in a different historical era, much of the rationale was framed in similar terms to that which accompanied the nationalisation of electricity and gas.

Yet the ascendancy of privatisation as a prescription for public utility organisation is attributable, in part, to the ascribed failure of the nationalised (or Morrisonian) model of ownership. A short history of nationalisation, based on a survey of the literature on this period, is provided in Annexe 1. This includes a case study of the operation of the nationalised energy utilities’ code of practice on debt and disconnection.

## ENDNOTES TO INTRODUCTION

1. Said by Chapman (1990) to be the originator of the term 'privatisation' - although Drucker actually uses the expression 'reprivatization':

*It would..be a systematic policy of using the other, the non-governmental institutions of the society of organizations, for the actual 'doing', i.e. for performance, operations, execution. Such a policy might be called 'reprivatization'. The tasks which flowed to government in the last century because the original private institution of society, the family, could not discharge them, would be turned over to the new, non-governmental institutions that have sprung up and grown during the last sixty to seventy years. Drucker (1969) p.218*

2. Privatisation will be defined in this thesis as the act of transferring functions and activities of the State - in the areas of either (i) production/delivery of goods and services (ii) financing or (iii) regulation - to other institutions in society, including the private and non-government organisation sectors. This is very similar to Gilbert & Gilbert's (1989, p.28) definition:

*Privatisation occurs when functions related to ownership, funding, regulation, management, and provision, are removed from the public domain.*

It is also similar to Alan Walker's (1985) definition of privatisation. Consequently, manifestations of privatisation in Britain, other than the denationalisation of public enterprises, would include: the contracting out of central and local state services, the sale of public housing, and the movement of responsibility for community care to voluntary organisations, private-for-profit agencies and to individual families.

3. Much has been written on the economic aspects of privatisation in recent years, but the best generic account remains that written by John Vickers and George Yarrow in 1988, *Privatization: An Economic Analysis*.

4. Although it strays a little beyond this date on the related issues of coal mine closures and energy policy.

5. "The Public Utilities Access Forum [PUAF] was set up in 1989 to develop policy on the regulation of public utilities and low-income consumers. Membership includes: the National Association of Citizens Advice Bureaux, Age Concern, the National Right to Fuel Campaign, RADAR, the Money Advice Association, Winter Action on Cold Homes, Help the Aged and other voluntary organisations with an interest in these issues. Observers include the Gas Consumers Council, the National Consumer Council, the local authority associations and the utility regulators" (PUAF letterhead). PUAF meets bi-monthly.

# CHAPTER 1: THE PROCESS AND STRUCTURE OF PUBLIC UTILITY PRIVATISATION IN BRITAIN

## INTRODUCTION

The gas, water and electricity industries were privatised, in succession, over a period of five years by the Conservative Government - British Gas in 1986, the regional water authorities in 1989 and the electricity supply industry (ESI) in 1990-91<sup>1</sup>. Despite their essential commonality as public utilities, the three industries had quite distinct organisational and operational histories and this, in conjunction with a range of exogenous factors, presented the Government with different issues and problems in steering the privatisation of each of the industries through the policy making and legislative process. As well as adapting the utility privatisation model (originally used in the privatisation of British Telecom in 1984) in light of the particular characteristics and circumstances pertaining in each industry, it is also evident that the Government utilised a degree of 'policy learning' in its management of the privatisation programme, with some of the lessons from earlier privatisations being applied to those that occurred subsequently. This is most noticeably the case in relation to the promotion of competition and to aspects of regulation.

This chapter will examine the process of privatising the gas, water and electricity supply industries between 1986 and 1991, giving particular emphasis to the legislative provisions and structures introduced for the economic and social regulation of the three utilities. It will provide a **synoptic**, rather than a detailed, account of the major events in the history of the privatisation of each of the three utilities, and it will give close





attention to the involvement of community sector and consumer organisations in the legislative process. This is partly because good general accounts of the privatisation process in these industries exist elsewhere (see for example, gas: Vickers & Yarrow, 1988; electricity: Roberts et al, 1991, Green, 1991; and on water, from different perspectives and different points in time: Kinnersley, 1988, Cook, 1989, Richardson et al, 1992 and Ogden, 1991). But also, given the focus of this study, it is more important to detail the regulatory framework developed at the time of privatisation - particularly as it relates to domestic consumers, and to identify the sorts of issues that organisations representing the interests of consumers were seeking to place on the policy-making agenda at the outset, rather than to simply reiterate the known history of utility privatisation. The involvement of the community sector has been largely overlooked in published accounts of the privatisation programme in Britain, which have tended to focus, by and large, on the economic aspects of privatisation and regulation.

The privatisation of the utilities did not, of course, take place in a social, political and economic vacuum and the broader ideological and political context of privatisation is considered in some detail in Chapter 4 (The Political Economy of Public Utility Privatisation).

## 1. THE PRIVATISATION OF BRITISH GAS

### (i) Background

*Merely to replace state monopolies by private ones would be to waste an historic opportunity. So we will take steps to ensure that these new firms do not exploit their powerful positions to the detriment of consumers or their competitors. Those nationalised industries which cannot be privatised or organised as smaller and more efficient units will be given top-quality management and required to work to clear guidelines.  
The Conservative Manifesto 1983 p.17*

The privatisation of the gas industry in 1986 has been perceived generally as a major opportunity lost. This is because it involved the straightforward metamorphosis of a public monopoly supplier, the British Gas Corporation, to a private monopoly supplier, British Gas Plc, without any significant attempt to restructure the industry, or to introduce competition into the domestic gas market.

Unlike in the earlier privatisation of British Telecom and in the privatisation of the water and electricity industries subsequently, the way to the sale of British Gas had not been paved by a clear election manifesto commitment, nor a White Paper outlining the details of the new structure for the gas industry in Britain. Indeed, as the quotation above shows, the 1983 Conservative Party Manifesto, argued against the very structure that was introduced in the gas industry when it was privatised.

Several months after the election of the Thatcher Government to a second term of office in mid-1983, the Secretary of State for Energy, Peter Walker, established a departmental working group to examine the options for privatising the British Gas Corporation. According to Lord Belstead, in his Second Reading speech on the *Gas Bill* in the House

of Lords, this working group carried out "the most careful scrutiny of the regulatory systems in a number of other countries and a full review of the existing and past arrangements for the control of the gas industry and other utilities here in Great Britain" (HoL, 10/4/86, col. 370).

In April 1985, the Secretary of State for Energy sought, and gained, Cabinet approval for the introduction of legislation to privatise the British Gas Corporation. The policy choices available to the Government for the future structure of the privatised gas industry in Britain included, (i) the retention of the unitary and monopoly structure of the British Gas Corporation, (ii) the separation of the transmission and supply functions into two businesses, and (iii) the sale of the twelve area boards of the Corporation as separate companies. In the event, the legislation made provision for the Government to sell its 100 per cent stake in a unitary British Gas plc - a company which looked little different from its nationalised predecessor, with the exception of the earlier divestment of the British Gas Corporation's on-shore and off-shore oil fields and the removal of its status as the sole authorised gas utility.

The Government's arguments for retaining the existing model were premised centrally on a recognition of the natural monopoly characteristics of the domestic gas industry, as the following excerpt from the Secretary of State for Energy's Second Reading speech on the *Gas Bill* illustrates:

*It has been argued that splitting the corporation into area boards serving different parts of the country would achieve greater competition. I carefully examined this possibility, and looked into the advantages and disadvantages that it would bring. Under such an arrangement, each consumer would, as is now the case with electricity, face a single supplier in their area. Breaking up the corporation would also put at risk economies of scale through the integrated transmission and distribution*

*system that has been developed, which allow best practices to be spread rapidly through all parts of the country.* HoC, 10/12/85, col. 776

The Secretary of State also argued that significant structural change would be attended by marked variations in gas tariffs throughout the country and would cause "disruption to consumers and industry" (ibid). Interestingly, these arguments have gained a new resonance in recent times, as a result of the referral of British Gas to the Monopolies and Mergers Commission (see Chapter 6).

Whatever the merits of the arguments in favour of a unitary model, the privatisation of the gas industry manifestly contradicted the restructuring and competition objectives explicit in both the Government's election manifesto and the privatisation programme as a whole. The failure to achieve these objectives in the sale of British Gas, in all but the most limited of ways, has been variously attributed to the negotiating power of Sir Denis Rooke (the then Chairman of the British Gas Corporation), the indifference of the Secretary of State for Energy to the Government's privatisation agenda, a desire to maximise the financial returns to the Government through selling the industry intact, and an imperative to complete the sale ahead of the upcoming General Election in 1987. Certainly, the board and senior executives of the British Gas Corporation appear to have played a pivotal part in shaping the outcomes of gas privatisation (National Audit Office, 1987; Vickers & Yarrow, 1988), and this pattern of executive influence on the 'privatisation settlement' was to be a recurring feature in the public utility privatisation programme.

The key events in the privatisation of British Gas are set out in Figure 1.1 overleaf.

### GAS PRIVATISATION: KEY EVENTS

April 1983:	Conservative Party election Manifesto promises to abolish "the Gas Corporation's statutory monopoly of the supply of North Sea gas to industry" and to increase competition in, and attract private capital to, the gas industry (pp.16-17)
September 1983:	Secretary of State for Energy sets up departmental working group to examine options for privatising British Gas Corporation
April 1985:	Secretary of State for Energy presents paper to Cabinet recommending privatisation of British Gas Corporation
May 1985:	Government announces intention to privatise British Gas Corporation
December 1985:	Second Reading of <i>Gas Bill</i> in House of Commons
April 1986:	Second Reading of <i>Gas Bill</i> in House of Lords
April 1986:	British Gas incorporated as public limited company
July 1986:	<i>Gas Act 1986</i> enacted
August 1986:	Transfer of British Gas Corporation's assets to British Gas Plc Director General of Gas Supply appointed
December 1986:	Flotation of British Gas

Figure 1.1: Key Events in the Privatisation of British Gas

(ii) Regulatory framework

The framework adopted by the Government for the regulation of British Gas was substantially based on the prototype developed for British Telecom. As is the case with all of the privatised utilities, the statutory instruments for the regulation of the industry consist of two parts: the primary legislation or enabling Act, and the operating licence (called in the case of British Gas, the "Authorisation"). The economic regulation of the monopoly gas supplier, contained in the Authorisation, was framed around the price cap formula  $RPI-X+Y$  developed by Professor Littlechild in 1984; where  $X$  (the 'efficiency factor') was set at 2 per cent and  $Y$  provided for the full pass-through of gas purchase costs to consumers. Because of the retention of the unitary, monolithic structure of the industry, the second critical dimension of economic regulation - the promotion of competition - was effectively excluded from the regulatory regime; although under sections 3 and 19 of the *Gas Act 1986*, British Gas lost its previously-held exclusive right to supply gas through pipes.

Responsibility for the economic regulation of British Gas and the enforcement of the terms of its licence, along with a duty to protect the interests of consumers, was vested in the Director General of Gas Supply. As well as being given a general duty to protect consumers, the Director General was also specifically required to "take into account, in particular, the interests of those who are disabled or of pensionable age" (s. 4(3) *Gas Act 1986*). However significantly, the Director General of Gas Supply's general and specific duties to protect the interests of consumers is secondary to his primary duties of (i) securing the satisfaction of "all reasonable demands for gas", and (ii) securing that

authorised suppliers of gas "are able to finance the provision of gas supply services" (s. 4, *Gas Act 1986*). A similar set of regulatory priorities (where social regulation is subordinate to economic regulation) also exists for the water and electricity regulators, despite the fact, as will be seen, that organisations such as the National Consumer Council and the Consumers' Association argued strongly against this, particularly during the passage of Water Bill.

In addition to the creation of an Office of Gas Supply, the legislation provided for the setting up of an independent national consumer body (with offices in each of British Gas' regions) - the Gas Consumers Council - to investigate complaints and, if necessary, to make referrals to the Director General of Gas Supply. Remarkably, the Council was given powers in a number of areas which exceeded those given to the Director General of Gas Supply, such as the scope to investigate matters affecting "contract" as well as "tariff" customers <sup>2</sup> and a mandate to deal with complaints related to gas appliances.

The establishment of a national, industry-specific consumer body working independently of but in conjunction with, the regulator was unique to gas privatisation (as will be seen below). This model was not replicated in either of the subsequent privatisations, despite the fact that in the electricity industry - as with gas - a national body representing consumers had been in existence for many years prior to privatisation. The reasons for the retention of a national consumer body in the case of gas and not electricity is likely to be related to the fact that the about to be abolished, National Gas Consumers Council (with the support of the National Consumer Council) argued for a national forum independent of the regulator and that Sir Denis Rooke apparently lent his influential

support to the argument for an independent consumer body <sup>3</sup>. Neither of these conditions applied in period leading into and during the privatisation of the electricity supply industry.

Despite the apparent superiority of the model of consumer representation put in place during the privatisation of British Gas (and this is discussed in Chapter 7), the overall framework for economic and social regulation in the gas industry was, on most criteria, the weakest of the regulatory regimes introduced for the three utilities under study. Many of the weaknesses of the system of regulation being developed were recognised by community sector and consumer organisations seeking to influence the passage of the *Gas Bill* through the House of Commons and the House of Lords in late 1985 and early 1986.

(iii) Community sector campaign

Unlike later privatisations, and most especially water privatisation, the involvement of the community sector <sup>4</sup> in activity surrounding the formulation of the primary and secondary legislation for the privatisation of the gas industry was relatively low key. It also lacked the cohesion and coordination evident in the water privatisation campaign. The absence of policy documents foreshadowing the privatisation legislation (in the form of Green and White Papers) and a lack of campaigning experience on an issue of such complexity, may partly explain the character of the community sector's response to the *Gas Bill*.



Most of the community sector organisations involved in lobbying over the Bill adopted a pragmatic approach i.e. they sought not to challenge privatisation per se, but to influence the shape of the regulatory environment that would attend the privatisation of the gas industry. This essentially pragmatic engagement with the policy making process was also characteristic of the sector's *modus operandi* in the subsequent water and electricity privatisations<sup>5</sup>. However, there were some organisations involved in lobbying over the *Gas Bill* and other privatisation legislation - of which the National Right to Fuel Campaign was a leading example - that adopted what could be described as a 'dual-pronged' strategy; where outright opposition to privatisation as a principle, was complimented by a set of 'second-best' proposals aimed at improving the regulatory regime and at advancing the interests of low-income consumers<sup>6</sup>.

The community sector campaign (or more accurately, campaigns) to influence the gas privatisation legislation was directed primarily along three fronts, namely:

- 1. Identifying the inherent flaws in the proposed system of economic regulation,*
- 2. Exposing the paucity of regulatory protection for low-income consumers,*
- 3. Arguing for energy efficiency obligations/incentives for British Gas*

The National Consumer Council (NCC) took much of the running in the first area, arguing in its briefings on the Second Reading of the Bill and to the Standing Committee on the *Gas Bill* that, because of the absence of competition in the structure of the privatised gas industry, consumers were unlikely to receive much benefit ("competition is the best way of transferring power from the producer to the consumer,

of increasing efficiency and of promoting technical innovation." NCC Second Reading Briefing on Gas Privatisation, undated p.1). In the absence of competition it was imperative, the NCC pointed out, that the regulatory bodies be given "real teeth..with proper powers and proper funding" and that "..trying to save money by reducing the power of the regulator is short sighted. The inefficiency of a utility is passed on to its consumers." (ibid, p.2). The NCC concluded that the powers being given to the Director General of Gas Supply were less than the already circumscribed powers given to the Director General of the Office of Telecommunications. The NCC's call for a stronger regulatory presence in the privatised gas industry was imitated by other community sector organisations, such as the National Right to Fuel Campaign (which also advocated the appointment of a "Gas Ombudsman.. with the power to award compensation" p.3), and the trade association-cum-energy efficiency lobby group, the Association for the Conservation of Energy.

On the primary instrument of economic regulation, the price control formula, the NCC argued that it was seriously deficient in that (a) the full pass-through of gas costs provided no incentive for British Gas to purchase economically and that consumers not the company would bear the brunt of any poor purchasing decisions ("If British Gas slips up in signing a long-term contract with its suppliers and makes a bad deal, it is the shareholders, not the consumers, who should shoulder the costs." ibid p. 4), (b) it took no account of a possible decline in standards of service ("lack of quality regulation") and (c) that the structure of formula "allow[s] the industry to reduce prices on services that are subject to competition, while raising prices on those that are not. This tends to mean

that prices to big business go down, while prices to householders and small businesses go up" (ibid, p. 3).

The NCC arguments were apparently given very little credence by the Government of the day, for none of these issues was addressed in the legislation. But, although their impact at the time was minimal, it is interesting to observe that these matters have been very much at the core of the regulatory agencies' engagement with British Gas over recent years. This has been exemplified in, for example, the OFGAS Tariff Review in 1991, the Office of Fair Trading injunction to British Gas to separate its transmission business and to reduce its dominance of the contract market, and the referral of the company to the Monopolies and Mergers Commission in July 1992.

The second strand of community sector action on the *Gas Bill* and the draft licence was directed at exposing the possible dangers that low-income consumers of gas might face in their dealings with a profit-oriented monopolist, and at introducing a set of formal protections for this group of consumers in the privatisation legislation. Although under the draft licence, British Gas was required to produce and publish codes of practice on debt and disconnection and on customer service there was, as the NCC pointed out "nothing in the licence about what they should contain." (NCC Comments on the Gas Bill and draft licence to Standing Committee on the Gas Bill, 9/1/86, p. 4). In the view of organisations such as the Child Poverty Action Group and the National Right to Fuel Campaign, codes of practice requirements in the licence afforded insufficient protection and they argued for statutory codes of practice as part of the primary legislation. In large part, scepticism about the efficacy of non-statutory codes of practice was conditioned

by experience of the operation of the voluntary, and substantially unenforceable, codes of practice introduced in the fuel industries in the mid 1970s (see Annexe 1).

As well as the introduction of statutory codes of practice, the National Right to Fuel Campaign sought the abolition of British Gas' right to disconnect (contained in the Public Gas Supply Code of Schedule 5 of the legislation) and argued that the industry should be obliged to recover its debts "through the courts or a tribunal", that controls should be placed on the amount by which the standing charge could be increased each year, and that "British Gas have a statutory duty to consider the welfare of disadvantaged gas consumers and to ensure that policies do not exacerbate their problems" (Fuel News Vol. 4, 1985). In the event, only one of these proposals met with any success - the level of annual increase in the standing charge was fixed to increases in line with movements in the Retail Price Index.

The third and final area around which community organisations attempted to influence the legislative and regulatory framework for the operation of British Gas concerned energy efficiency. In making their case, the National Right to Fuel Campaign, the Association for the Conservation of Energy and others, emphasised the seeming incongruity of energy efficiency principles and practice with a privatised energy industry, released from the public accountability and policy constraints of government, and operating under a price control formula explicitly biased in favour of maximising gas sales. It was argued, therefore, that the only way in which this 'market failure' might be corrected would be through placing a statutory obligation on British Gas for ensuring the efficient use of energy<sup>7</sup>. Detail of the actual mechanics of how this

obligation might be defined, monitored and enforced by the regulator was less precise. The ground on energy efficiency was to be re-visited three years later during electricity privatisation, with only marginally more success.

The issues relating to low-income consumers and energy efficiency which were raised during the passage of the legislation in 1985/86 made (with the minor exception of the standing charge) little discernable impact on the Government's policy decisions at the time. Yet, as in the case of the NCC's critique of the system of economic regulation, their pertinence and relevance has been confirmed over the short history of the privatised gas industry, as will be seen in Chapters 6 and 7.

## 2. THE PRIVATISATION OF THE REGIONAL WATER AUTHORITIES

### (i) Background

The sale of the ten regional water authorities in England and Wales was unequivocally the most contested part of the Thatcher Government's privatisation programme. This was reflected in the strong, and largely successful, extra-parliamentary campaign to change the Government's original plans for the organisation of the industry in the private sector, and in the failure of the Government, throughout the entire process of water privatisation, to win broad public support for the sale. For most of this period, between 70 and 80 per cent of people interviewed expressed their disagreement with the idea of privatising the water industry (Consumers' Association, 1989b, 1989c; *The Guardian*, 17/5/89 and 28/9/89; *Observer*, 2/7/89; McAllister and Studlar, 1989). Nevertheless, the Government completed the sale of the water authorities in December 1989.

The character of the privatisation programme generally has been evolutionary and opportunistic (albeit within a coherent ideological world view, see Chapter 4) and this is exemplified nowhere better than in the sale of the water industry<sup>8</sup>. The story of the idea of water privatisation "arriv[ing] on the agenda suddenly" (Richardson et al, 1992) and the way that "the government and water authorities stumbled into it" (Kinnorsley, 1988a) has been documented fully elsewhere (see sources above, plus *Water Bulletin*, 1/9/89), and therefore only the outline will be sketched here.

It is generally acknowledged that the precipitating event in water privatisation was a dispute between the Government and the Thames Water Authority in early 1985 over the accelerated repayment of loans and a consequential increase in water charges. In the subsequent House of Commons debate on the issue, the Minister for Housing and Construction announced that the Government "will be examining the possibility of a measure of privatisation in the industry" (HoC 7/2/85 col. 1142).

Following the dissemination of a hastily put together and poorly-drafted (according to Kinnersley, 1988a) discussion paper by the Department of the Environment (*Water authority privatisation: a discussion paper*, 1985), which drew an indifferent response from the water industry, the Government released the White Paper *Privatisation of the Water Authorities in England and Wales* (HMSO, 1986b) outlining its plans for the sale of the ten regional water authorities. Along with articulating the rationale for privatising the industry (which, interestingly, made no mention of the 'environmental imperatives' that were to occupy such a prominent place in the Government's arguments in 1988/89), the White Paper set out the proposed privatised industry structure and the system of economic regulation to be introduced.

The publication of the White Paper attracted, almost immediately, a strong negative response. A response, not directed primarily at the principle of privatisation as such, but at the core proposal that the integrated river-basin management model introduced under the *Water Act 1973* (involving the organisation and management of water resources and the water-related environment around river basin catchment areas<sup>9</sup>) be retained and that

the privatised water companies continue to perform both a water production and an environmental regulation function.

Although the integrated river-basin management approach to the organisation of the water industry was viewed as generally successful, strong apprehension was felt about private profit-making bodies performing the critical environmental management responsibilities explicit in the integrated model. Also as the water authorities themselves were major contributors to water pollution (e.g. through sewerage discharges), there was concern that the advent of private water companies with regulatory responsibilities would serve to deepen the inherent conflict of interest involved in combining production and environmental policing functions.

In the face of concerted opposition from organisations as diverse as the CBI, Council for the Protection of Rural England, Country Landowners Association, Green Alliance and the water sector trade unions (plus apparently the new Secretary of State for the Environment, Nicholas Ridley <sup>10</sup>) and doubts about the legality of private water authorities being constituted as ‘competent authorities’ under European Commission environmental law, Nicholas Ridley advised the House of Commons that the tabling of water privatisation legislation would be indefinitely deferred (i.e. effectively until after the next General Election) <sup>11</sup>.



A solution to the conflict of interest problem inherent in the integrated approach was subsequently found at the expense of the retention of the integrated river-basin management model. As part of its election manifesto, the Government announced that, upon re-election, it intended establishing a separate water environment watchdog to complement the privatised water authorities. Following the election, this was formalised in the Department of the Environment paper *The National Rivers Authority: The government's policy for a public regulatory body in a privatised water industry* (July 1987), where it was indicated that the new authority would subsume *inter alia* the pollution control, water resource management, discharges consents, flood defence and land drainage functions of the regional water authorities.

The plans for the creation of an independent water environment regulatory body were greeted with wide approval, although the Water Authorities Association (representing the ten water authorities) expressed dissent about the abandonment of integrated river-basin management. This was to be, however, the only major disappointment for the water authorities in the privatisation process. In their analysis of the water privatisation policy-making process, Richardson et al (1992, p.172) conclude that "..the WAA lobbying was very effective indeed. The NRA issue was a defeat, but the rest of the [financial settlement] package, as was privatisation itself, represented a very good deal for the industry".

The reversal of the original blueprint for the privatisation of the water authorities in 1986/87 represented the nadir of the Government's water privatisation project. After this initial setback, for all the moral outrage expressed about the notion of expropriating a "public good" like water for private profit, regardless of a deep, but latent, popular opposition to the sale, and notwithstanding the 'unhelpful' interventions of the European Commission on the timetable for meeting environmental obligations, the Government experienced remarkably few problems in completing its legislative programme for water privatisation. Only once did the Government appear to lose its *sang-froid*, when in March 1989, the Prime Minister ostensibly rebuked the two ministers responsible for water privatisation, Nicholas Ridley and Michael Howard, for not handling the process well enough (*Sunday Times*, 5/3/89).

The major landmarks in the legislative journey towards privatisation of the water industry are summarised in Figure 1.2 overleaf.

## WATER PRIVATISATION: KEY EVENTS

February 1985:	Government announces that it "will be examining the possibility of a measure of privatisation in the [water] industry"
April 1985:	DoE releases discussion paper on water privatisation
February 1986:	White Paper <i>Privatisation of the Water Authorities in England and Wales</i> published
July 1986:	Privatisation of water industry postponed
May 1987:	Commitment to privatise water industry and to create National Rivers Authority contained in Conservative Party election manifesto
June 1987:	Conservative Government re-elected
July 1987:	Plans for revised framework for water privatisation and for the creation of a National Rivers Authority published
May 1988:	<i>Public Utility Transfers and Water Charges Act</i> enacted empowering water authorities to transfer property to other bodies corporate and sanctioning the introduction of water metering trials
December 1988:	Second Reading of <i>Water Bill</i> in House of Commons
April 1989:	Second Reading of <i>Water Bill</i> in House of Lords
July 1989:	<i>Water Act 1989</i> enacted
	Director General of Water Services appointed
September 1989:	Transfer of RWA assets to successor companies Instruments of Appointment (licences) come into effect
	Transfer of water resource and environmental management functions to NRA
December 1989:	Sale of the 10 Water Holding Companies
July 1991:	Consolidating Acts, including <i>Water Industry Act 1991</i> , enacted

**Figure 1.2: Key events in the privatisation of the water industry**

Under the legislation introduced into the House of Commons in November 1988, the ten regional water authorities were 'converted' to public limited companies with responsibility for the provision of water and sewerage services within their designated regional areas; although technically two companies were created out of each RWA: one generic holding company (unregulated) and one with specific water and sewerage undertaker functions (regulated). In contrast to the British Gas situation, it was formally acknowledged that water and sewerage provision is dominantly a natural monopoly. Hence, by and large, the regional water and sewerage companies would constitute monopoly providers within their geographical boundaries and that in lieu of substantive competition, a form of proxy competition involving comparisons of the performance of each of the companies would be the 'second best' solution adopted (this is also known as 'yardstick competition' and the way it could be employed in the water industry was initially outlined by Professor Littlechild; see for example, Littlechild, 1988).

However, arguably in deference to the ascendancy of competition as the ruling principle rather than because of any realistic expectation of practical achievement, a nominal element of competition - relating to 'inset appointments' - was contained in the Bill.

'Inset appointments' enable, at least in theory, water and sewerage undertakers to compete for large customers outside their area, who are not already serviced by a water and sewerage company e.g. a new large residential or commercial development. Measures have been introduced subsequently to extend the possibility of companies competing for the business of large customers, i.e. through changes made to the *Water Industry Act 1991*, via the *Competition and Service (Utilities) Act 1992* <sup>12</sup>.

The legislation also made provision for the (then) 29 statutory water companies, supplying around 25 per cent of water to consumers in England and Wales, to convert to public limited company status.

(ii) Regulatory framework

The regulatory regime proposed in the Bill and subsequent draft licences<sup>13</sup>, shared the broad contours of the systems introduced in the privatisation of the telecommunications and the gas industries, but in a number of respects it was marked by some quite distinct differences. One obvious difference, which will not be discussed at length here, relates to the fact that the function of the economic regulator (Director General of Water Services) was complemented by the existence of the so-called "quality regulators" [i.e. environmental and water quality regulators], the National Rivers Authority, HM Inspectorate of Pollution and the Drinking Water Inspectorate. The intersection and "goodness of fit" of the different interests and constituencies represented in these four regulatory bodies has raised particular problems in the overall regulatory environment of the water services industry, which is touched on in Chapter 6.

As with gas, in the absence of competition between water companies<sup>14</sup>, the price control formula becomes the primary lever for the economic regulation of the industry; although because of the existence of 39 companies [now 33], the Director General of Water Services has an ability to undertake performance comparisons not available to his counterpart in the gas industry<sup>15</sup>. The price control formula set for the water industry was  $RPI+K$ , where  $K$  represented the amount that water companies were allowed to

increase charges above the rate of inflation, to offset the substantial injections of capital required to upgrade the infrastructure and to meet existing environmental obligations (totalling an estimated £26 billion at 1989 prices). The level of *K* set for the first five years varied between companies, but the national average was five per cent. The companies were also given the right to seek *interim adjustments to K* to take account of "a relevant change of circumstance" arising from factors such as unanticipated costs associated with meeting additional European Commission environmental obligations, the costs associated with the introduction of domestic metering, and increases in national construction industry costs above those assumed in the initial setting of *K*.

The Director General of Water Services was given two primary duties, one of which was to ensure that the water companies could operate profitably:

*to secure that the functions of a water undertaker and of sewerage undertaker are properly carried out as respects every areas of England and Wales*

*and to secure that companies holding appointments..as water undertakers or sewerage undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of the functions of such undertakers*

(s. 7 *Water Act 1989*, changed subsequently to s. 2 *Water Industry Act 1991* <sup>16</sup>).

The Director General's secondary duties included a general provision to protect the interests of customers and to take specific account of the interests of the disabled and pensioners. The Director General has an additional duty, resulting from a House of Lords amendment during the Third Reading of the Bill, to protect the interests of customers and potential customers in rural areas in respect of charging for water services (s. 7 (3) (a) *Water Act 1989*, s. 3 (a) (i) *Water Industry Act 1992*).

The legislation provided for the setting up of ten regional customer services committees (CSCs), with responsibility for dealing with complaints and for advising the Director General on matters related to the interests of consumers. In contradistinction to the structure of consumer representation established under the *Gas Act 1986*, the consumer bodies in the water industry were attached to the Director General's office (e.g. the Director General makes the appointments and funds the committees) and the bodies were structured on a regional rather than national level. As will be seen below, the power given to the Director General of Water Services with respect to the management and work of the CSCs was a major area of concern to consumer organisations during the passage of the legislation.

The water legislation also made explicit provision, for the first time in the regulated industries, for a measure of quality regulation. This may possibly have been the result of concerted on-going advocacy of community sector and consumer organisations, in tandem with a belated recognition of the difficulties confronting OFTEL and OFGAS, in the absence of significant powers in this area. Along with the traditional requirement that the companies establish codes of practice in particular areas of customer service (of which more will be said in the section that follows), the Director General of Water Services was required to establish two sets of enforceable standards: the first, for **overall** standards of performance that the companies would be expected to attain, and the second, for service standards that "ought to be achieved in **individual cases**" (s. 38 *Water Act 1989* and *Water Industry Act 1991*). In the latter, it was envisaged that a small financial penalty would be levied (and payable to the consumer) for failure on the part of a company to meet the specified service standard. This Guaranteed Standards

Scheme was announced, with much fanfare, by the Minister for Water and Planning, Michael Howard, during the passage of the *Water Bill*. The Minister described it as:

*...a no-nonsense, no-quibble scheme to provide a spur to management for good commercial manners and quick recompense to customers for the inconvenience that they have suffered. It will be a new remedy for the customer. It will be in addition to existing legal rights. It will be but one of the many advantages that will accrue to the customer as a result of privatisation.* HoC, 8/12/88, col. 524.

(iii) Community sector campaign

Amongst the triad of utility privatisations forming the focus of this study, the privatisation of the water industry saw the most concerted community sector campaign aimed at influencing the post-privatisation regulatory model. The same appears to be true for other activist sectors in the British polity, for example, the environmental and trade union movements (Ogden, 1991, Nalgo <sup>17</sup>).

The reason why the activity of the community sector was more concentrated and cohesive during the passage of the *Water Bill* is not terribly clear, although it is possible to speculate on a few of the likely contributory factors. Firstly, the general political climate that attended the privatisation of the water industry suggested that the Government's plans might be more vulnerable than had hitherto been the case, giving rise in turn to a view that appropriately targeted action could lead to success. The fact that the Government had experienced a significant defeat in its first approach to the sale, along with wide ranging popular and media scepticism about the water privatisation process, possibly strengthened activist resolve and contributed to a new sense of political



efficacy. In the upshot of events, the Government's fragility was more illusory than real, but this was not apparent for much of the time in 1988 and 1989.

Secondly, the experience of political lobbying in the earlier privatisations had reinforced the need for a collaborative and coordinated campaign, involving a cross-sectional and broadly-based political alliance. The agenda for change in the water privatisation process was wide enough, and without the tensions implicit in earlier campaigns<sup>18</sup>, for a coalition to be forged for the first, and only time, between community and consumer organisations, environmental groups, local government peak bodies and the industry trade unions.

Thirdly, and this is relevant only to a comparison with the involvement of the community sector in the *Electricity Bill*, the timing of the passage of the two pieces of primary legislation for water and electricity privatisation (both were introduced into Parliament in late 1988) was such that the organisations concerned were effectively forced to make tactical choices about where and how they would deploy the bulk of their campaigning effort<sup>19</sup>. In the event, the community sector directed more of its attention to the *Water Bill* than to the contemporaneous passage of the electricity privatisation legislation.

Figure 1.3 (overleaf) indicates the major community sector groups involved in the water privatisation campaign; it also cites the issues for which they individually took notional responsibility.

### Major community sector players involved in the Water Bill

- \* AMA Social Services group: charges, metering & disconnections
- \* NACAB: disconnections, billing & payment procedures, metering
- \* NCC: Consumer representation, consumer protection, standards of performance
- \* Consumers Association: price regulation, consumer representation & the regulators powers
- \* National Council for Voluntary Organisations: Co-ordinating & Parliamentary liaison function

**Figure 1.3: Community sector involvement in the Water Bill**

The general strategic position of the community sector organisations lobbying around the *Water Bill* was summed up by one of the NCC campaigners as "working for what you can win rather than what you want..realistically we had to focus on some pretty small areas." (interview with researcher, July 1989). In seeking to influence the legislation, the alliance focused primarily - but not exclusively <sup>20</sup> - on the passage of the Bill through the House of Lords. This was argued on the grounds that:

*the huge majority of the Government in the House of Commons dictates everything and there is no real pressure on the Government in the Commons..the ethos in the House of Lords is different, its a place where people still listen to debates and where votes can be won..although the Government can overturn this, it can cause embarrassment if they do so.*  
AMA campaigner in interview with the researcher (18/8/89)

The issues identified by the coalition of community sector organisations as the major ones upon which to focus in their campaigning were:

1. *Payment methods and Disconnection*
2. *Consumer representation*
3. *Duties of Director General of Water Services*
4. *Service Standards and redress*

Each of these issues will be considered briefly in turn, including the response of the Government to the arguments raised by the coalition.

### *1. Payment methods and Disconnection*

The advent of metering trials in a number of areas throughout the country, in combination with the prohibition on charging for water according to rateable value after the year 2000 under section 80 of the *Water Bill*, raised fears that the newly privatised water companies would introduce the compulsory metering of domestic properties. Early data from the metering trials indicated that "water bills for large families on low incomes, in low rateable value properties [were] increasing by as much as sevenfold" (Fimister, 1989b). In addition, it was anticipated that the water companies would take up the power available to them in the legislation and directly pass on to domestic consumers the costs of meter installation (estimated at between £150-£200 per property).

Because of this, the community sector organisations proposed that a statutory requirement be placed "on the water companies to offer consumers at least one option for paying for water which does not involve metering" (AMA Briefing to the House of Lords). It was also suggested that, in light of the budgeting problems of low-income

households arising from the traditional practice of the water authorities of levying charges in standard half-yearly or yearly cycles, that provision be made in the Bill for consumers to pay by more regular instalments. And that consumers be given a choice of a range of flexible payment options similar to those made available by the fuel utilities. In response, the Government gave no ground on the metering issue, but the Minister for Water and Planning indicated that he would encourage the water companies to adopt a more imaginative and customer-sensitive approach to water billing.

Disconnection from water supply was, relative to the standards of the fuel industries, a relatively rare occurrence. However, there was evidence that the level of water disconnection for debt had risen sharply over the years leading into privatisation (amongst the regional water authorities from less than 2,000 in 1981 to over 9,000 in 1987/88). Concern about the prospect of increasing disconnections in an area with such acute public health implications was reinforced by the experience of gas privatisation, where the level of disconnections had escalated between the period 1985 and 1988.

As this was an issue of fundamental importance to low-income consumers, as well as being one where a high degree of public and political sensitivity existed, the community sector alliance decided to put considerable effort into this area.

A tactical decision was taken to present two distinct lines of argument: the first, carried by the AMA Social Services group, that the power to disconnect domestic customers for debt should be abolished, and the second, argued by NACAB and NCC, that disconnections for water debt should not be allowed to occur without recourse to county

court action, and that this should be enshrined in an statutory code enforceable by the Director General of Water Services:

*We never thought we'd achieve our position but we hoped that in pushing our position that the NACAB line might win acceptance. AMA campaigner in interview with the researcher (18/8/89)*

As anticipated by the campaign members, the no disconnections argument was rejected by the Government. Lord Hesketh, Parliamentary Under-Secretary Department of the Environment concluded, for example, that it was "advocating what amounts to a free water policy. In the experience of the water industry, a small minority of customers choose not to pay their water charges even after a county court order has been obtained..for this minority the water undertakers must retain their right as a last resort to disconnect supply." (HoL, 18/5/89, Col 1300).

However, earlier the Government in concert with the Water Authorities Association and the Water Companies Association, had produced a revised code of practice which specified that water disconnections for debt would not occur without reference to the county court, except for those customers who had previously appeared before the court for the recovery of water charges, or where a payment agreement between a customer and water company had been broken (irrespective of whether this had involved county court action or not). It was subsequently argued by the coalition, ultimately with success in the House of Lords, that the exemptions contained in the draft code excluded the very people most likely to be in need of a court assessment of their level of indebtedness and that it discriminated against consumers with multiple debts. In the same House of Lords debate where Lord Hesketh had rejected the call for an abolition of the power to

disconnect, the Government indicated that it would remove the exemptions (with one exception <sup>21</sup>) and that the code on disconnections would form part of the licence conditions [subsequently Licence Condition H] which would be enforceable by the Director General of Water Services. The changes effected in disconnection policy were generally perceived by members of the coalition as the major achievement of their *Water Bill* campaign.

## *2. Consumer representation*

*Consumer representation is..a partisan activity. Regulation and consumer advocacy, are not, therefore the same thing.*  
Consumers' Association (1989b) p.9

The ability of the new Customer Service Committees to represent effectively the interests of domestic consumers was directly challenged by the community sector coalition involved in the *Water Bill* campaign. Their discontent about the provisions for consumer representation fell under two broad headings: (i) the absence of a national consumer forum equivalent to that established in the gas industry, and (ii) concern that the CSCs were being set up in a way that would make them the creatures of the Director General of Water Services rather than being independent agents promoting the consumer interest. In the latter, it was argued *inter alia* (i) that the members of the CSCs should be appointed by the Secretary of State and not the Director General in order to ensure independence and public accountability, (ii) that the CSCs should have control over the appointment of their own staff and budgets, and not be beholden to the Director General for these essential resources, (iii) that the Director General should not hold 'censorship' powers over the reports of the CSCs, (iv) that they should be given the scope to advise

agencies other than the Office of Water Services on matters of importance to consumers (such as the National Rivers Authority, the Monopolies and Mergers Commission and the European Commission), and (v) that provision should be made for representation of low-income and disabled consumers on the CSCs. The National Consumer Council encapsulated the coalition's position on the issue when it stated:

*We believe that the effectiveness of a CSC as a robust, independent consumer voice will be severely muted if it is unable to express its views independently of the Director General to, for example, the MMC and the European Commission..The Director General's role is to maintain a balance between the interests of the industry, the shareholders and consumers, and it would be entirely inappropriate for him to have editorial control over the publications of the CSCs.*

(NCC Briefing House of Lords - Report Stage of the Water Bill, June 1989)

*Consumers must be assured that their interest in important debates such as metering, charges, sewerage law and the control of disconnections will be robustly promoted in public. The Customer Services Committees must have an independent voice.*

(NCC Water Bill 1989 Consumer Representation, May 1989)

The Government rebutted the coalition's case by stating that those amendments aimed at increasing the autonomy of the CSCs "would drive a wedge between the customer service committees and the director general" (Lord Hesketh, HoL 15/5/89, col 977) and by arguing that the nexus between the CSCs and the Director General actually enhanced the power of the former:

*The committees carry that much more weight in their investigations of complaints through such an association. Any divorce between him and those committees would therefore weaken rather than strengthen them.*

Minor victories were achieved, however, in guaranteeing that the Director General would be obliged to set up CSCs in the first place (the "may" in the original legislation was changed to "shall"), that the CSCs role be broadened to include a general policy review

function, and that their meetings be opened up to public. But the unsatisfactory nature of these outcomes, for the organisations involved, is illustrated in the NCC's admission that "[we] have also failed to ensure that the CSCs are independent of the Office of Water Services. We must conclude that the government is determined to limit the effectiveness of the CSCs." (NCC HoL Third Reading Briefing, June 1989)

### *3. Duties of Director General of Water Services*

The priority given to the duties of the Director General in the enabling legislation is of fundamental importance to the operation and scope of the regulatory regime. If his/her mandate for ensuring that the interests of consumers are protected (in relation to matters such as charging, debt and disconnection and service quality) is given equivalent status to those powers relating to the financial operation of the privatised utilities, then the Director General is in a position to arrive at a reasonable balance between the interests of the various stakeholders in the industries (i.e. consumers, management, shareholders). In particular the regulator would have the ability to rule in favour of the consumers and/or 'public interest', even though this might conflict with, or bear negatively on, the interests of management and shareholders. If, however, the regulator is given superordinate responsibility for protecting the commercial interests of the privatised companies (representing a clear imperative to conclude in favour of shareholders and management when conflicts arise), the 'consumer watchdog' function will be legally and operationally shackled as a consequence.



As shown earlier, in the *Water Bill* tabled in Parliament, the duties of the Director General were firmly prioritised, with the consumer protection function occupying a subsidiary position. However, in a widely-leaked unpublished draft of the Bill, provision had been made for the Director General to apply equal weight to the duties of consumer protection and advancing the interests of company shareholders <sup>22</sup>.

During the passage of the Bill through the House of Commons Standing Committee, and later in the House of Lords, the National Consumer Council and the Consumers' Council argued vigorously against the apparent change in the Government's thinking on the duties of the regulator and pointed out the contradiction between the framing of these duties and the statement in the 1986 White Paper that "[the] Director General's principal duty will be to safeguard the interests of the customers.." (*Privatisation of the Water Authorities in England and Wales*, HMSO, 1986b, para. 57). In proposing an amendment in the House of Lords, aimed at balancing the duties of the regulator, in May 1989, the NCC expressed the core of the issue:

*If left unamended the companies will not be prevented from overcharging or providing a low standard of service, because the Director General will be required to put the profitability of the water and sewerage companies above the interests of the protection of consumers.*  
(NCC Briefing Paper on Amendment 77A, May 1989).

In the debate on the amendment, tabled by the Labour peer Lord McIntosh of Haringey, the Government argued that the financial performance of the water companies and the interests of consumers were inherently interwoven:

*[if] a service cannot be properly carried out that is not in the interests of the consumer. The consumer is right up front..  
The creation of this dual framework is quite deliberate. It reflects the paramount importance for customers that companies are able to carry out their functions properly, and to do this they will need to be able to finance those functions and*

*earn a return on capital. For that reason the duties in subsection (2) are a necessary precondition to the others. Similar, but not identical, structures are provided in the Gas and Telecommunications Acts and in the Electricity Bill. (Earl of Caithness, HoL, 4/5/89 col. 354 & col. 355)*

The amendment was subsequently withdrawn.

#### *4. Service Standards and redress*

The arguments put by members of the community/consumer alliance in the general area of service standards and redress were (i) that the codes of practice needed to be enshrined in statute (based on the view that licence-based codes of practice would be virtually unenforceable <sup>23</sup>), (ii) that the Guaranteed Standards Scheme was substantially limited to "administrative matters" and did not cover key areas of service performance such as water quality <sup>24</sup> and (iii) that an effective complaints procedure was required. The alliance made little headway with on any of these issues, and on the major question of the legal status of the codes of practice, the Government claimed that

*[operating] through a licence condition provides more flexibility than would a statutory code, recognising the continuing role of the Director General in policing this and other aspects of the framework of regulation we are introducing..It is not, however, a soft option: an undertaker cannot be appointed unless he meets the requirements I have described. Letter from Michael Howard [Minister for Water and Planning] to Chris Patten, 20/1/89.*

Two other matters advocated by the community sector - unrelated to service standards - but of importance to tenants, were more successful, i.e. that the Director General be given the power to set the maximum price for the resale of water and the removal of the provision making tenants liable for water charges if they had not been paid by the landlord.

### 3. THE PRIVATISATION OF THE ELECTRICITY SUPPLY INDUSTRY

#### (i) Background

*The privatisation of the electricity supply industry was both the biggest and most successful of all the Government's privatisations. It marked another major milestone in the remarkable Conservative programme of popular capitalism and private enterprise.*

Conservative Research Department (1991) p.157

If the sale of the water authorities was the Government's most controversial privatisation, the sale of the electricity supply industry was its most complex and troublesome. The scale of the Government's plans for the privatisation of the ESI, announced in its White Paper *Privatising Electricity* (HMSO, 1988a) in February 1988, prescribed the most radical restructuring of a utility industry to date, involving the vertical and horizontal separation of a traditionally highly integrated industry.

The monolithic Central Electricity Generating Board (CEGB), responsible for electricity generation and transmission, was to be broken up into three distinct parts. The generating infrastructure of the CEGB was to be split between two new companies: *GEN.1* (later to become National Power) with 70 per cent of generating capacity, and *GEN.2* (later PowerGen) with 30 per cent of generating capacity. The decision to allocate the generating resources (i.e. power stations) of the CEGB in this uneven fashion was premised on a recognition that the larger generating company would be required to carry the 'liability' of nuclear generation. The transmission network of the CEGB was to be established as a functionally and operationally separate entity, owned and managed conjointly, not by the generators, but by the regional electricity companies

(National Grid Co.). The twelve existing area electricity boards, responsible for the distribution and supply of electricity to 'end-users', were to be sold as twelve separate public limited companies. At the same time as the Government published its blueprint for the ESI in England and Wales, the Secretary of State for Scotland announced that the electricity in Scotland would also be privatised. But in contrast to the proposed ESI structure south of the border, the Scottish industry was to be sold as two vertically integrated companies, with generation, transmission, distribution and supply functions intact (Scottish Hydro-Electric and Scottish Power).

This scenario for the future of the ESI in Britain was formalised with the tabling of the *Electricity Bill* in the House of Commons in December 1988.

In comparison with the earlier utility privatisation legislation, the *Electricity Bill* made provision for the introduction of an unprecedented level of competition. The two non-natural monopoly dimensions of the electricity industry - generation and supply <sup>25</sup> - were to be exposed to full competition over the medium-term. New entrants to electricity generation and supply were to be encouraged through the granting of operating licences, and through the opening up of the 'common carriage' networks to "second tier" operators. The purchasing of electricity from the generators was to occur through a form of electricity spot market, known as the "Pool" (and run by a subsidiary of National Grid Co.). It was believed that the combined impact of these structural changes would result in a more efficient ESI, supplying electricity at a lower cost to consumers

However, because the regional electricity companies (RECs) were allowed to retain their monopoly franchise for supply to users of medium and small amounts (i.e domestic consumers) of electricity until 1994 and 1998 respectively <sup>26</sup>, the gains accruing from this new competitive structure would initially be directed mainly to large industrial and commercial users of electricity. Although in theory at least, the small user stood to gain some benefit from the lower costs of purchasing wholesale electricity in this new competitive market <sup>27</sup>. This was based on the twin assumption, of course, that the competitive generation market would function effectively and that the savings made by the RECs in purchasing electricity would be passed on to consumers and would not be expropriated as surplus profit.

Yet within this pro-competitive framework, the legislation and draft licences contained some distinctly non-competitive features. These included the limitations placed on the generating companies' ability to enter the supply market (limited to an average of 15 per cent of demand for the first four years and 25 per cent for the four years thereafter) and conversely, the limits applied to the amount of generation activity that the REC's could undertake (15 per cent of total capacity).

Most controversial of all the competitive constraints, however, was the requirement that the RECs purchase a proportion of their electricity from nuclear sources until 1998, under the Non-Fossil Fuel Orders <sup>28</sup>, and the provision that the extra costs associated with purchasing nuclear power be retrieved through the application of a so-called *fossil fuel levy* on electricity prices. The level of the levy set by the Secretary of State for Energy at the time of privatisation was 10.6 per cent. In justifying this premium on

electricity prices - estimated to be about 3p per kilowatt hour (HoC Energy Committee, 1992a) - to subsidise the nuclear industry <sup>29</sup>, the Secretary of State for Energy, Cecil Parkinson, argued that:

*The consumer will pay no increased costs beyond those he would have paid under the existing structure. Our proposals will simply identify costs which had previously remained hidden. The fact that these costs will be identified does not mean that there will be an increase. It simply means that they will be identified and subject to scrutiny not rolled up in the bulk supply as at present.* HoC, 12/12/88, col. 686

The validity or otherwise of this argument aside, the formalisation of a heavy measure of cross-subsidisation could be seen as an extremely ironical outcome for a programme designed to create a competitive electricity supply market and ostensibly operating under economic pricing conditions.

The Government was to face an even deeper irony after the *Electricity Act 1989* was given Royal Assent. The Conservative Party's long-standing commitment to the development of Britain's nuclear power industry had been given a considerable boost after the industry contributed to the defeat of the Coal Miner's Strike in 1984-85. In the run-up to privatisation, a number of economic and energy commentators (for example, Helm, 1987, 1988b; Vickers & Yarrow, 1988; Bunn & Vlahos, 1988) questioned the true costs of nuclear power (as opposed to those published by the CEGB) and identified some of the possible problems that might be encountered in any attempt to sell the nuclear generation sector in the marketplace.

Regardless of the mounting critique of nuclear power as a saleable commodity, the Government held to its belief that the sector could be sold, as long as it was bundled

with the major generating company (National Power) and if a sufficient level of public subsidy could be guaranteed to partially underwrite the massive decommissioning costs of the nuclear industry <sup>30</sup>. But finally the increasingly close analysis of the economics of nuclear power by the City in the summer and autumn of 1989, forced the Government first to withdraw the ageing Magnox stations from the sale and ultimately, in November, to withdraw nuclear power completely. The irony of the capital market dealing a body blow to the Government's favourite energy sector was further compounded by the associated announcement that the nuclear sector, unfit for private consumption, would be retained in public ownership, under the guise of Nuclear Electric and Scottish Nuclear. (See Chesshire, 1992 and Roberts et al (1991) for interesting and informative accounts of what the latter authors describe as "the nuclear fiasco").

The consequential change to the originally-proposed industry structure resulted in three generators in England and Wales (National Power with 50.2% of net capacity, PowerGen with 32% and Nuclear Electric with the 14.2% <sup>31</sup>) and three in Scotland (with the addition of Scottish Nuclear). In retrospect, the exclusion of the 'nuclear burden' from the privatisation equation at the outset would have given the Government far greater scope for breaking up the generating sector into smaller units. This, rather like the privatisation of British Gas, is now viewed as an opportunity lost:

*When the CEGB was abolished, the opportunity to divide its existing stations among more than three successor companies was missed, and so greater competition can now only come about through new companies building new stations or the two main generators selling stations.*  
HoC Energy Committee (1992a) s.38

The Government experienced other problems along the way, such as the 'on again, off again' and finally aborted, trade sale of PowerGen to Hanson Holdings during the

summer 1990, and the Iraq crisis (with its reverberating effect on the stock market); but despite extending the timetable for the sale of the RECs by six months, the Government completed the entire sale of the ESI in Britain by June 1991. Figure 1.4 below summarises the major events in the sale.

<b>ELECTRICITY PRIVATISATION: KEY EVENTS</b>	
May 1987:	Commitment to privatise the electricity supply industry (ESI) contained in Conservative Party election manifesto
February 1988:	White Papers <i>Privatising Electricity</i> and <i>Privatisation of the Scottish Electricity Industry</i> published
May 1988:	<i>Public Utility Transfers and Water Charges Act</i> enacted empowering electricity boards and Electricity Council to transfer property to other bodies corporate
December 1988:	Second Reading of <i>Electricity Bill</i> in House of Commons
April 1989:	Second Reading of <i>Electricity Bill</i> in House of Lords
July 1989:	<i>Electricity Act 1989</i> enacted
September 1989:	Director General of Electricity Supply appointed
November 1989:	Withdrawal of nuclear generation from the ESI sale program and creation of Nuclear Electric and Scottish Nuclear
March 1990:	Transfer of CEGB and Area Board assets to successor companies Licences come into effect
December 1990:	Sale of the 12 Regional Electricity Companies (and National Grid)
March 1991:	Sale of National Power and PowerGen (60% of shares)
June 1991:	Sale of Scottish Power and Scottish Hydro-Electric

**Figure 1.4: Key events in the privatisation of the electricity supply industry**



(ii) Regulatory framework

Given the complex structure of the ESI, it is hardly surprising that the system of regulation introduced under the *Electricity Act 1989* was also likely to be characterised by a degree of complexity. The Director General of Electricity Supply was given substantial economic regulation powers in those domains of the ESI where natural monopoly elements prevail: transmission, distribution and (for the sub-1MW market) supply; his powers in relation to generation and the Pool - where competition theoretically prevails - are somewhat more oblique. Discussion in this section will concentrate primarily on those areas of regulation most immediately affecting the interests of domestic consumers.

As in the other regulated utilities, the ubiquitous *RPI-X* price control formula was introduced as the central mechanism for economic regulation of the ESI; and with a sense of poetic justice perhaps, the inventor of the device, Professor Stephen Littlechild, was appointed Director General of Electricity Supply, with responsibility for making it work. The price formula, with different constituent elements, was applied to the areas of transmission charges, distribution charges and supply charges to sub-1MW consumers. Wholesale electricity purchasing charges were not subjected to price control, as these are notionally 'regulated' by the law of supply and demand through the Pool (although in reality most wholesale purchasing currently occurs outside the Pool under 'contract for differences' or through direct sales arrangements <sup>32</sup>).

The complicated array of pricing prescriptions built into the operation of the privatised ESI were additionally compounded by the introduction, under Condition 3C of the Supply Licence, of a "supplementary" supply charge for the sub-1MW sector, which is operable until April 1993. The "supplementary" price cap was devised with the aim of limiting electricity tariff increases to the rate of inflation, and was inserted by the Secretary of State for Energy following political anxiety about the movement in prices in the early years after privatisation. The *X* factor for transmission and supply charges was set at zero (i.e. without an efficiency saving), and for distribution charges it was set for each of the RECs, across a range from zero to plus 2.5 per cent (with an average of 1.3 per cent).

The duty of the Director General of Electricity Supply to protect the interests of consumers was accorded, consistent with the other regulators, secondary status:

*A curiosity of the regulatory system is that among the Director General's three primary duties is the duty 'to secure that licence holders are able to finance the carrying on of their activities which they are authorised by their licences to carry on'..whereas his duty 'to protect the interests of consumers of electricity' is only a subsidiary duty to be exercised subject to the primary duties. This is a strange way of ensuring that 'the customer, not the producer or distributor, comes first, which was one of the principal declared aims of electricity privatisation.*

HoC Energy Committee (1992a) s.134

His duties with respect to the generality of consumers was supplemented with specific duties to protect the interests of electricity consumers in rural areas and the disabled and pensioners.

Amongst the repertoire of powers given to the Director General were the ability to set overall standards of performance and standards of performance in individual cases (Guaranteed Standards of Performance) for the RECs. The Director General was also given a number of additional powers, which his regulatory colleagues originally did not have (subsequently, under the *Competition and Service (Utilities) Act 1992*, the powers of the four utility regulators have been 'levelled up' - see Chapter 7). These included the power to determine disputes and to make orders for the settlement of disputes carrying the weight of a county court judgement (sections 23 & 39 *Electricity Act 1989*), and wider information collection and publication powers.

A similar model of consumer representation to that in the water industry was introduced i.e. regional Consumers' Committees under the jurisdiction of the Director General. This was later supplemented by an amendment to the original Bill providing for the convening of a *National Consumers' Consultative Committee*, chaired by the Director General and composed of the chairmen of the Consumers' Committees. Under the amendment the national committee was given a potentially wide-ranging brief, "to keep under review matters affecting the interests of consumers of electricity generally" (s. 53 (2)(a) *Electricity Act 1989*) and was required to meet at least four times each year. This amendment was achieved largely as a result of successful advocacy of the National Consumer Council.

(iii) Community sector campaign

The community and consumer sector's endeavour to influence the passage of the electricity privatisation legislation did not really gather pace until the *Electricity Bill* was debated in the House of Lords. Nor did it have the same sense of united purpose that characterised the water campaign<sup>33</sup>. The former appears to have had less to do with strategic considerations (as mentioned in the previous section on water privatisation) and more to do with the fact that during the passage of the legislation through the Commons the over-stretched resources of the sector were almost exclusively focused on the *Water Bill*. Also there was an assumption that the Electricity Consumers Council (ECC) would make much of the running on the Bill. This expectation was not realised, however. And this, in conjunction with the ECC's position on the structure for consumer representation post-privatisation (see below), was for some of the activists involved one of the most disappointing aspects of the campaign:

*..the ECC just sat there and watched..their silence was deafening..the chairman took a different view of regulation to us..believed that it is basically a technical activity and therefore there is no need for consumer regulation.*

Electricity privatisation campaigners in interview with researcher (25/7/89)

During the passage of the Bill through the House of Lords, organisations such as the National Right to Fuel Campaign, the National Consumer Council, Age Concern, Winter Action on Cold Homes, NACAB, and the Association for the Conservation of Energy, concentrated on a set of issues not dissimilar to those at the forefront of earlier lobbying; namely:

*# Disconnection*  
*# Consumer representation*

*# Standards of performance*  
*# Energy efficiency*

Much of the sting had been taken out of the disconnection issue by the alacrity with which the Government 'imported' into the regulatory framework of the ESI, the Condition 12A modification to British Gas' authorisation by OFGAS earlier in the year. Under the terms of this modification, British Gas were obliged, prior to taking disconnection action, to offer consumers in default a prepayment meter "where safe and practical to do so". The Government stated that it would be inserting a similar provision into the supply licences of the RECs (later to become licence Condition 19).

The community organisations argued that while the OFGAS measure represented a considerable advance, it did not go far enough. In order for this 'protection' to apply, the utility company needed to make contact with the defaulting consumer. And evidence from British Gas was already showing that thousands of consumers were still being disconnected because of "no contact". The alternative, in the view of organisations such as NCC and the National Right to Fuel Campaign was to place the RECs under an obligation to supply, but not necessarily on credit terms. Thus, when a consumer defaulted, the companies should be required to install a prepayment meter whether contact had been made with the consumer or not. The Government, with some justification, rejected this amendment on the grounds that the imposition of a prepayment meter irregardless of the wishes of the consumer would represent an severe invasion of privacy. To which the NCC responded:

*We do not think that installation of pre-payment meters as an alternative to disconnection is an invasion of customer privacy, indeed it could be*

*the only means by which a customer retains access to an essential supply.*

(NCC HoL Report Stage Briefing, June 1989, p.4)

The Government remained unconvinced. Rather ironically, the NCC also sought an amendment requiring companies to obtain the consent of consumers prior to the calibration of a prepayment meter to recover a previous debt, and in the event of this not being obtained the "debt would need to be recovered in the same way as any other consumer debt, i.e through the courts." (Ibid, p.6). Apparently there was a limit to the number of consumer rights that the Government was willing to defend on this occasion, for the amendment was rejected.

The well-trammelled ground over the arguments for a national independent consumer body was covered again, but with only slightly greater success than during water privatisation. The decision by the Electricity Consumers Council to abolish itself ahead of the enabling legislation, weakened the case for the establishment of a national body of electricity consumers. As indicated above, though, the NCC was successful in having the inferior 'fall back' provision on the formation of an ad hoc National Consumer's Consultative Council added to the Bill.

In welcoming the power of the regulator to set guaranteed standards of performance, the campaigning organisations maintained that the proposed areas to be covered by the scheme were too limited, in that they did not cover many of the areas of service delivery most germane to domestic consumers. In order to give some real teeth to the concept of quality regulation it was additionally suggested that a system of financial penalties

or some form of price formula adjustment should be available to the regulator for breaches in the overall performance standards. Neither of these matters gained Government support at the time, but they have been pursued, in part, by the regulator in more recent times (see Chapter 7).

The amendments on energy efficiency, particularly the one promoted by the Association for the Conservation of Energy (ACE), came closest to giving the sector a major victory in the electricity privatisation legislative process. As with gas, the price control formula provided in-built incentives for the companies to maximise the sale of electricity and contained no off-setting mechanism for promoting energy efficient practice. Utilising research on the American experience of regulation, ACE proposed that a US-like clause on 'least-cost planning' be inserted in the Bill. This would have forced the companies to explore the cost-benefit of energy efficiency alternatives to capital investment on new plant and would have empowered the Director General to penalise companies through the price control formula if they failed to do so.

The amendment was successfully negotiated through the House of Lords despite the fact that it was "technically deficient" (Roberts et al, 1991, p.77) <sup>34</sup>, but it was rejected by the Government when the Bill returned to the House of Commons. In lieu of the original amendment, the Government added the clause that the Director General "determine such standards of performance in connection with the promotion of the efficient use of electricity by consumers as, in his opinion, ought to be achieved by..suppliers" (s.41 *Electricity Act 1989*). This effectively gave the regulator a promotional function without the complimentary enforcement power to back it up. In the view of a leading advocate

of the amendment, its defeat reflected "the power of the vested interests and industries supporting the anti-conservation status quo"; whereas another campaigner, less closely associated with the amendment described its flawed drafting as "a disaster" (both interviews with the researcher, July 1989).

## CONCLUSION

This account has shown that the Government introduced a number of structural changes to the model of utility privatisation over the course of the programme. This is illustrated most distinctly in the juxtaposition of the complex, dis-aggregated model of the ESI with the unitary model of British Gas. Yet from the perspective of the domestic consumer, for all the competition-oriented refinements introduced between the privatisation of British Gas and the privatisation of the electricity supply industry, the broad statutory and organisational framework for the three utilities was substantially similar, notwithstanding the incremental modifications made to the regulatory regime over this period.

It is apparent, reflecting over the three community sector campaigns, that although some successes were achieved, most of these were of a relatively modest nature. On the major issues - such as those concerning the priority to be accorded to the interests of ordinary consumers in the regulatory system, the balance between equity, service quality and company profitability considerations, and the ability of domestic consumers to achieve a strong independent voice - the community sector campaigns had a minimal impact; at



least at the time. With this in mind, it is difficult to dispute the conclusion of the organisation that played a leading part in the three campaigns - the National Consumer Council - in its book *In the absence of competition* (1989):

*Although the interests of consumers have been given increasing emphasis as the [privatisation] programme has progressed, the overall impression is that they have largely been treated as a residual of other policy considerations. NCC (1989a) p.18*

The community sector was not alone in its impotence, of course. One of the more striking aspects of the history of the Government's utility privatisation programme is the way that it emerged from the legislative process almost completely unscathed. But then given the Government's resolve to complete the project, its parliamentary dominance, over the period 1986 to 1991, and the powerful coalition of utility industry and City interests supporting the original terms of the privatisation settlement, this is neither particularly surprising nor inexplicable. Following Hill et al (1989), the process of privatising the three utilities could be seen as an expression of 'elite policy making'.

Significantly, many of the issues raised unsuccessfully by the community sector at the time of privatisation were to become residual problems in the regulation of the public utilities, as later chapters reveal.

The organisational structure established through the three pieces of primary legislation is illustrated diagrammatically in Figure 1.5 on the next page.

**Figure 1.5 PUBLIC UTILITY ORGANISATION - POST PRIVATISATION**

<b>PROVIDERS</b>	<b>REGULATORS*</b>	<b>CONSUMER REPRESENTATION</b>
1. <b>GAS</b> (Dec. 1986)		
BRITISH GAS PLC	OFFICE OF GAS SUPPLY	GAS CONSUMERS COUNCIL (central & regional)
2. <b>WATER</b> (Dec. 1989)		
WATER SERVICES PLCs (10)	OFFICE OF WATER SERVICES	REGIONAL CUSTOMER SERVICE COMMITTEES
WATER COMPANIES (33)	NATIONAL RIVERS AUTHORITY HM Inspectorate of Pollution Drinking Water Inspectorate	
3. <b>ELECTRICITY</b> (Dec. 1990 - June 1991)		
GENERATING COMPANIES (National Power, PowerGen, Nuclear Electric & Scottish Nuclear)	OFFICE OF ELECTRICITY REGULATION	REGIONAL CONSUMER COMMITTEES
NATIONAL GRID		
DISTRIBUTION COMPANIES (12 & 2 integrated companies in Scotland)		

\* Non-ministerial government departments, financed through utility companies' licence fees.

## ENDNOTES TO CHAPTER 1

1. In stating this it needs to be recognised that in the case of Northern Ireland (electricity and water) and Scotland (water) the privatisation programme is yet to be completed. In April 1992, Northern Ireland's power stations were sold to three separate companies, with the remainder of the industry is due for sale later in the year. The Government has also taken preliminary steps towards the ultimate privatisation of the water industry in both Northern Ireland and Scotland. Currently, water and sewerage services functions are performed by the Water Service of the Department of the Environment in Northern Ireland, and by the Regional and Islands Councils in Scotland. In the middle of November 1992, the Government published a consultation paper on the options for privatising the Scottish water industry.
2. A contract customer is defined in the legislation as anyone who receives a supply of gas in excess of 25,000 therms in any period of twelve months.
3. Sir Denis Rooke's support was suggested as an influential factor by Gas Consumer Council policy officers in an interview with the researcher (24/7/89).
4. The term community sector will be used hereafter to encompass community service organisations (such as NACAB) and consumer organisations (such as NCC and the Consumers Association)
5. Both the National Consumer Council (1989) and the Consumers' Association (1989) declared that ownership *per se* was not a significant issue.
6. The National Right to Fuel Campaign, for example, in declaring its opposition privatisation of the British Gas Corporation ("as we can see no advantage for the low income consumer that could not be achieved within the existing framework"), supplemented this with the proposal that money from the sale be used to invest in energy efficiency improvements in low income households. *Fuel News* Vol. 4 1985
7. The Association for the Conservation of Energy suggested that the regulatory body might most appropriately be entitled the Office of Gas Regulation and Efficiency - i.e. OGRE, *Evidence from the Association for the Conservation of Energy to the Select Committee on Energy on the Regulation of a Private Sector British Gas Corporation* (undated)
8. It is important, however, to recognise the level of policy continuity vis-a-vis the water industry leading up to privatisation, and that the changes introduced in 1983 in particular, (see Annexe 1) laid the foundation for the radical restructuring of the industry embarked on in 1985. Richardson et al (1992, pp.159-160) make this point well:

*Since 1973 water has been seen less and less as a 'service' and more as a 'commodity'. The further restructuring of the industry through the Water Act 1983 pushed the RWAs towards an ethos which stressed commercialism, as did the final exclusion of local authority representation on RWAs, and hence from the policy community itself. The distribution of power within the policy community changed: local*

*authorities were finally excluded, and economic considerations became more important than technical ones. Increasingly tighter government financial restrictions were also placed on the RWAs. Thus, the decision to privatize may not be as radical as it appears, in terms of the historical development of the industry. The industry had become more 'managerial' and 'technocratic' and conventional public accountability had declined."*

9. See Parker & Penning-Rowsell (1980) and Kinnersley (1988a) for accounts of the development and operation of the river-basin management approach.

10. "Mr Ridley was never keen on the proposals which he inherited from his predecessor Kenneth Baker. Mr Ridley was concerned by the notion of one private company having the power to prosecute another." Richardson et al (1992) p.167

11. For far more detailed accounts of the defeat of the Government's first model of water privatisation see Kinnersley (1988a), Richardson et al (1992), Bowers et al (1988) and Ogden (1991).

12. Up to October 1991, no inset appointments had been made (DoE, 1991).

13. A model "instrument of appointment" [licence] was published by the Government on 20th December 1988, during the House of Commons Standing Committee stage of the Bill.

"..each Appointment runs for a minimum of 25 years from 1st September, 1989 and may be terminated by the Secretary of State at any time on or after the expiry of that period, provided at least ten years' prior notice has been given. An Appointment may be removed from a Water Services Company at any time as a result of making a special administration order.." Water Prospectus (1989) p.36

14. The term water companies will be used as a generic descriptor of both the regional water and sewerage companies and the old statutory water companies. Where they are to be separately identified the term "water services companies" will be used to designate the former and the term "water only companies" the latter.

15. Interestingly, the Government questioned the efficacy of the yardstick comparison methodology at the time of gas privatisation:

*In reality, as our examination of the American system showed clearly, there is no effective competition as a result of comparisons with gas prices in one region as opposed to another. In fact, there are always considerable differences in the cost of distribution and other factors that give a reason for variation. Secretary of State for Energy in Second Reading speech, HoC, 10/12/85, col.776*

There is no reason why this argument should not hold similar weight in the water industry.

16. In citing sections of the original legislation, it is necessary to give its 1991 equivalent, as the *Water Industry Act 1991* (which was fundamentally a piece of consolidating legislation) is now the relevant legislation for the industry.

17. Account of the trade union campaigns by Nalgo policy officer in interview with the researcher (25/7/89). On gas, it was suggested that "a lack of confidence at the time that the government could be beaten" and the fact that "industrial relationships in the industry had always been pretty cosy" explained the relative impotence of the union's campaign. In relation to electricity privatisation, the view was put that "they [i.e. electrical trade unions] don't appear to have learnt the lessons of the water campaign [in terms of public relations, forming alliances with other sectors and promoting a positive agenda like the *Charter for Water*]" and that "there was a reluctance to really go for it..a concern that this might affect their post-privatisation negotiating position." Certainly, Nalgo economic committee minutes over the period of the passage of the *Electricity Bill* provide evidence of the ambiguous position of some of the electricity unions to the anti-privatisation campaign. For a more sanguine account of the contribution of the Electricity Supply Trade Union Council see Davies (undated).

18. For example, during gas privatisation "there was not the same willingness to open up a broader alliance with sectors like the fuel poverty lobby..there was a lack of sympathy amongst industry trade union members for people who defaulted on their gas bills..the general view from amongst the rank and file tended to be negative regarding this sector of the customer population." Nalgo policy officer in interview with researcher (25/7/89). The same conclusion might be drawn about the attitude of electricity trade unions towards fuel poverty issues. It is perhaps significant that the "low-income consumer agenda" does not figure amongst the array of amendments to the *Electricity Bill* advocated by the Electricity Supply Trade Union (see Davies, undated).

19. The National Consumer Council, for instance: "because the Electricity Consumers Council existed it was decided tactically to concentrate our efforts on water lobbying." NCC privatisation campaign staff in interview with researcher (25/7/89).

20. The National Consumer Council had been active in lobbying for amendments during the passage of the Bill through Standing Committee D in the House of Commons.

21. "except where the Appointee or, as the case may be, the Water Authority, has obtained an enforceable judgement against him [the consumer] for the payment of those Relevant Charges but they remain unpaid for any reason (other than by virtue of compliance with the terms of the judgement)." Licence Condition H, Instrument of Appointment of the Water and Sewerage Undertakers. The extent to which this caveat could be exploited by the water companies was not, understandably, appreciated at the time. See Chapter 7 for a discussion of the impact of Condition H.

22. "(a) to ensure that the interests of every person who is a customer or potential customer of a company..are protected as respects-

- (i) the fixing, imposition or recovery by that company of charges for any services, facilities or rights which are performed, provided or made available by that company in or in connection with the carrying out of any of the functions of such an undertaker;

- (ii) the terms on which any services, facilities or rights are so performed, provided or made available; and
- (iii) the quality of any services or facilities and the nature and extent of any such rights;

..(c) to secure that the carrying out of the functions of a water undertaker or sewerage undertaker is profitable for any such company which is both economical and efficient."  
s.5 (3) draft Water Bill

23. "That the code of practice is a condition of the licence does not provide sufficient protection. The policing of the licence is very unwieldy and the loss of a licence seems an inappropriate instrument to deal with breaches of the Code of Practice."  
NACAB Briefing to Water Bill Standing Committee

24. They also disputed the exclusion of customers in default from the Guaranteed Standards Scheme (i.e. consumers who had not paid their water bill within the previous four weeks): "Non-payment of bills is a separate matter and collection of outstanding debts is covered in the Bill and the Code of Practice for Disconnection..The issue is that the undertaker has failed to meet a service standard and therefore should be obliged to make compensation payments. If the customer has failed to pay his bill the normal procedures for collection of the outstanding debt should be followed." p.11 NCC response to GSS, June 1989. In the *Water Act 1989* this caveat was amended to six weeks in default.

25. Because it would be uneconomic to duplicate existing transmission and distribution networks for carrying electricity it was recognised that they would, under present technological conditions, remain natural monopolies.

26. "Until 30th March 1994, the franchise limit is 1MW [monthly demand] and from 31st March 1994 until 30th March 1998 the franchise limit is 100kW [monthly demand]." RECs Prospectus (1990), p.32

27. Fuel and generation costs represent 71% of the final price of electricity, according to Vickers & Yarrow (1991, Table 1, p.190).

28. In effect, this means that all of the nuclear generation capacity in the country has a guaranteed and secure market. At the 31st December 1990, nuclear generation accounted for 14.2% of declared net generation capacity in England and Wales (National Power and PowerGen Prospectus, 1991).

29. Only 1% of the fossil fuel levy goes to non-nuclear sources i.e. renewable energy generation (e.g. wind, wave, landfill gas and waste incineration). The levy totalled £1,265 million in 1991-92 and contributed 52% of Nuclear Electric's income (Nuclear Electric, 1992). The Director of Electricity Supply raised the level of the levy to 11% from 1st April 1991.

30. Technically, under Schedule 12, s. 1 of the *Electricity Act 1989* the scope for providing direct financial assistance to the nuclear industry was much broader than decommissioning nuclear plant, however, it was in the area of decommissioning that the greatest fears were held about the size of the expenditure involved [estimated at £13

billion in 1989 prices, Whitfield (1992) p.180]. Section 4 of Schedule 12 allows for grants to be given in the range £1 billion to £2.5 billion. In July 1989, the Government indicated that it would be necessary to award the maximum level of grant.

31. The remaining 3.6% is held by National Grid Co. for its own purposes. National Power and PowerGen Prospectus (1991)

32. "95% of the electricity traded through the Pool is wholly or partly determined by contracts." HoC Energy Committee (1992a) s.104

33. In a rare reference to the community sector campaign, Roberts et al (1991) conclude:

*..they [community sector organisations] had other more immediate objectives, concerning improvements to consumer rights, that resulted in their efforts being spread over several issues.*

*Early on there were some attempts to co-ordinate the lobbying efforts of the various groups by the National Council for Voluntary Organisations. This however proved to be ineffectual. p.128*

34. "The DGES [Director General of Electricity Supply] did not have the power to give capital investment approval and so could not refuse it." Roberts et al (1991) p.77

## CHAPTER 2: THE SOCIAL AND ECONOMIC CHARACTERISTICS OF THE PUBLIC UTILITIES AND THEIR RELATIONSHIP TO PUBLIC POLICY

### INTRODUCTION

*The public utility concept appears to involve two conditions: one is that the service should be considered to be so essential that it requires public regulation, ownership or operation; the other is that the service should be monopolistic..water, gas, electricity, ports and harbours are indubitably public utilities. Robson (1960) p. 18*

*The inclusion of the utilities in this approach [based on market principles] is highly significant. It implies an impatience with the idea that utility services are special or essential and need to be treated in ways vastly different to other goods or services. Instead, the products of utility industries are, as far as possible, to be treated as a commodity like any other. It also places the emphasis of public policy firmly on the promotion of efficiency, with the issue of equity in second place, and identifies the introduction of competition as the best (almost the only) way of achieving that goal.*

National Consumer Council (1989) p. 18

The commercial basis to the provision of utility services, like water, electricity and gas has been given increased emphasis in a number of Western economies in recent years (e.g. OECD, 1987; IEA, 1991). While the ascendancy of commercial objectives over social objectives has long been a characteristic of the organisation and management of public utilities in Britain (as illustrated in Annexe 1) and in other countries, 'utility commercialisation' could be seen to have reached its apotheosis in the privatisation programme of the British Conservative Government. Elsewhere, measures by governments to liberalise and deregulate <sup>1</sup> the utility industries - such as those presently being countenanced by Federal and State administrations in Australia <sup>2</sup> - appear to be



similarly premised on assumptions about the incontestable dominance of commercial considerations in public utility practice.

The growth of a highly economic formulation of public utility practice - with an implicit change in the meaning of the term itself <sup>3</sup> - has been paralleled by the promulgation of the view that public utility services are, first and foremost, **commodities** that can and should be traded like any other product in the market economy. Directly or indirectly, this 'commodification' (or perhaps more accurately, 're-commodification') of utility services, has had a substantial impact on ideas about the most appropriate way to organise and manage the industries concerned. It has also had a pivotal influence on the long-standing debate about the scope of public utility responsibility for 'non-commercial' objectives and activities; particularly in the field of social policy.

Under the conceptualisation of public utility services as 'merely another set of commodities', there is ostensibly little justification, in market economies, for the industries concerned to be owned and managed outside the private sector; or at an absolute minimum, to be isolated from the disciplines and efficiency criteria of the private market. The sanguine view of the nonpareil capacity of the private market as a mechanism for commodity production, distribution and consumption - much invoked by advocates of the New Right in the 1980s (see Chapter 4) - has been given additional credibility by the events in Eastern Europe in 1989 and 1990.

Similarly, the commodity view of utility services, effectively pre-determines the scope of producer/supplier responsibility vis-a-vis their consumers. If utility services are of the same fundamental character as the array of products purchased by customers in the conventional market place, it follows that the suppliers of these services have no more, nor less responsibility for customer care than is applicable in the market place generally. This requires the operation of a customer service regime, expressive of the principles and statutory obligations of fair trading, and the use of customer relations approaches (including possibly, the promotion of access to supply for groups such as the elderly and disabled) essentially designed to gain commercial advantage over competing firms or industries <sup>4</sup>.

It certainly does not require - and indeed usually proscribes - that attention be given by the utility industries to access, equity and distributional impacts as they affect different classes of customers. These considerations are seen to fall exclusively within the territory of government; as is deemed to be the case with other essential commodities, like housing, clothing and food.

But can utility services, like water, electricity and gas, reasonably be viewed as commodities like any other? Do they have internal and external properties that differentiate them from other goods and services traded in the general market place? If they are more than 'mere commodities', what then are the broad implications for public policy? These are the questions that form the substance of this Chapter.

In an exploration of the nature of public utility services, it is useful to make a distinction between their **demand** and **supply** characteristics. The demand features of utility services relate to what might be seen as their 'internal' attributes and to the importance they occupy in the hierarchy of consumption needs at an individual and collective level. Included in this dimension would be the essentialness of utility services, their relative non-substitutability, their status as "merit goods", their strategic importance, and their inelasticity of demand features.

The supply properties of utility services, on the other hand, refer to the particular character of their production and distribution (or 'external' attributes), and would include natural monopoly provision, externalities, and pricing (particularly cross-subsidisation). The demand and supply dimensions of public utility services will be considered in Parts 1 and 2 respectively.

## PART 1: PUBLIC UTILITY SERVICES - DEMAND CHARACTERISTICS

### (i) The essentialness of utility services

Access to water and energy is generally perceived to be one of the fundamental service benchmarks of a modern civilised society. Water and energy represent two of the vital ingredients in the physical and social infrastructure of all contemporary societies; albeit that in some countries, notably in the developing nations, this infrastructure is still often in a rudimentary form.

For the individual, water and energy - or more specifically in the case of the latter, fuel for lighting, cooking and warmth - form part of the quartet of goods, along with food and shelter, which are universally acknowledged as necessities for living. For society at large, the water and energy utilities provide much of the motive power for physical, economic and social development. Because of their centrality to individual and collective well-being, water and energy are, as Helm & Yarrow (1988, p.iv) suggest, "basic social primary goods" (alternatively they might be described as "natural-rights goods", Dasgupta, 1986).

Indeed it is usually argued, that on the basis of their contribution to personal and social welfare, water and energy are essential services; with the corollary that minus one or the other, life would become unsustainable:

*'Essential' means that they cannot be cut off without danger of total or partial collapse of the economy. Starting from an allocative point of view, we stress the importance of these goods and services as part of the infrastructure, for producers and consumers. Starting from a*

*distributional point of view, we would have to stress their importance for providing consumers with necessities of life. Bos (1986) p.18*

While the essentialness of water services would seem to be beyond dispute (at least in respect to its water supply part), there is less unanimity about whether energy should reasonably be held to be an essential staple of everyday life. Bradshaw, for example, in his introduction to one of the few texts written on energy and social policy, puts the view that the "trouble with fuel is that it is questionable whether it is essential to survival. Given food, adequate clothing and shelter most households could exist without fuel, at least in our temperate climate. Indeed some do, even in Britain in the 1980s" (Bradshaw & Harris, 1983, p.3).

Although, in his view, the physiological need for fuel in Britain is uncertain, Bradshaw goes on to acknowledge that if a different frame of reference were used - i.e. social norms and expectations - then most people "would probably accept that fuel for cooking, light and perhaps heating water are basic needs, or that living without them is too severe a deprivation to countenance." (ibid p.3)

There would be many, including the fuel poverty lobby, who would challenge the validity of Bradshaw's view of the non-essential nature of personal fuel consumption in the climatic conditions of this country; particularly in a context where "in an English winter up to 4 million homes may be at risk of becoming particularly cold, of which roughly a quarter were at risk of becoming very cold indeed" (DoE, 1991b, p.51). However, to pursue the issue of the physiology of energy consumption here, would be largely beside the point; for as Bradshaw acknowledges in his second statement, the

question of essentialness is fundamentally a **socially defined** one. And access to energy services for the purposes cited by Bradshaw, and for warmth, are generally viewed, as essential to the maintenance of an acceptable standard of living by the populations of Britain and Europe. This is illustrated in Figure 2.1.

Public perceptions of the importance of utility services		
Public utility-related services occupied primary places on the list of publicly-defined necessities derived from MORI surveys undertaken as part of the <i>Breadline Britain</i> series in 1983 and 1990. The top five standard of living items (with percentage of survey sample classing them as necessities) were:		
	1983	1990
Heating to warm living areas of the home if it's cold	97%	97%
Indoor toilet (not shared with another household)	96%	97%
Damp-free home	96%	98%
Bath (not shared with another household)	94%	95%
Beds for everyone in the household	94%	95%
Other utility-related items also rated highly as necessities [1983 figure first, followed by 1990 figure] e.g. refrigerator (77%; 92%), washing machine (67%; 73%), television (51%; 58%) and telephone (43%; 56%). Mack & Lansley (1985) p.54; Frayman (1991) p.4.		
A European Commission study on the <u>Perception of Poverty</u> in 1989 (Commission of the European Communities, 1990), found that across the 12 member states, 94% of the sample of people interviewed rated "having running water, electricity and one's indoor toilet" as "absolutely necessary". 71% of people also rated "having basic equipment such as refrigerator or television set" as "absolutely necessary". p.10		

**Figure 2.1: Public perceptions of the importance of public utility services**

(ii) Non-substitutability

Associated with the essentialness of water and energy services is the fact that they are, in many instances **non-substitutable**, i.e. there is a substantive or practical absence of alternative means for meeting water and energy-related needs. This is most clearly evident, in the substantive sense, in the area of water services; where there are no realistic and hygienic alternatives to running water for meeting the requirements of household washing, cleaning, food preparation and disposal of human waste. While there are an array of commodities available for satisfying personal drinking requirements (such as bottled mineral water, soft drinks and alcohol), these are generally used as a complement to, rather than as a full substitute for, drinking water, in most households.

The possibilities for product substitution are greater in domestic energy use than is the case with water services. This is due to the product rivalry that exists within certain sectors of the domestic energy market (most particularly between electricity and gas), namely in space and water heating and for the running of certain appliances. However, for a large number of households the prospect of substituting gas for electricity - or vice versa - as the fuel source of heating or cooking, is foreclosed, in a practical sense, due to the high conversion costs involved (e.g. the purchase and fitting of new appliances, multiple standing charges etc.). In the case of lighting and for appliances other than those used for heating and cooking, there are presently no technically or socially viable substitutes for electricity <sup>5</sup>.

(iii) "Merit goods" status

This fusion of essentialness and non-substitutability in water and energy, clearly differentiates them from most other consumption goods traded and purchased in the orthodox market place. Because of the product character of water and energy, the scope for individuals to exercise purchasing choice amongst an array of similar commodity alternatives (as in the case of food for example) is highly circumscribed. This has the attendant effect of creating formidable barriers to the realisation of consumer sovereignty, for as Hood (1986, p.173) concludes, "these pressures in practice get weaker the more practically indispensable the service is to the ordinary consumer".

The fundamental place that water and energy services occupy in the structure of daily life - on an individual and societal level - is sometimes characterised under the concept of "merit goods". "Merit goods" as defined by Musgrave and Musgrave (who originally enunciated the term) are those goods,

*the provision of which, society (as distinct from the preferences of the individual consumer) wishes to encourage or, in the case of demerit goods, to deter. Musgrave & Musgrave (1984) p.78*

Beckerman (1986, p.17) adds that they "are goods that, on basically ethical grounds, society believes should be supplied to - and where appropriate actually consumed by - everybody, perhaps only to certain minimum levels, whether they like it or not and whether they can pay for it or not."



Universal access to a clean water supply is generally seen as an integral part of basic package of rights and living conditions for citizens in most contemporary societies; and much of the public hostility in England and Wales to the privatisation of the water industry, over the period 1986-1989, might be attributable to a high level of public anxiety about the potential impact on access, service and water supply standards, in the wake of private management of the industry. Supporting the normative position (or what Beckerman calls "ethical grounds") that access to a decent water supply is part of the common inheritance of all citizens in contemporary society, is a self-interested recognition of the externality effects - particularly in relation to public health - of excluding individuals and groups from adequate water and sewerage services. Martin and Wilder (1992) express this interaction between private and public utility in the provision of water services in the following way:

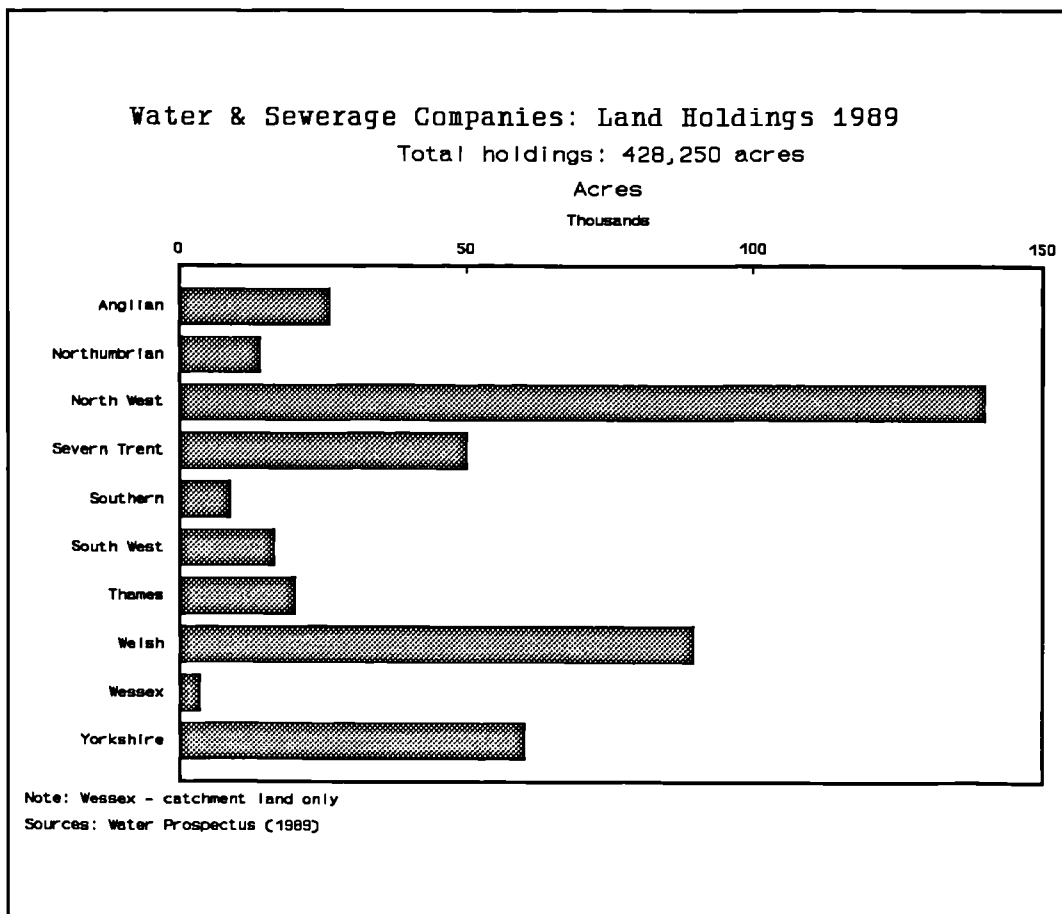
*..increased cutoffs of low-income households..not only leads to substandard living conditions but also raises public health concerns. Water and sewer service therefore has some characteristics of a public good, in the sense that if my neighbour's service is cut off, both of us suffer. p.101*

Because of their importance to both individual and collective welfare then, water services might reasonably be seen as "merit goods", or indeed even, quasi-public goods. The implication of this is that public policy should be directed at ensuring that all members of society have access to an adequate level of water services provision.

Some dimensions of the water industry - such as the provision of water for public fire protection and the recreational use of water company reservoirs and land - fall within the realm of "public goods" in the classical economic sense. They contain elements of indivisibility/non-rivalness and non-exclusiveness, which in turn undercuts the capacity

to employ the price mechanism as a means of limiting entry and charging for service use <sup>6</sup>. The public good character of water for fire-fighting was recognised in the *Water Act 1989*, where under section 81 "no charge may be made by any water undertaker in respect of..water taken for the purpose of extinguishing fires or taken by a fire authority for any other emergency purpose" <sup>7</sup>.

Concern over the potential impact of privatisation on public access to and use of water authority land was raised by a number of public amenity groups during the privatisation process (e.g. National Trust, Rambler's Association, Council for the Protection of Rural England (CPRE), and anglers' groups) and formed part of the substance of a major report by CPRE, the Royal Society for the Protection of Birds and the World Wildlife Fund for Nature (Bowers et al, 1988). The *Water Bill* was subsequently amended to provide protection for areas of outstanding natural beauty and sites of special scientific interest. The water companies are also subject to a code of practice, issued by Secretary of State for the Environment, on the environmental and recreational aspects of water-related land management. The land holdings of water companies are considerable, and are often located in environmentally and recreationally strategic sites. Figure 2.2 overleaf shows the land holdings of each of the ten water and sewerage companies in 1989.



**Figure 2.2: Water company land holdings**

The "merit goods" status of energy services is arguably less clear cut; although Dilnot and Helm (1987, p.33) see little cause for equivocation when they assert "that energy is a merit good should follow from its being necessary to fulfil the basic capability of living". While access to energy for heating, lighting, cooking and indeed, leisure purposes, is generally viewed as a basic necessity (Mack & Lansley, 1985; Frayman, 1991), the extent to which there is consensus about supplying even a basic minima of energy to all households, independent of the issues of income and capacity to pay, is rather less apparent. The slightly more ambiguous position of energy as a "merit good" (relative to water), is possibly reflected in the rather different tenor of the parliamentary

debate on disconnection of domestic consumers during the passage of the *Electricity Bill* compared to that of the *Water Bill*, and in the ostensibly less stringent conditions for disconnection devised for the privatised electricity supply industry <sup>8</sup>.

The delineation of certain areas of individual and household consumption as "merit goods", is more than simply an exercise in economic taxonomy and semantics. For the attribution of "merit goods" status connotes a sense of public priority, and brings with it an overlay of public policy attention and intervention; in particular, the need for action to overcome information failure, imperfect knowledge and under-consumption (Dilnot & Helm, 1987; Head, 1974). Beckerman (1986) captures the policy dimension of "merit goods" when he states:

*Once 'merit' goods are admitted into the proper sphere of public policy it is obviously easy to show that most of them will not be consumed to socially optimal levels unless they are provided or financed or subsidised by the public authorities in one way or another, or made the subject of mandatory legislation. p.17 <sup>9</sup>*

If an obverse test of what constitutes "merit goods" were applied - i.e. they consist of those areas of consumption where the public believe that substantial government involvement is necessary - then survey evidence (Figure 2.3 on next page) suggests that water and energy are perceived by the British public, and the population of other countries, as visible exemplars of "merit goods".

**British Social Attitudes Special International Report**  
**Percentage of sample favouring either government ownership or control of the**  
**electricity industry**

Britain	USA	Australia	West Germany	Austria	Italy
73%	68%	81%	83%	96%	96%

Taylor-Gooby (1989), p.38

In an *Observer*/Harris opinion poll (reported 1/10/89), 56% of the sample surveyed expressed the view that a future Labour government should renationalise the water industry.

**Figure 2.3: Attitudes to government ownership or control of public utilities**

(iv) The strategic importance of the utility industries

The strategic position that the utility industries occupy in the economic life of all countries, parallels the centrality of water and energy services in the everyday lives of individual households. The 'lifeblood' products of electricity, gas and water run through the veins of the entire economy and form an integral part of the foundation for economic, physical and social development. Investment decisions in these primary infrastructural areas have wide-ranging 'knock on' effects in other sectors of the economy.

The provision of core physical services, in the form of water and energy infrastructure, is an essential precursor to, and catalyst for, residential and industrial development. Decisions about the timing and location of these services predetermines the pace and direction of urban growth. They also interact directly with the issues of territorial and

inter-generational equity (Rees, 1981). Investment in the capital infrastructure required to supply water and energy to new or remote communities may be inordinately low, or alternatively, may result in the setting of disproportionately high access charges for individual consumers (e.g. water infrastructure charges introduced following privatisation), if left to market forces alone. An additional complication of releasing the levers of public control over infrastructure planning and development, is that private water services companies could potentially exploit the strategic power of the industry, in respect to land use and development, for their own commercial advantage:

*The capacity for the bodies responsible for providing water infrastructure to influence the location and pace of development cannot be overstated. Nor should the potential for the abuse of this capacity be underestimated in a situation in which commercial pressures for development are not fully externalised from those responsible for servicing it...WUPLCs might give priority for advance infrastructural investment to land which it owns itself, in order to facilitate its profit objectives; WUPLCs as subsidiaries of larger construction companies may prioritise their land/development sites and obstruct or delay servicing rival companies' land developments.*  
Bowers et al (1988) p. 29

The management of utility industry resources demands the adoption of long-term planning horizons and an assessment of the collateral effect of capital development decisions on other sectors of the economy. In other words, to be effective, utility resource management cannot be conducted in a policy vacuum. The accelerated movement towards gas-fired electricity generation in Britain, with its consequential detrimental effect on the domestic coal industry, is illustrative of the inter-relationship between public utility capital decisions and macro-economic policy generally.

The critical impact that the industries have on the economy directly, as well as the pervasiveness of their 'second order' planning effects (either of a positive development or negative externality kind), suggests that they are unsuitable candidates for laissez faire de-regulation approaches.

The reverberating effect that utility policy and practice, at a macro- and micro-level, has on collective and individual welfare, is likely to demand a framework of decision-making for these industries that provides a clear avenue for public accountability and public influence. The degree to which this can be achieved along different points of the public ownership-public regulation continuum is, of course, one of the primary questions in this thesis.

(v) Inelasticity of demand for utility services

Conventionally, the market system of commodity production and exchange is predicated on *inter alia* two explicit operational principles. The first principle maintains that there is a strong and continuous nexus between the demand for a particular good and its price. Therefore if price moves, in either an upwards or downwards direction, demand will respond in an obverse manner (*price elasticity of demand*)<sup>10</sup>. The second principle holds that the demand for a particular good changes in line with income. Hence the higher a household's income the more a particular good will be consumed. Or alternatively, the higher the income the more consumption of basic goods will be supplemented by the consumption of luxury goods (*income elasticity of demand*).

If, however, in the case of specific classes of goods, the interaction between demand and price, or demand and income is low or ambiguous, then the self-regulating power of the supply and demand *deus ex machina* of the market system, in these product areas, will be inevitably muted.

The essential and relatively non-substitutable nature of water and energy services suggests *a priori* that the association between level of demand and price or income, in the domestic sector at least, is likely to be weak. That is, irrespective of how low a household's income may be, or regardless of price increases, a reasonably constant level of demand for water and energy services will exist, as this is necessary for physical and social well-being. Similarly, although the level of demand may rise with an increase in income or a decrease in price, it will not do so in direct proportion to changes in income or price, nor will it continue to rise indefinitely beyond the point where the need for these basic services are satisfied. In this sense, water and energy will exhibit the properties of inelastic demand.

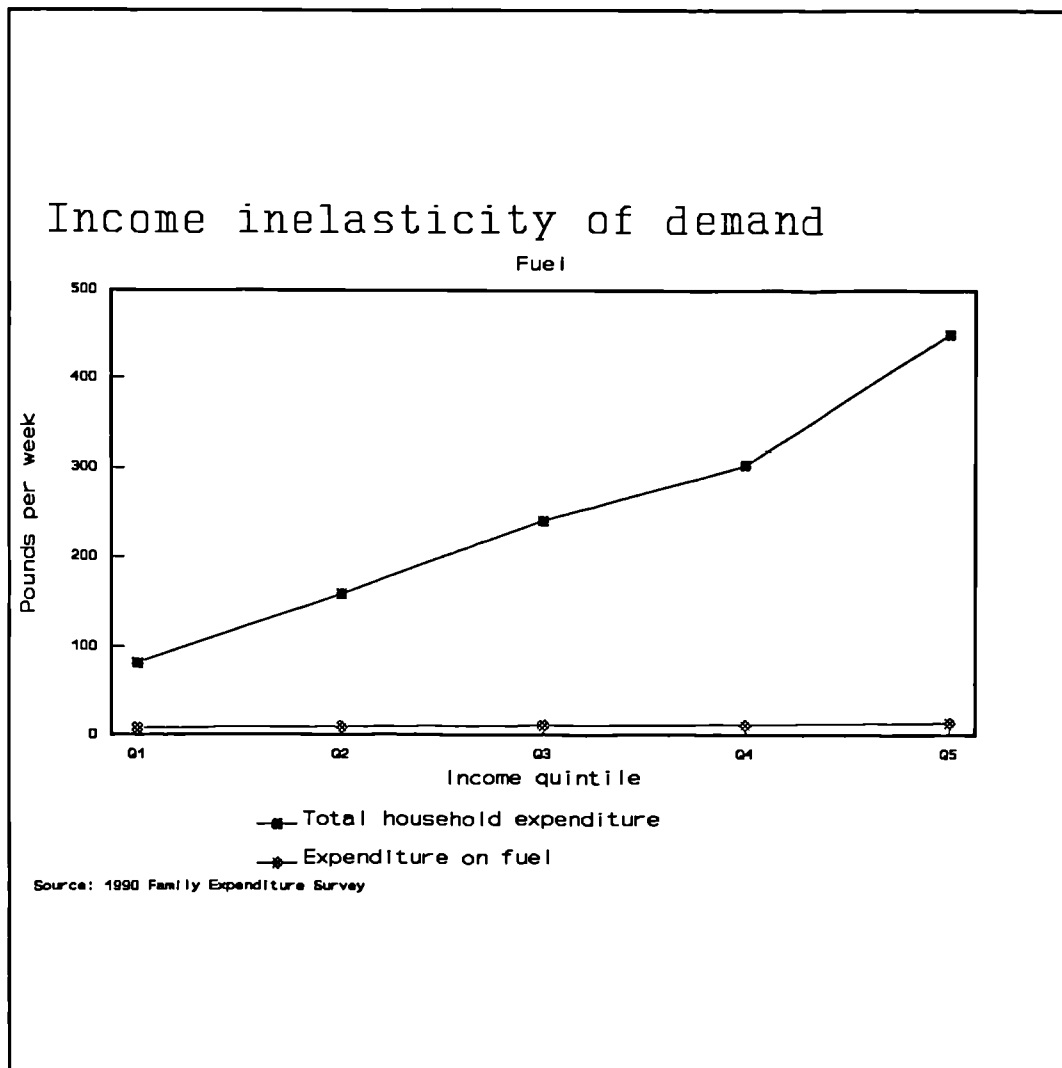
The income inelasticity of demand for energy has been well documented (for example, Bradshaw & Harris, eds., 1983; Hutton, 1983; Dilnot & Helm, 1987; Helm & Yarrow, 1988; Micklewright, 1988; Johnson et al, 1990; Boardman, 1991a; Brechling & Smith, 1992) <sup>11</sup>. In contrast, the inelasticity or otherwise of water services - according to income or price - has received less attention; possibly in part, because the historical absence of volume-related charging systems in the water industry in Britain has made the task of calculating this virtually impossible <sup>12</sup>.



Consumption and expenditure studies in Britain have consistently underlined two central themes in the structure of domestic fuel demand: (i) that fuel expenditure represents a far greater proportion of low-income household budgets than it does in the budgets of higher income groups, and (ii) that although household expenditure on fuel generally rises with income, it does so at a proportionately lower rate than for most other commodities, and for expenditure generally (NCC, 1976a; Hutton, 1983; Dilnot & Helm, 1987; Johnson et al, 1990; Boardman, 1990, 1991a; Pearson & Smith, 1991; Hutton & Hardman, 1992a, 1992b):

*The elasticities confirm the results of other studies of household energy demand that domestic fuel has the demand characteristics of a 'necessity' - in other words, a 1 per cent change in income will result in less than a 1 per cent change in domestic fuel use. The income elasticity is especially low for private renters and pensioner households.*  
Brechling & Smith (1992) p.38

Expenditure data from the *1990 Family Expenditure Survey* shows, for example, that the lowest income quintile spent an average of £8.62 per week on fuel, which represented 10.5 per cent of total expenditure; whereas the highest income quintile spent £14.05 per week, which was 3.1 per cent of total expenditure <sup>13</sup>. Yet significantly, while fuel expenditure amongst the highest income group was 63 per cent higher than that of the lowest income group, total expenditure across all commodity areas was 446 per cent higher. Figure 2.4 illustrates the way that fuel demand - as expressed through expenditure - differs from demand for other commodities generally, as household income increases.



**Figure 2.4: Income Elasticity of Demand for Fuel**

The relative income inelasticity of demand can also be viewed by comparing expenditure on fuel with expenditure on other specific commodities. Figure 2.5 (overleaf) based on data from the 1990 Family Expenditure Survey, juxtaposes the change (from the bottom to the top quintile) in fuel expenditure with changes in expenditure in other major commodity areas, excluding housing. It can be seen that, with the exception of tobacco, expenditure on fuel stands out as being by far the least responsive to changes in income.

Average Weekly Household Expenditure Increase in expenditure between 1st and 5th income quintile groups	
Commodity/Service Group	% Inc.
Fuel	63
Food	241
Alcohol	666
Tobacco	65
Clothing & footwear	727
Household goods	519
Household services	432
Personal goods & services	563
Motoring expenditure	1692
Fares & other travel costs	554
Leisure goods	667
Leisure services	1103
Miscellaneous	674
TOTAL EXPENDITURE	446

Source: CSO (1991) Table 6

**Figure 2.5: Differences in household expenditure on major commodities**

The implications of the finding that fuel expenditure forms a disproportionately high component of low-income household budgets, and that fuel demand is relatively inelastic, are at least two-fold. First, it confirms the status of energy services as "basic social primary goods"; 'primary' in the sense that a discernable minima (or core level) of demand is apparent, irrespective of income or objective capacity to pay, and 'basic'

in the sense that growth in demand for fuel rises at a far lower rate than virtually every other area of household consumption, as income increases <sup>14</sup>. Second and most importantly, it highlights the distributionally sensitive nature of energy policy and practice (Dilnot & Helm, 1987). Helm, Kay & Thompson (1988, p.43-44) allude to this when they state:

*Since energy comprises a substantial proportion of the household budgets of the poor, the pricing policy of the energy utilities is likely to have a considerable impact on poverty.*

The primary place that energy consumption occupies in most households also effects the extent to which price elasticity of demand exists in this sector of the market. As a result of its physiological and ascribed importance to individual well-being, domestic consumers are, in effect, locked into particular patterns and levels of demand; and the basic parameters of this demand are likely to be fixed, irregardless of movements in price. This is confirmed in the Department of the Environment qualitative study on *Attitudes to Energy Conservation in the Home* (DoE, 1991a):

*Most saw the scope for making savings as fairly small, whether by cutting down what they use or by becoming more efficient. They felt that a more than marginal reduction in spending would eat into their comfort or change their lifestyle in unacceptable ways. Many would compensate for a fuel cost increase by cutting back on other areas of spending, rather than by cutting fuel use itself. p.86*

There will be, of course, some scope for reducing household demand in the face of extreme price pressure (for example, through moderating appliance use and introducing more efficient heating systems). However, the margin for reducing demand will generally be more constrained amongst low-income households; either because the minima of energy demand has already been reached or because access to the capital

required to make energy efficiency savings is limited (DoE, 1991a, 1991b<sup>15</sup>). But, in any case, response to price signals in the energy market will be substantially conditioned by what households regard as the point beyond which reductions in demand would be intolerable. Once this point is reached (and it will obviously vary amongst different sets of consumers) the impact of price increases on domestic demand markedly declines; and it is here that the price inelasticity of demand of energy becomes most apparent.

To date, there has not been a sustained effort to exert downward pressure on energy demand through the price mechanism in Britain. Certainly domestic energy prices were used by Labour and Conservative administrations during the 1970s and 1980s as an instrument of macro-economic policy. But the purpose of tariff increases was to increase the self-financing capacity of the energy industries (and related to external financing level targets) and to raise additional revenue for the Exchequer, and was not aimed at achieving reductions in energy demand *per se*. However, in the future environmental imperatives will, in all probability, transform the methodology of pricing energy. With the possible result that energy prices will be deployed as the efficiency/conservation 'shock troops' in the battle against global warming [see Part 2 (ii) below]. The efficacy of such a strategy remains to be seen; but certainly the evidence from the past is not encouraging, notably in the mid-1970s and early 1980s, when electricity and gas prices were raised substantially in real terms, without any notable impact upon domestic demand (Harris, 1983).

The comparative insensitivity of energy demand in the domestic and non-domestic sectors to changes in price - at least over the short-term - is shown in Dr Scott Barrett's analysis for the Department of Energy of the impact of the introduction of a carbon tax (cited in Pearson & Smith, 1990, p.7). According to Barrett's estimates taxes in the order of 40% (gas) and 67% (coal-generated energy) would be required to produce a drop in demand of 4% (gas) and 11% (coal-generated energy) in the space of about one year. Although, Barrett estimates that over the long run (i.e. about 10 years) smaller levels of tax would produce better results, with a 14% tax on gas resulting in a 3% increase in demand, and a 24% tax on coal-generated energy leading to a 25% reduction in demand. But as Pearson & Smith (1991 p.16) argue, the responsiveness of the domestic energy market even over the longer-term will be constrained by the fact that "energy consumption is not heavy enough to justify the fixed costs of moving from one form of energy to another".

Research into the distributional consequences of environmental taxes by the Institute for Fiscal Studies (Johnson et al, 1990, p.15) where it is concluded that an "increase in the price of fuel by 75% would be needed..in order to reduce consumption by around 20%", highlights the relatively indirect relationship between energy prices and energy consumption <sup>16</sup>. This is also highlighted in the DoE-commissioned qualitative study on domestic energy consumption:

*Increasing energy cost seems a blunt instrument for controlling usage. Increases might need to be substantial before they began to bite hard on consumption - and many people were worried about the effects this might have on low-income families and the elderly. (DoE, 1991a, p.16)*

As the above quotation implies, the price inelasticity of demand characteristics of energy has potentially serious ramifications for domestic consumers generally, and low-income consumers in particular. Because many domestic consumers are effectively 'captive' to an established level of energy consumption (determined by factors such as condition and energy efficiency level of housing, type and range of appliances, amount of reserve capital for improvements, and commitment to a particular life style), their ability to respond to price increases in conventional consumerist ways, by for example reducing consumption or finding substitute products, will inevitably be circumscribed. Because expenditure on energy services is a more substantial part of the budgets of low-income households, price increases, by implication, will have a disproportionately severe effect:

*..to the extent that demand elasticities are lower among lower income groups, the poor may end up paying higher prices and the resulting distributional consequences might be judged unsatisfactory. Generally, it is not obvious that charging more to precisely those customers who have the least opportunity to substitute out of the given good or service is a desirable outcome. Helm & Yarrow (1988) p.iv*

At a more general level, in a commercial environment where the capacity of domestic consumers to respond to price signals is limited, the utility industries - particularly when backed by the power of monopoly supply - will have formidable leverage. This could result in the introduction of tariffs for the domestic sector well in excess of those necessary to meet marginal costs requirements, with virtual impunity. There is also the danger that charges levied in the price inelastic sector of the market (i.e domestic consumers) may be artificially inflated in order to enable lower prices to be set in more competitive, price elastic sectors (indeed this is given economic sanction under so-called "Ramsey pricing" principles). In many instances, commercial and industrial enterprises have considerably greater room for manoeuvre in terms of energy consumption (i.e. in

aggregate level, form of energy used and time of use <sup>17</sup>), particularly over the longer term, than is generally the case with domestic consumers. Hence the motivation exists for energy utilities to adopt a more 'creative' marketing strategy with the non-tariff sector, possibly at the direct expense of domestic consumers through some form of cost cross-subsidisation.

The existence and influence of income and price inelasticities in water services is less well known (in Britain in particular); although as suggested earlier, because they share many of the properties of energy services - with an even more substantive claim to essentialness - a strong *a priori* argument could be made that similar inelasticities will apply.

The historical system of charging for water (i.e. standard charge based on rateable value of property) and the absence of data on household water consumption, have not been amenable to calculating domestic demand elasticity; yet it has apparently been an issue of interest to the industry and economic analysts since at least 1960 <sup>18</sup>. In the last few years, as a result of the introduction of domestic metering trials throughout selected areas of England in 1989, some very rudimentary information, relevant to the question of elasticity is becoming available. Because of the small number of water companies and consumers involved and because of unrepresentativeness of the population in the trial areas (see Chapter 6), the data emerging from the metering trials should be treated with caution, and should be viewed as suggestive only, at this stage.

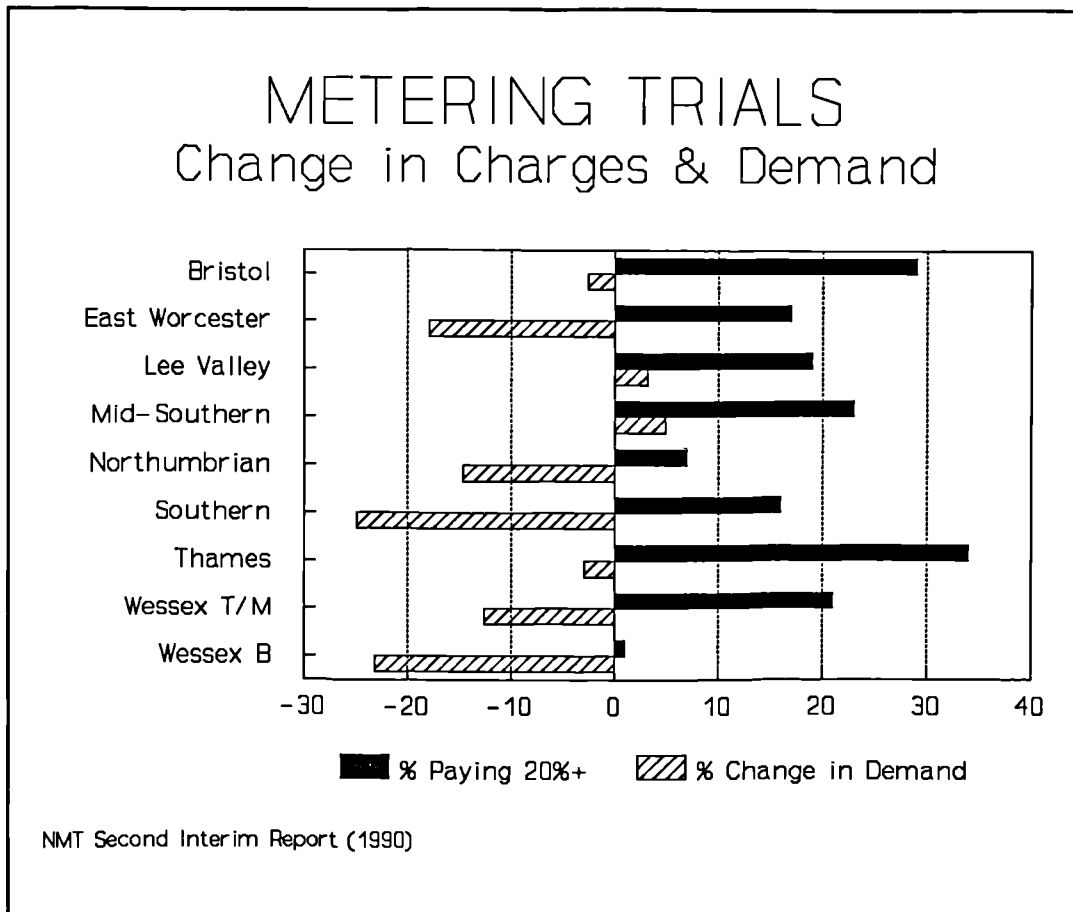


Two of the primary issues being tested in the current water metering trials are the impact that charging for water, on the basis of volume consumed, has on tariffs and on demand. The results of the trials, contained in the *Second Interim Report* of the National Metering Trials Co-ordinating Group, published in July 1990, indicate that:

*About 65% of households in the small scale trial areas are paying less than or the same as their previous RV bill. About 20% of households are paying more than 20% over their previous RV bill.* <sup>19</sup>

*The short-term impact on demand has varied considerably, from a 25% fall to a small increase. It averages around a 10% decline, and it appears that the drop is greater where there is a multi-rate tariff, with higher marginal charges for water as consumption increases or during the peak; the drop has been much less with the more traditional tariffs.*  
NMTCG (1990) pp.iii-iv

In essence, evidence from the metering trials indicates, that although domestic consumer demand for water may be influenced - at the margin - by price, the overall relationship between demand and price is generally an inelastic one <sup>20</sup>. This is reflected more clearly, in Figure 2.6 overleaf, which is based on data from nine of the twelve trial areas where comparable figures were available. Figure 2.6 juxtaposes the proportion of domestic consumers paying over 20% more for their water, with changes in demand. It shows, in the metering trials at least, that there is generally an indirect and imprecise relationship between price and demand, in water consumption; with the overall picture portraying a distinctly inelastic complexion.



**Figure 2.6: Relationship between water charges and demand**

Remarkably, the distributional effect of water metering on different classes of consumers, such as low-income households, has not been fully explored in the metering trials<sup>21</sup>. Therefore, because information on the income of participating households has not been gathered, an assessment of the income elasticity of demand for water (as revealed in the trials) is not possible. There is, though, evidence that the level of demand beyond a "fixed element of usage" (NMTCG, 1990, p.51) is influenced by factors such as, occupancy rate (household size), housing type, and socio-economic status:

*Levels of demand vary with socio-economic grouping and housing type. The highest levels of demand are observed in J, J/B and J/I [Acorn] classifications (Suburban/High Status/High Income). The lowest levels of*

*usage are found at E/II/F classifications (Flats/Council Properties/Poorer Status Housing).*  
p.51 <sup>22</sup>

The unspecified "fixed element of usage" component clearly represents the most inelastic part of household water demand; and it is this core area of consumption that will be most resistant to changes in price or income. The shift in water tariff systems, from rateable value to metered charges, as a general rule, will be likely to impact more heavily upon low-income households than other types of households. This is largely because the former, generally occupy low rateable value properties and hence have hitherto paid relatively low water charges. But it is also because low income households probably have less scope to reduce demand; that is, as they are less likely to have large gardens, swimming pools and the like, they will use less water in 'discretionary' areas and their current pattern of consumption is more likely to fall around the core or "fixed element" of water use. The differential impact of the introduction of volume-related charges is apparent in the interim results of the metering trials:

*About 20% of households with low rateable values are paying more than 50% extra under metered charging. For high RV properties, less than 2% are paying more than 50% extra. In cash terms, bill increases of £40+/year fall on 20% of low RV properties and 6% of the high RV properties.*  
NMTCG (1990) p.42

Additionally, the obvious fact that demand inelasticity for utility services will differ **within**, as well as between, different groups of domestic consumers (based, for example, around household size and the water-related needs of different household types) is illustrated in the interim results of the water metering trials:

*It should be emphasised that within the relatively small percentage of customers who are paying more there will be a very few who are*

*experiencing substantial increases in their bills, perhaps at the extreme as much as 500% or £500..*

*This problem appears particularly to affect families with individuals with medical problems which require constant washing or laundry.*

NMTCG (1990) p.44

The emerging data on elasticity of domestic water demand in Britain is broadly consistent with that from countries elsewhere (OECD, 1987; Patterson, 1987; Mann, 1989; MMBW, 1991); which shows that although there appears to be a relationship between prices and demand, the nature of this relationship is relatively weak and indirect compared to the 'price elasticity' of commodities generally. And it suggests that, very considerable increases in tariffs (even to a greater extent than for energy) will be required, if reductions in domestic water consumption are to be sustained over the longer term.

## PART 2: PUBLIC UTILITY SERVICES - PRODUCTION AND SUPPLY CHARACTERISTICS

### (i) Natural Monopoly

The water and energy industries have been conventionally classified as natural monopolies, with the attendant scenario of absence of competition and single firm dominance. And this has often formed the substance for arguing that these public utilities should operate within a framework of public ownership. However, the basis for classifying electricity, gas and water services as natural monopolies is by no means clear-cut, nor unproblematic.

The case for defining utility services, like water and energy, as natural monopoly services has been predominately an economic one. Sharkey (1982), in one of the most influential recent works on the subject, enunciates the core of the economic basis of natural monopoly, when he states:

*..there is natural monopoly in a particular market if and only if a single firm can produce the desired output at lower cost than any combination of two or more firms. Natural monopoly is defined in terms of a single firm's efficiency relative to the efficiency of other combinations of firms in the industry. p.54*

However, as the privatisation programme of the British Government over the last decade has tended to illustrate, the designation of areas of production and supply as natural monopolies (or more pertinently in a number of instances, their re-classification as 'less than natural monopolies') is not decided on economic factors alone. That is to say, the 'least cost' economic test of what constitutes the appropriate structural arrangements for

utility industry operation, like those indicated by Sharkey above, may be attenuated by political objectives, such as a desire to break-up the monolithic structure of the industries, or to introduce an element of choice, however contrived, for domestic consumers of utility services.

In addition, the allocation of natural monopoly status to particular industries is temporally-located, and hence it is possible that this will change over time, for as Waterson (1988) asserts:

*Whether or not an industry is a natural monopoly is not an immutable fact. Technology and tastes (demand) are the fundamental influences, and as these change, optimal industry organisation can change; industries which once were in this category may be removed from it, and new industries may become natural monopolies.*  
p. 145

Within these shifting boundaries of the concept of natural monopoly then, to what extent can the water and energy industries be described as natural monopolies? In assessing the natural monopoly characteristics of utility industries, a distinction needs to be made between the production and supply of utility services; although this distinction is sometimes less than clear in practice.

Generally it is argued that the production of electricity, gas and even water (via generation, procurement, and water and sewerage systems development and management respectively) do not bear the theoretical hallmarks of natural monopoly, for it is possible to introduce competition and to reduce unit costs through the entry of new firms in these areas of production. Also while it may be possible to secure cost economies of scale through monopoly production, these are seen to be substantially outweighed by the

efficiency and pricing gains that are derived from competitive pressures under a more heterogeneous model of industry organisation (Vickers & Yarrow, 1988; Littlechild, 1988; Yarrow, 1988; Veljanovski, 1989b) <sup>23</sup>.

Whether utility production is theoretically amenable to efficiency improvements via direct competition (and hence would not qualify as a natural monopoly) is often, in a practical sense, beside the point. The more important issue, from an implementation perspective, is whether efficiency-enhancing competition is indeed likely to emerge in the productive structure of the industries, theoretical possibilities notwithstanding.

The character of the industries, in terms of their history, capital requirements, technology etc. may be such that new producers may be deterred from entering the field. Waterson (1988) draws attention to the possible hiatus between theory and reality in the production and supply of utility services in the following terms:

*Of course, many natural monopoly industries are not in fact ones in which entry, even if allowed, is easy. Entry often involves very substantial expenditure, much of which would not be returnable if the project were to fail. For example, a potential supplier of water to a particular area would have to engage in earthworks whose alternative uses would be very meagre. In such cases entry may not be attracted into the industry even if the incumbent firm is grossly inefficient, as long as it has some hold either on customers or over the necessary resources for supply.*  
p.146

Along with the high level of "sunk investment" (Vining & Weimer, 1990) involved, another major barrier to the entry of new utility enterprises, is the possible predatory and anti-competitive behaviour of existing monopoly producers intent on preserving their privileged position in the market for utility services. Concern about the restrictive practices of British Gas as the dominant producer and supplier of gas to the 'contract

market' (i.e. large industrial and commercial users) has been a residual theme in the regulation of the gas industry since 1986:

*In spite of the strong economic factors acting in favour of a competitive contract market, in the late 1980s, the competition stayed away. It did so for two main reasons: first, British Gas' dominant market share enabled it to offer bargain-basement prices to selected (usually high load factor) customers who appeared likely targets for competition. Meanwhile, it could subsidise its revenues by charging more to customers where competitors did not wish to trade or could not afford the distance-related costs of transmission. Second, insufficient gas was available for any single competitor to take the risk of market entry. Powe (1992) p.8*

The alleged anti-competitive posture of British Gas led to the Office of Fair Trading referring it to the Monopolies and Mergers Commission (MMC) in 1987-88 and forms the basis for the current parallel reference to the MMC by the President of the Board of Trade and the Office of Gas Supply (see Chapter 6).

The electricity industry, likewise, is characterised by a strong suspicion that the major producers have been engaging in anti-competitive practices, with the aim of maintaining market dominance <sup>24</sup>. In an inquiry into the operation of the Pool (where electricity is bought and sold) in late 1991, the Director General of Electricity Supply found some evidence to support the view of major industrial customers and the RECs that the generating companies PowerGen and, to a lesser extent, National Power had been manipulating the Pool to their commercial advantage <sup>25</sup>.

In contrast to production, the supply - and certainly the distribution - of water and energy services has been viewed as rather less susceptible to the introduction of competition; and as such they have often been referred to (until recent times, at least) as classic exemplars of natural monopoly.



The arguments underlying the designation of water and energy supply as natural monopolies are essentially rooted in the fact that these services are distributed and supplied to consumers through an extensive network of pipes or power lines <sup>26</sup>. Because the mechanism for supplying consumers involves a complex and capital-intensive infrastructure, it would be inefficient, uneconomic and disruptive (to the physical environment) to duplicate these networks, in order to provide alternative avenues of supply (Helm, Kay & Thompson, 1988). The operational consequence of the economic case for having a single network of water, or electricity, or gas supply, across a given geographical area, was inevitably seen to be the existence of monopoly provision.

In recent years, however, the seemingly immutable link between a single supply system and monopoly provision has been challenged; particularly in relation to energy services. Within a single distribution system, it is argued, the potential exists for the advent of multiple carriers, each of whom would compete (in terms of price and service quality) for business from industrial, commercial and domestic consumers. With the introduction of appropriate metering technology, consumers would be able to switch instantly from one supplier to another on the basis of an evaluation of which firm offers the best value for money at any given point in time <sup>27</sup>.

It has been argued consistently by the Director General of Electricity Supply, that this scenario of multiple sources of supply, attuned to consumer demand, and providing domestic consumers with the opportunity to break free of geographically-bounded

monopoly supply, will apply in the British electricity industry following the introduction of unrestricted competition in 1998 (OFFER, 1992b). Since October 1992, firms other than British Gas have been able to compete for the business of customers using 2,500 therms and above, and under section 37 the *Competition and Service (Utilities) Act 1992*, provision exists for the Secretary of State to lower, or to eliminate altogether, the competitive market threshold in the gas industry <sup>28</sup>. This potentially opens up the domestic gas market to full entry by competitors of the current monopoly supplier, British Gas in the future. While under the *Competition and Service (Utilities) Act 1992* there is also the theoretical prospect of domestic consumers choosing their water supplier <sup>29</sup>, it is generally acknowledged, not least by the regulator himself, that water services will retain its natural monopoly features for some time to come (Byatt, 1991).

The extent to which the theoretical and policy dissolution of the natural monopoly basis to energy supply will radically alter the monopoly base of domestic electricity and gas supply, of course remains to be seen. As does the issue of whether similar structural and technological changes can be effected in the water industry, which is the most naturally monopolistic of all public utilities. It would be little more than blithe speculation to assert with confidence, at this stage, that such a system will indeed result in concrete gains for domestic consumers in respect to choice, price, and quality, in the provision of utility services <sup>30</sup>. For the medium-term future though, in electricity and gas supply, and for the foreseeable future in water supply, the domestic consumer will remain subject to a regime of geographical monopoly supply, with the consequential constraints that this places on the exercise of consumer sovereignty.

(ii) Externalities

The existence of externalities, as part of the process of producing and supplying energy and water services, is an important, and increasingly controversial, dimension to the operation of public utilities. Externalities arise, as Helm, Kay & Thompson (1988) state:

*..when the private costs of production and consumption are not equal to those of society, because costs or benefits spill over to those not directly involved. These social costs are typically considered to be large in the energy sector. p.44*

Externalities are the systemic by-products of the method of production and supply of energy and water services, which are effectively unaccounted for in the conventional pricing mechanisms of the market (Pearce et al, 1989). In this sense, the existence of externalities represents market failure, for the distribution of costs (or benefits) associated with a particular good is not confined to the parties directly involved in its production, exchange and consumption. The displacement of costs or benefits, under situations where externalities exist, is further complicated by the fact that future, as well as current generations of citizens, will experience their negative or positive outcomes.

Much of the discussion of externalities in the energy and water industries has focused (with considerable justification) on their manifestation as negative costs; for example, the release of large amounts of carbon dioxide into the atmosphere through fossil fuel generation (with its consequential effect on "global warming", Donaldson & Betteridge, 1990), the ecological and social devastation caused by accidents in the nuclear power industry, and the environmental hazard of sewerage and effluent discharges into fresh water streams and coastal areas <sup>31</sup>. Public concern about the environmental impact (or

externalities) of the water and electricity industries was a powerful undercurrent throughout the privatisation process in both industries in Britain <sup>32</sup>.

Yet, as the earlier definition suggests, utility externalities can also be of a positive kind (Stiglitz, 1988) <sup>33</sup>. The benefits to public health of wide access to clean water supplies and efficient effluent systems, or the macro-economic effects of a vibrant power industry, are instances of positive externalities. This is because the sum of their aggregate contribution to social welfare is greater than the sum of their individual 'transactional' parts.

The positive externality dimension of public utilities extends well beyond the examples cited above. In fact, because of their overall contribution to systems maintenance, social well-being and lifestyle enhancement, it could be argued that the paramount example of positive externality in the water and energy industries, would reside in the universal provision of adequate quantities of energy and water to all households. The basis for arguing this need not be altruistic or normative, but instead could arise from a self-interested concern about the negative externality effects of non-universal provision, in terms, for example, of the dangers to public health, the public expenditure impost of the treatment of hypothermia (King, 1992), the economic productivity impact of poor diet (from lack of energy-related cooking and storage facilities), or at a more general level, the threat to social cohesion of the exclusion of certain sectors of society from base line quality of life services. Albon (1988) discussing positive externalities in telecommunications states:

*The subsidization of access has been argued by many economists..The basis for the subsidy is an externality - being on the telephone benefits*

*both the individual user and all other users who can now contact the newly connected subscriber. Externalities are notoriously difficult to evaluate and this one is no exception. Nonetheless, there is a theoretical case for some subsidization of access. p.104*

And as is the case with externalities generally, left to its own devices, the market place is likely to be a blunt and ineffective instrument for achieving these desired distributional outcomes. In this respect, arguments about positive externality intersect with the previously discussed concept of "merit goods".

A recognition of utility industry externalities, coupled with an acknowledgement that conventional market mechanisms are unable to take account of the social costs or the social benefits involved, infers that a level of government intervention is necessary in order to provide a corrective for the mis-allocation of costs and benefits. Stiglitz (1988) articulates the rationale for government involvement, when he states:

*Whenever there are such externalities, the resource allocation provided by the market may not be efficient. Since individuals do not bear the full cost of the negative externalities they generate, they will engage in an excessive amount of such activities; conversely, since individuals do not enjoy the full benefits of activities generating positive externalities, they will engage in too little of these. Thus, for example, there is a widespread belief that without government intervention of some kind, the level of pollution would be too high. To put it another way, pollution control provides a positive externality, so without government intervention there would be an underprovision of pollution control. p. 76*

Government intervention of some sort is usually seen as the natural corollary of externalities, but there is less agreement about the shape that government action should take, and over the extent to which surrogate market-based solutions can be devised <sup>34</sup>. The relative merits of using regulatory or pricing systems (although they are not in any sense mutually exclusive), have become the axes in the debate over the most appropriate way for governments to deal with externalities; particularly those of a negative kind.

The set of possible regulatory actions, designed to ameliorate the dysfunctional environmental outcomes of utility production and consumption, lie on a continuum from *dirigiste* forms of state intervention and ownership, to the enforcement of minimalist standards (in areas like pollution control) within a private sector utility industry structure. Recourse to ownership as a means of controlling negative externalities, has increasingly fallen out of favour with policy-makers and academic analysts alike. While the British Government has clearly been in the forefront of this disaffection with ownership as a regulatory device, other governments - with ostensibly less of an ideological axe to grind - have tended to mimic the arguments against conjoint state stewardship of utility industries and the environment (see, for example, Australian Industries Assistance Commission, 1989; Industry Commission, 1991a) <sup>35</sup>. What might be described as the 'empirical' (as opposed to the ideological) argument against ownership as effective regulation, is outlined by Helm & Pearce (1990):

*Is regulation likely to be tougher and easier to impose and monitor in the private or public sector? The intuitive and conventional answer that greater control is engendered through ownership is highly misleading. It may be better not to own the regulatee. The problem can be modelled through 'principal-agent' analysis. The incentives of government regulators needs first to be assessed. If they also own the polluter, they are likely to be susceptible to its financial performance. In the public sector, a politician is answerable for the performance of the firm, and will inevitably want to defend its record. In the UK water industry, Government Ministers frequently acted as de facto apologists for the low standards of water quality. Now that the industry is privatised, Ministers are still answerable for water quality, but have no financial responsibility to the shareholders of the water companies. There is an incentive gain through privatisation. p.12*

Even with the incentive gain that arguably accrues from the separation of ownership from regulation, formidable difficulties are said to stand in the way of regulation as the 'leading edge' of externality control. No matter how precisely a government, or its

regulatory agencies, set standards for the performance of utility industries vis-a-vis environmental management, the problem of effective monitoring and enforcement of these standards remains acute.

In addition to the informational and financial imposts associated with external agency regulation of utilities as complex and heterogenous as those found in the water and electricity industries in Britain, there is the danger (based in the American experience, e.g. Swann, 1988; Weyman-Jones, 1989) of 'regulatory capture'; i.e. the co-optation of the enforcement agency by the regulated industries <sup>36</sup> (see next Chapter).

Partly because of these factors, a superior alternative to government regulation in addressing negative externalities, is seen to reside in the use of the market pricing system <sup>37</sup>. Although the specific elements of a market-based approach to environmental management differ, they essentially revolve around the introduction of new forms of **taxation**; designed both to offset the costs of environmental damage and to act as a deterrent to the production and consumption of utility services with high negative externality effects. In this sense, reference to them as "market-based solutions" is a misnomer, for they represent government-imposed 'environmental taxes' and not some form of price adjustment that emerges endogenously out of the market mechanism. Among the more commonly discussed types of environmental taxes are carbon taxes (paid either at source by the industries or at the point of consumption by the consumer <sup>38</sup>), a generic value-added tax (on all domestic fuel), pollution permits (which are purchased and can be subsequently traded), and fines for breaches of environmental standards.

Apart from having the potential for generating substantial amounts of revenue, which could be used to counteract environmental damage <sup>39</sup>, environmental taxes allow for the apportionment of costs to those industries where the negative externality effects are greatest; although the precision with which this will occur depends on the type of tax adopted <sup>40</sup>. Despite the fact that these taxes are formally predicated on the "polluter pays" principle, it will be consumers of environmentally damaging goods who, directly or indirectly, will be required to carry the bulk (if not the entirety) of the additional costs involved. David Pearce, environmental economics advisor to the Secretary of State for the Environment in 1990 and a leading advocate of environmental taxes, explains the rationale for this when he says:

*Making the consumer of the polluting product pay some of the clean-up cost may seem at odds with the PPP [Polluter Pays Principle] but in fact it is exactly what should happen. For the price mechanism now signals the "true" costs of production to the consumer, comprising normal costs of production and the hitherto free environmental inputs. This is how the "green power of market forces" works.*

Pearce et al (1989), p.158

The power of "green taxes" to raise revenue is one thing, but their ability to substantially re-shape the behaviour of either the utility industries or that of domestic and non-domestic consumers of utility services, is another. The inelastic nature of water and energy demand will manifestly weaken the signal of increased prices; although this will be less the case with energy, where there is the possibility of substituting electricity with the cleaner technology of gas in some areas of household consumption. Research from the Institute of Fiscal Studies (Pearson & Smith, 1990, 1991) indicates that, following the introduction of carbon-related taxes, a long lead time is required for any significant drop in consumption to occur. Also, the ability of industries to pass on the



additional production and supply costs associated with "green taxes" may well inhibit their impact on the environmental practices of utility concerned.

Thus far the introduction of environmental taxes, such as a carbon tax, has been resisted by the British government (although Fells & Lucas, 1991, describe the fossil fuel levy as "a primitive carbon tax", p.72) <sup>41</sup>, but they are almost certain to become a prominent feature of the utility policy landscape internationally over the next decade. In September 1991, the European Commission announced plans for the introduction in 1993 of a carbon/energy tax throughout the member states of the European Community. It is proposed that this carbon/energy tax be phased in over a period of eight years, and it is estimated that it will increase the price of coal by 60 per cent and the price of gas by one third (Pearson & Smith, 1991, p.14). The additional revenue generated by the tax - estimated at over 42 billion ECU in 1988 prices <sup>42</sup> - would be distributed back to the member states to use as they wish, although,

*..the Commission's proposals stress that the tax should be introduced on a revenue-neutral basis - in other words, the revenue should be used to reduce other taxes rather than to increase public spending.*

Smith & Pearson (1991) p.1

If revenues from the tax are used in this way, it will have the effect as Pearson & Smith point out of being doubly regressive, in that tax cuts in other areas will largely benefit the well-off, while the application of a flat-rate carbon tax on energy consumption will have a disproportionately negative impact on the budgets of low income households.

Notwithstanding their possible merit as a means of identifying and allocating negative externality costs therefore, environmental taxes raise substantial social policy issues (Boardman, 1990). Of particular importance is the distributional effect that value-added, pollution and carbon taxes will have on domestic consumers; most notably, low-income consumers. In a context where 'price inelasticity of demand' is high, an increase in water and energy prices, to meet the costs of environmental externalities will *ceteris paribus* impinge more heavily upon low-income households. Attention is drawn to this by Helm & Pearce (1990):

*Income effects from taxes may at least partially offset the substitution effect. Many goods produced by polluting technologies are merit goods. Electricity, transport, and water are obvious examples and the resulting demand behaviour from taxes may conflict with distributional objectives. Indeed, in the case of a tax on electricity, the substitution effect is very small, while the income effect is large. p.13*

Kiers (1983) expresses the distributive problem rather more directly when she says:

*It is particularly important to note that many of the measures available for substantially reducing energy consumption cost money. It is therefore likely to be higher-income earners who will be able to afford to adjust their consumption levels. It is the low income earners, many of whom may have already adopted all the available inexpensive measures to reduce costs and are depriving themselves of comfort, who can least afford to contain the ever increasing percentage of their budget necessary to pay essential energy bills. p.5*

An analysis of the distributional effects of the introduction of a 15 per cent value added tax on electricity and gas, carried out by the Institute for Fiscal Studies in 1990 (using Family Expenditure Survey data), highlights the disproportionate impact that environmental taxes are likely to have on certain classes of domestic consumers:

*The distributional effects of the change are strongly adverse. The increase in tax paid by households in the lowest decile by income would be £1 per week, and that of the richest 10 per cent of households would be around £2, yet the richest decile are sixteen times richer before tax*

*than the poorest. Worse still, the poorest decile cut their consumption of energy by 10 per cent, whereas the richest decile would hardly reduce their consumption at all.*

Pearson & Smith (1990) p.12

The more recent analysis of the distributional consequences of the proposed European carbon tax by the same authors confirms these findings (see Pearson & Smith, 1991, Chapter 5; also Tasman Institute, 1992 for similar conclusions about the impact of carbon taxes in the Australian context).

The major implication of the regressive impact of environmental taxes is that compensatory mechanisms will need to be devised to ensure that low income households are not substantially disadvantaged in the important public policy quest to reduce global warming. These would need to take several forms including, the provision of additional social security benefits to offset price increases, and the extension of energy efficiency programmes (i.e. capital grants, energy efficiency advice and information) designed to ensure that low income households have the capacity to substitute and conserve energy, without experiencing a decline in their overall quality of life. Only in this way, as Johnson et al (1990) suggest would the twin goals of environmental care and social justice be reconciled:

*Where specific heating objectives form part of the aims of public policy, reliance on higher taxes and income compensation alone is likely to put environmental policy and these other objectives at odds. Policies aiming to encourage insulation and thermal efficiency, especially in poorer households, would then appear a necessary adjunct of policies, such as environmental taxation, which aimed to reduce the overall level of domestic use.*

Johnson et al (1990) p.52

Significantly, in this context it is most unlikely that environmental taxation measures could be 'revenue neutral'.

In the area of water services, consumers are already subject to a form of 'water environment tax'. This arises from the £26 billion programme (1989 prices), introduced at the time of privatisation, to clean up the water-related environment. Because of these environmental improvements, water charges are expected to rise on average around 5-6% above inflation each year between 1990 to 2000; excluding the 'pass through' costs of the water industry meeting additional European Commission environmental directives. The flat-rate nature of these increases in water charges, in tandem with the inelastic character of domestic water consumption, means that they will have a regressive effect similar to that of carbon taxes.

The use of general taxation revenue would have provided a progressive (in a taxation sense) alternative to the financing of necessary environmental improvements in the water industry, but clearly this would have confounded the fiscal management objectives of the Government in the water privatisation programme (see Chapter 4). The need to increase social security benefits in order to off-set the financially detrimental impact of substantially increased water charges on low income households was not formally recognised by the Government until October 1991 (see Chapter 7).

One of the more striking aspects of the vigorously argued case for the superiority of the price mechanism (and targeted taxation measures) in dealing with externalities, is that there is considerably less enthusiasm for using this approach in promoting positive externalities; most notably those that contain a distributive or welfare element. If the manipulation of prices and taxes can legitimately be applied to the task of tackling negative externalities, it would seem to follow that they might be deployed with similar

justification and efficacy in positive externality areas, such as extending access to utility services (through, for example, the provision of subsidies for the payment of energy and water bill payments in low-income households). Advocates of environmental taxes, such as Pearce et al (1989) and Helm & Pearce (1990) appear to recognise that compensation is often required in order to reduce their regressive effect on low-income households:

*..an energy tax tends to be regressive in so far as the poor and aged respond less in terms of energy conservation than do the better off and younger sections of society. But many taxes are regressive and mechanisms to offset the regressiveness do exist, eg. through other tax or benefit concessions.*

Pearce et al (1989) p.164

But usually only remedial measures are envisaged under the "theory of pricing" as a device for the management of externalities, rather than a more proactive strategy for access and equity in the provision of utility services.

A more proactive strategy, like the approach to environmental pollution, would be premised on strong government action aimed at influencing externality outcomes. To an extent, the positive externality objective would require an inversion of the goal of environmental economics of shifting the distribution of costs from the social to the private sphere (or from society at large, to individuals). This could be justified on both social justice and self-interest grounds. The former relates to the status of water and energy as "merit" or "participation goods". In the case of the latter, some of the costs which attend insufficient access to utility goods by certain households will, directly or indirectly, be borne by a larger section of society, and hence warrant collective action aimed at their prevention.

### (iii) The pricing of utility services

The drive towards the privatisation and 'commercialisation' of public utilities has served to sharpen a long-standing debate - amongst economists, and between consumer advocates and the industries concerned - on the question of what is the most appropriate system of charging for utility services.

The elements contained in this debate on charging are intricate and often, highly technical in their exposition. But essentially they can be distilled into one issue namely, should the industries formulate their charges (for each unit of consumption) on the basis of the **actual costs** involved or should the setting of charges be influenced by factors other than simply unit costs? Additional factors which could be taken into account in any charging formula include, 'equalisation' considerations (i.e. a similar framework of charges within a defined geographical area), a desire to structure charges competitively in the most demand elastic sector of the market ('Ramsey pricing'), and ability to pay concerns.

Inevitably, if the industries are to be financially viable, charging systems which deviate from the actual (marginal) costs of production and supply, will require an element of direct or indirect **cross-subsidisation**. This is because the application of attenuated charges for one group of consumers will need to be offset by the use of marginal cost-plus charges for other categories of consumers (direct cross-subsidisation). Alternatively, revenue shortfalls resulting from artificially low prices for particular sectors of the consumer population - e.g. large industrial, low income or rural consumers - could be

supplemented by government subsidies, in the form of direct grants or taxation allowances, to the industries concerned (indirect cross-subsidisation) <sup>43</sup>. Taken to its extreme, this latter approach would involve the full financing of utility services through the taxation system, rather than through user charges, and organisations such as the Welsh Consumer Council have argued, in the past, that this would be an appropriate way of funding water services (NCC, 1991b).

The case against the structuring of utility charges to reflect anything other than the true costs of supply, is most often framed around arguments about **efficiency and efficacy** (e.g. Musgrave & Musgrave, 1984; Webb, 1976, 1978; Helm, Kay & Thompson 1988; Industries Assistance Commission, 1989). First, it is held that the introduction of factors other than actual costs into the charging equation, undermines both allocative and productive efficiency. In the former, because they distort consumer pricing signals which in turn leads to the misuse (i.e. the over- or under-utilisation) of utility services, and in the latter, because cross-subsidies can be used to disguise ineffective organisational performance and poor productivity.

Second, it is argued that the manipulation of utility tariffs to achieve 'welfare objectives' (like geographical and vertical equity), represents a crude, ineffective and possibly even counterproductive, device for influencing distributional outcomes (e.g. Rees, 1981). Commenting in the mid-1970s on what he described as the "equalisation bug", Williams expressed this concern as follows:

*I cannot help feeling that water charges are a very inappropriate, clumsy and ineffective way to deal with the social injustices which flow from the inequalities in income and wealth in our society, and if the pattern of water charges were significantly adapted with this end in view, then they*

*may well prove self-defeating (like rent control) because they may well dry up the supply of the underpriced good altogether. For if water authorities are still to break even, other people's charges will rise, with consequent increasing political resistance to service expansion in low-revenue-yielding areas.. pp.5-6*

The view that tariff manipulation aimed at assisting low-income households is, at best, distributionally-imprecise, is given empirical support in the research of Bradshaw & Hutton (1983) and Dilnot & Helm (1987). The analysis by Frankham & Webb (1977) of the likely effect of the proposed introduction (in 1976) of a national equalisation policy of water charging, raised substantial queries about the distributive merit of a uniform pricing system for water.

The case for moving beyond the confined parameters of unit cost considerations, in the calculation of utility charges, stems from two very different roots; although on occasions the two may, inadvertently, intertwine. The first is built on an assessment of which system of charges is most likely to further the commercial interests of the utility industry concerned. Potentially, the structure of charges devised through this commercial prism, may conflict with the costing prescriptions of pure economics. For example, the use of a 'competitive' schedule of charges in the more volatile and demand elastic areas of consumption (i.e. in the 1 MW and above sector in the electricity industry) may deviate from marginal unit cost requirements - and hence breach a fundamental economic precept - but it may also be in the best long-term interests of the utility firm to do so (in terms of securing new business etc.). Also, as the Australian Industries Assistance Commission report (1989) points out, the use of equalisation measures may make more commercial sense than many economists seem to allow:



*As in the case of private enterprise, a public firm may adopt uniform pricing as a sensible commercial decision to avoid the expense of accurately costing every unit of the good or service supplied. p.F-4*

Presumably, this sort of consideration underlies the national standard pricing practices of many large retailers in Britain, such as Sainsbury, Tesco and Marks & Spencer.

The second set of arguments for a more flexible approach to utility charging are built around a desire to use the charging mechanism to promote **equity objectives**. Also, arguably, they connote a rather different conceptualisation of the purpose and function of public utilities in contemporary society than that envisaged by the advocates of full cost pricing; i.e. one that implicates the public utilities directly in the promotion of universal access to utility services.

Equity, as Frankham & Webb (1977) and Rees (1981, 1992) caution, is a normative and imprecise concept; but in its application to utility charging it appears to be founded on two quasi-philosophical precepts: the 'benefit principle', and the 'ability to pay' principle. The 'benefit principle' suggests that "charges to consumers should be related to the benefits which they receive from the supply of particular goods or services" (Frankham & Webb, *ibid*, p.198; see also Beatley, 1988); and hence where these benefits are similar, charges should be similar. In this sense it could be used to support a case for the application of a uniform schedule of energy or water charges for domestic consumers - irrespective of where they live - as the benefits that accrue will be broadly the same (a variant of horizontal equity) <sup>44</sup>. The case for the 'equalisation' of water and energy charges, within and between different regions of the country, can also be argued

on externality grounds, in that it encourages population dispersal, and obviates the rise of pervasive ill-effects that attend under-consumption; particularly in respect to water.

The 'ability to pay' principle is more assertively re-distributive in its focus, and implies that intervention in the pricing system is necessary if equal access to adequate levels of utility services is to be achieved. This may necessitate, for example, the setting of a scale of utility charges for domestic consumers, that is roughly proportional to the amount of disposable income held. Kiers (1983) argues in favour of this approach:

*Given what we know of the persisting differences in the consumption of energy necessities by different income groups, the reduction in these inequalities and the redistribution of energy resources should be regarded as a valid objective of government policy. At the very least, this requires that energy prices be structured progressively, in much the same way that the income tax system, for all its faults, attempts a measure of income redistribution through progressive structures. Energy tariffs should not be allowed to undermine the objectives built into the social security system. p.29*

Additionally, it has been suggested that ability to pay objectives could be furthered by actions such as, eliminating the standing charge (although the equity outcomes of this are, at best, unreliable <sup>45</sup>), and through the provision of seasonal concessions to low-income households (e.g. reductions in energy bills for pensioners over the winter months) <sup>46</sup>.

The British system of charging for energy and water services, to date, might be described as pragmatic and eclectic, rather than being built primarily on economic pricing principles. And while there has progressively been a general movement towards the full economic cost approach - stimulated by tighter financing controls in the 1970s

and by privatisation imperatives from the mid-1980s onwards - the structure of charges in the electricity, gas and water industries contain strong residual elements of a number of different approaches to charging.

This is reflected in the continuing application of uniform charges within regional boundaries in most cases (and indeed in the case of British Gas, uniform tariffs across the country <sup>47</sup>), the apportionment of an element of unit costs within standing charges (particularly in the water industry) <sup>48</sup>, and in the differential setting of charging schedules in order to gain competitive advantage.

The domain of charging that has attracted the least interest amongst British utilities historically has been in relation to the issue of ability to pay; where under the protective guise of being statutorily obliged to avoid 'undue discrimination' between classes of consumers, the utilities have generally been circumspect about assuming, what they perceive as, an invidious social security role. Writing in the early 1980s, Bradshaw (in Bradshaw & Harris, eds., 1983, p.105) remarked that "to date economic rather than social objectives have continued to determine both the level and structure of prices". However, a number of pricing initiatives aimed at assisting low income consumers have been introduced for short periods in the past with mixed success. These include the Labour Government-funded "Electricity Discounts Scheme" during the mid to late 1970s (involving a 25 per cent discount on the winter electricity bills of social security beneficiaries), and the area electricity boards' "Domestic Standing Charge Rebate Scheme" in 1982-1985 <sup>49</sup>.

Much has been made of the what Williams described as the "equalisation bug" in the utility industries, where as a result of cross-subsidisation, consumers in certain areas of the country are seen to have been insulated from the true costs of production and supply. Yet, in practice, the water - and to a lesser extent, the energy industries - have been characterised by significant regional variations in charges. This is illustrated for the water industry in Figures 2.7 and 2.8 on the pages that follow; where it is evident that up to privatisation the pattern of variability in inter-regional domestic charges remained reasonably constant over time.

# WATER & SEWERAGE CHARGES

Average Household Bill

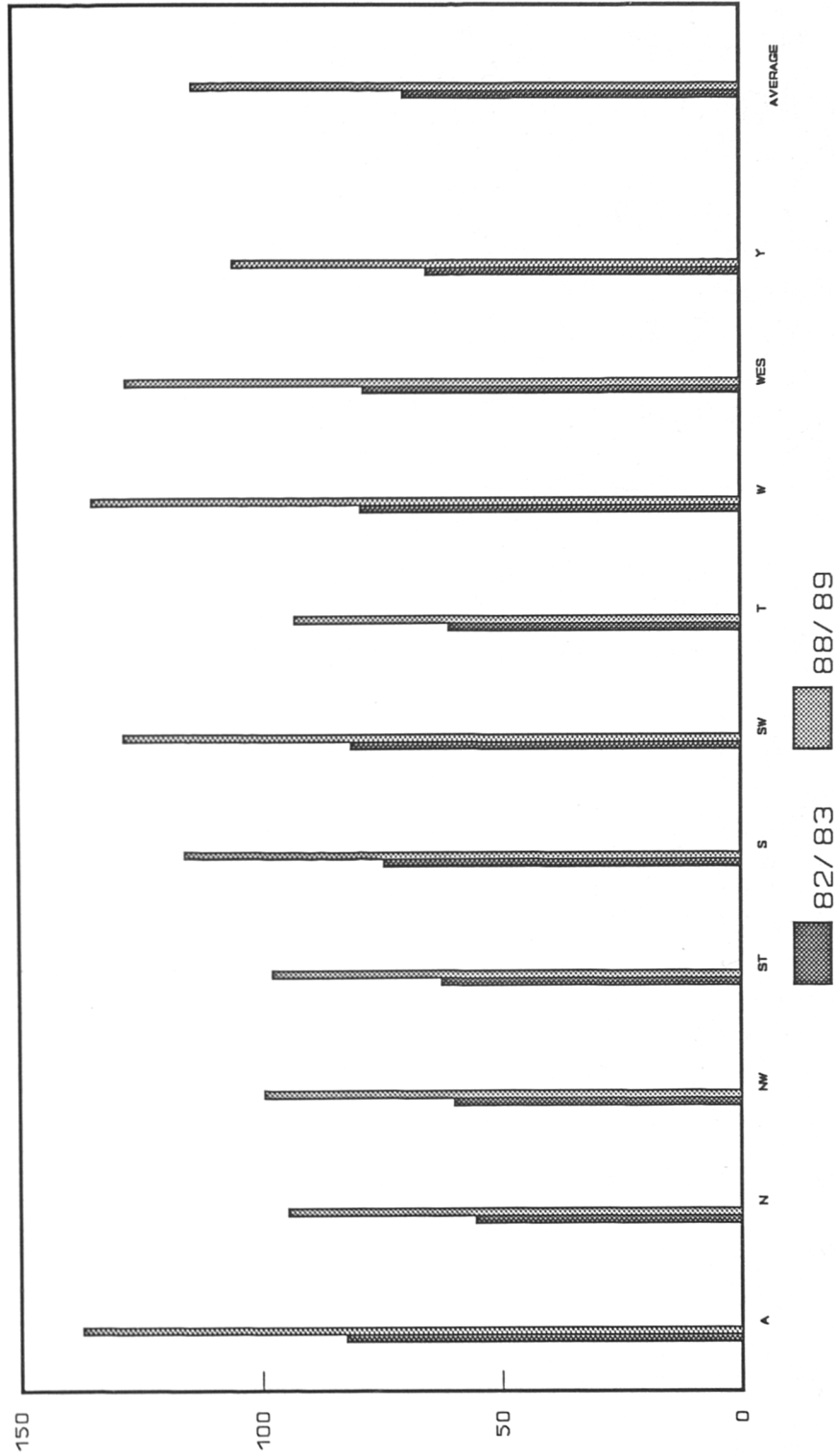
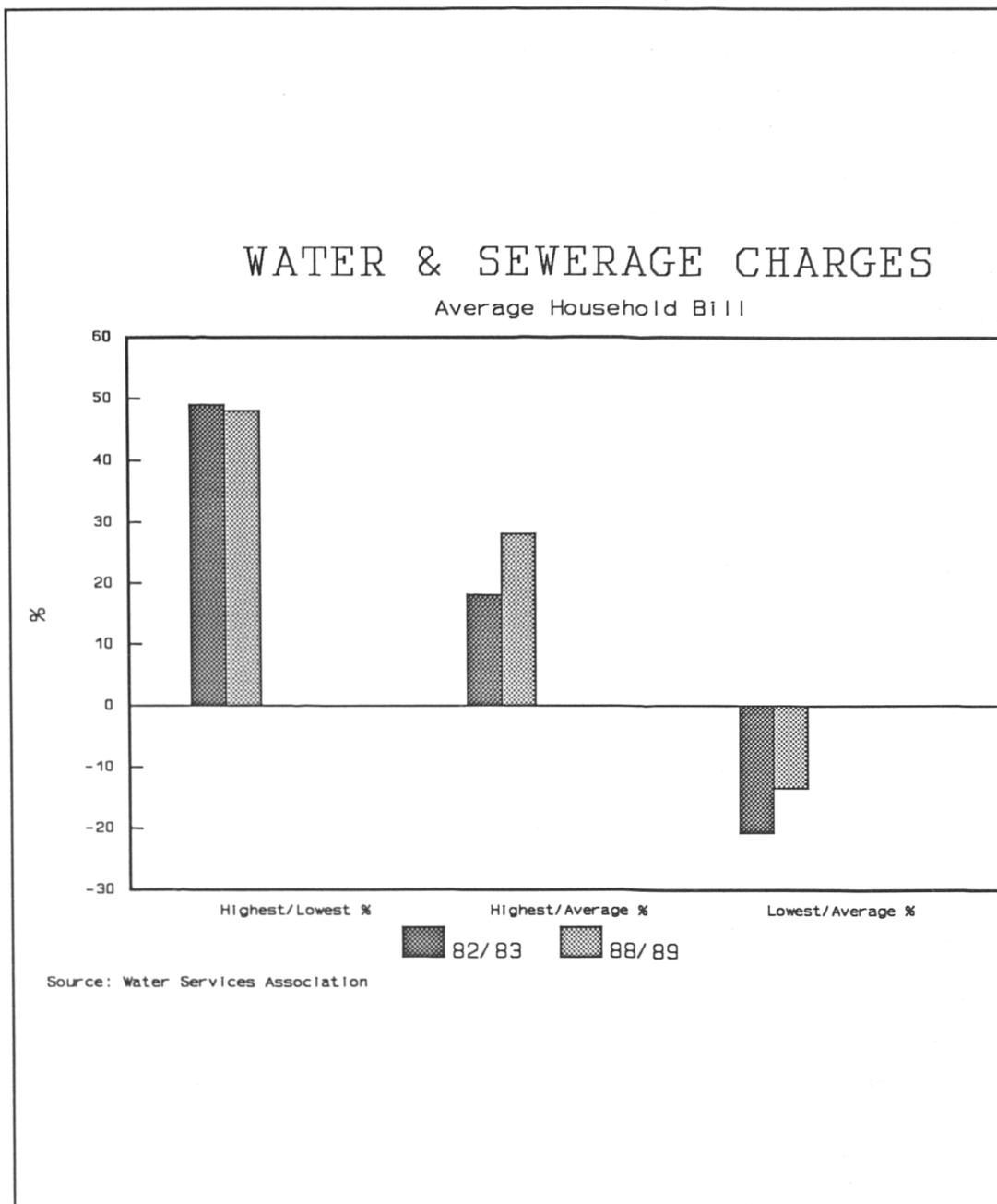


Figure 2.7: Average household water services bills 1982/83 and 1988/89



**Figure 2.8: Variations in water services charges 1982/83 and 1988/89**

As the privatisation (and competitive) regime develops, it is not only likely that differences in domestic water charges between regions across England and Wales will increase, but the injunction to "let costs lie where they fall" will possibly result in the creation of large price variations within individual water company areas. This was

foreshadowed in the Office of Water Services *Charging Policy Consultation Document* published in May 1990:

*There is the further issue..of the extent to which tariffs should reflect differences in cost across a company's area, between different times of the day or year, and for different quality of service. p.2*

In the new framework of utility industry organisation in Britain, the system of formulating charges for utility services is likely to be subject to considerable re-conceptualisation and change. The moves to establish water metering as a primary method of charging for water (OFWAT, 1991u; DoE/Welsh Office, 1992 - see Chapter 6) is one expression of this.

The regulatory challenge - as much for the Government as for the industry regulators - is to see that the principle of horizontal equity occupies a place in the structure of utility charges, as well as to ensure that the demand inelastic (domestic consumer) side of the market is not disadvantaged in the competitive struggle for large industrial and commercial custom. In a discussion of the RPI+K pricing formula in the water industry, Rees (1989, p.8) draws attention to this fundamental regulatory problem:

*Under the proposed tariff basket system price controls apply to the average charge increase across services, consumers and tariff elements. Some price rises could therefore, far exceed the average as long as others are below it. In these circumstances a profit maximising company has every incentive to restructure its tariffs to ensure more rapid price rises for standing charges, consumers and services with inelastic demands, and for customers in strongly growing sectors of the business. In practice cross subsidisation is likely to occur, as indeed it does now.*

Almost inevitably, under privatisation, the opportunity for using the structure of utility charges to further vertical equity objectives, unless accompanied by substantial public subsidies, will disappear altogether.

## CONCLUSION

In this Chapter it has been argued that public utility services display particular characteristics which, in composite, substantially differentiate them from most other commodities and services in the economy. While it is true that some other commodities share one or two of the features of public utility services (e.g. food and housing in terms of 'essentialness'), no other area of human consumption manifests the array of complex demand and supply attributes found in public utility services. Because of this, it is inappropriate to assert - as has been the case in government and industry circles in recent times - that public utility services are essentially no different from other commodities and that as such their production and distribution should be devolved to market forces alone.

The life enhancing products, and potentially life destroying by-products, of public utility services places them in the front line as determinants of contemporary quality of life, at both an individual household and societal level. And this, in combination with the structural characteristics of the industries, which will be monopolistic for some time to come for ordinary consumers at least, invariably means that the random stewardship of the free market will be inadequate to the task of managing the major distributional and environmental issues implicit in the provision of public utility services.



This Chapter has illustrated how water and energy services provision is interwoven with major questions of public policy and as such the state is inevitably implicated in the management of public utilities, irrespective of where the locus of ownership lies.

The function of the state is first and foremost a regulatory one, aimed at ensuring that the strategic contribution of the public utilities is directed at constructive economic and social ends. In addition, the state has a vital financing role to play, aimed at securing equity of access to utility services.

The next Chapter examines the regulatory function of the state and in particular, it explores the emerging model of public utility regulation in Britain.

## ENDNOTES TO CHAPTER 2

1. Waterson (1988, p.122) suggests that privatisation, liberalisation and deregulation are the three dominant contemporary forms of "experimentation with the loosening of control" of natural monopolies.

2. See, for example, Industry Commission (1991a) *Energy Generation and Distribution, Volume 1: Summary and Recommendations*, Canberra: Australian Government Publishing Service; Industry Commission (1992) *Water resources and waste water disposal: Draft Report*, Canberra; Public Bodies Review Committee (1991b) *Discussion Paper on Corporatisation*, Melbourne, October 1991; Economic and Budget Review Committee. (1991) *Out on the Table: The Cost of Community Service Obligations*, Thirty-Second Report to the Parliament, Melbourne: Parliament of Victoria.

3. This change of meaning might be characterised simply, as the movement away from the use of the term 'public utility' as connoting a form of *public service* (with all that this implies), to its use primarily to describe the production and distribution of essential infrastructural services. Interestingly, however, Sherman (1989, p.14) defines a public utility as "a privately owned corporation serving public purposes". [author's emphasis]. See Ogden (1991) for a discussion of how the "discourse of accounting" has permeated the water industry.

4. The major generic consumer protection statutes in the UK are outlined by Swann (1988) p.30.

5. The test of 'social viability' (i.e. what would be deemed to be acceptable under contemporary living standard norms) would clearly exclude the use of 'technically viable' forms such as candles and paraffin lamps for lighting.

"In the domestic market about half of total electricity consumption is estimated to go on applications for which there is no effective substitute for electricity (such as lighting)." OFFER (1991) *Energy Efficiency Consultation Paper*, p.8

6. "Once a public good is produced, non-excludability makes it impossible to prevent people from using it, hence it is not possible to levy charges (this is the *free-rider* problem); in such cases the market may fail entirely. Non-rivalness implies that the marginal cost of an extra user (though *not* of an extra unit of output) is zero. The efficient price should therefore be based on individual marginal valuations of the good, i.e. on perfect price discrimination; where this is not possible, the market is likely to be inefficient. If a public good is to be provided at all, the appropriate form of intervention is generally public production." Barr (1987) p.83

7. Under the consolidated water legislation enacted in 1991, this provision is now contained in section 147 of the *Water Industry Act 1991*.

8. Under Condition H of the *Instrument of Appointment of the Water and Sewerage Undertakers*, county court action is generally required before the disconnection of domestic customers can occur. Whereas under Condition 19 of the *Public Electricity*

*Supply Licence*, based on the Condition 12A amendment to British Gas' licence, an electricity company is only obliged to offer a prepayment meter to a defaulting tariff customer "where safe and practical to do so", as an alternative to, disconnection.

9. Head (1974) concludes similarly:

*Since merit goods are those satisfying merit wants, merit goods may be defined as those of which, due to imperfect knowledge, individuals would chose to consume too little. In such cases the government should intervene to encourage consumption. p.216*

10. An obverse relationship is also, of course, seen to apply i.e. that price responds to demand.

11. "...households tend to spend a relatively fixed amount on fuel regardless of income. They tend to spend what they need." Bradshaw (in Bradshaw & Harris, eds., 1983) p.5

12. Also the fact that, until recently, the cost of water services was viewed as a minor item in the expenditure of most households, may have contributed to a neglect of the distributional consequences of water charges.

13. "For low-income households fuel is the third largest expenditure commodity after food and housing" Bradshaw (in Bradshaw & Harris, eds., 1983, p.5). In 1990, fuel remained the third largest area of expenditure for the lowest income quintile (after housing and food). For the median quintile, on the other hand, fuel was the seventh largest area of expenditure out of the fourteen commodity groupings in the FES.

14. Dilnot & Helm (1988, p.34) also view this as confirmation of energy's "merit goods" status:

*This pattern [of expenditure] strongly suggests that we could think of energy as being a merit good, the consumption of which forms a vital part of life.*

15. "as expected, the likelihood of a house or flat becoming cold appears to be largely governed by its energy efficiency, particularly the availability of a comprehensive and efficient heating system, and by the income of the household governing the fuel consumption" English House Condition Survey 1986: Supplementary (Energy) Report DoE (1992b), p.51. A recent analysis of the 1986 English House Condition Survey by the Institute for Fiscal Studies has contested the importance of income as a factor in energy efficiency investment, rather it found a much closer association between the latter and type of tenure, i.e. private and council tenants are far less likely to reside in an energy efficient home (Brechling & Smith, 1992). Of course, in many ways, tenure might be treated as a proxy for level of household income.

16. A similar finding is given in the Institute for Fiscal Studies examination of the proposed European carbon tax (Pearson & Smith, 1991, pp.16-17):

*Microeconomic estimates of the effects of higher energy prices on the demand for domestic energy and petrol by private households seem to confirm this general conclusion that the price elasticity of demand for energy is low. Estimates using the IFS model of consumer expenditures indicate that an increase in domestic energy price of 15 per cent would cut energy consumption by 5.5 per cent..*

17. Reflected, for example, in the gas and electricity industries 'interruptible' and non-peak load contracts with industrial and commercial customers.

18. A summary account of the 'history' of interest in water metering is given in OFWAT (1990d) Annexe 7.

Writing in the mid-1970s Williams (undated), alluding to the water metering studies carried out in Fylde and Malvern, states:

*At the lower end of the scale, price elasticities of -0.1 have been reported for domestic water (i.e. the proportionate fall in utilisation is one-tenth of the proportional rise in price) but figures as high as -1.0 have also been found (i.e. utilisation falls in the same proportion as the price increase). Thus the actual magnitude is clearly of some significance, and the British data is very scant on this matter. p.8*

19. These figures are exclusive of the costs of installing meters in domestic properties; which are estimated in the *Second Interim Report* to cost on average between £165-£200 per property (depending on whether they are internally or externally located).

20. How this information from the water metering trials underlines the 'inelasticity' of demand for water, is made apparent in the following technical definition of 'price elasticity of demand' by Norton (1984, p.15):

*..if a price increase of 5% leads to a 5% reduction in demand (that is a change of -5%), the coefficient  $E$  [price elasticity of demand] = -1, and demand is neither elastic nor inelastic. Where the percentage change in quantity demanded is less than the percentage change in price,  $E$  will lie between -1 and 0, and demand will be inelastic. An  $E$  less than -1 (say, -1.5) means that the percentage change in quantity demanded is greater than the percentage change in price, and demand is elastic.*

21. Although some limited information on this issue was gathered in the Department of the Environment/OFWAT sponsored study into the Social Impact of Metering (1992u) conducted in 1992. The major findings of this research are discussed in Chapter 6.

22. The percentage difference, on a per capita basis, in annual water consumption (April 1989 to March 1990) between the highest and lowest consuming groups - 'affluent suburban housing' and 'mixed council estates' respectively - was 36% (or 16 cubic metres per person per year). NMTTCG, 1990, p.53.

23. This view has underpinned the British Government's approach to electricity privatisation (White Paper, 1988); albeit that the breakup of the monopoly generating power of the CEGB, via the creation of National Power, PowerGen and Nuclear Electric, has been rather less ambitious than free market advocates have sought.

In contrast, the water industry has been privatised minus any substantive change in the monopoly production position of the previous water authorities. The earlier privatisation of British Gas similarly retained the monopoly production position of the former nationalised gas utility.

It need not, by any means, automatically follow that the introduction of competition will impact positively on price (i.e. result in reduced prices). Nelson (1990), for example, in a study of the effects of competition on publicly-owned electricity utilities in the U.S. found that:

*..competitive plants had higher generating costs than monopoly plants for most output levels. In addition, it appears that operating costs would fall significantly if a single monopolist were to replace two competitors in a given market. p.48*

Although his explanation of the possible reasons for this is rather ambiguous (see pp. 48-9).

24. This, as with gas, preceded privatisation. The failure of the 1983 Energy Act to engender a measure of competition in the electricity generation industry in Britain, for example, has been attributed, in part, to the 'anti-competitive behaviour' of the Central Electricity Generating Board at the time (e.g. Weyman-Jones in Button & Swann, 1989).

25. *During one period, PowerGen followed a policy of declaring some plant unavailable which was subsequently redeclared available. This policy increased Pool Prices, and introduced greater uncertainty into the market. I conclude that it represented an abuse of the company's dominant market position.*

*The interests of customers would be served, and confidence in the Pool increased, if the two major generators were not able to manipulate availability so as to exercise monopoly power. I therefore propose a new licence condition on National Power and PowerGen explicitly to prohibit monopolistic or anti-competitive behaviour in relation to the availability of plant and the closure or mothballing of stations [change to Licence, new Condition 9A, made in June 1992; applicable to Nuclear Electric as well as the other two generators]. It would oblige a licensee to publish information relating to these matters, and to establish arrangements under which it will seek to establish whether, and if so at what price, others would be willing to purchase any power station which it intends to close or mothball. OFFER (1991m) p.3*

See Helm & Powell (1992) for an analysis of the workings of the Pool over the first couple of years of operation.

26. "Natural monopolies arise most frequently in networks.." Helm, Kay & Thompson (1988) p.47

27. This system of competitive supply is somewhat analogous to the way that the privatised regional electricity companies and second tier supply companies notionally purchase electricity from the generators via the Pool.

28. The Government has indicated that it will review the limits on competition in the gas market in May 1993. This will no doubt take into account the findings of the MMC which is due to report around the same time.

29. Under section 41 of the *Competition and Service (Utilities) Act 1992*, domestic consumers can technically choose a water supplier other than the one in whose area they are located. The connection costs associated with this (i.e. laying of separate pipes etc.) preclude it from being a realistic choice at this point.

30. The informational demands of a domestic variant of the electricity Pool system, from the individual consumer's perspective, are likely to be extremely exacting, which may outweigh any benefits accrued. Also as is the case with complex consumer-information systems, it is likely to discriminate against the elderly, the disabled and the disadvantaged. Although hardly an "unrestricted competitive environment", the evidence from the advent of competition in the British telecommunications industry tends to indicate that it has been the business user rather than the domestic customer who has been the primary beneficiary (Bishop & Kay, 1988; Vickers & Yarrow, 1988).

31. The report on water privatisation prepared for the Campaign for the Protection of Rural England, the Royal Society for the Protection of Birds, and the World Wildlife Fund by Bowers et al (1988) gives an extended example of the interactional externalities in the water industry:

*The key water services are users of a freely available natural resource, water. In one case the industry is merely supplying that resource with minimum of processing to ensure potability to consumers, in the other it is using that resource as a medium of transport of waste products. These are not the only uses made of common property: industry and agriculture directly discharge waste products into the system and draw from it without the interposition of the water and sewerage companies. Parts of the system are also used for fisheries and for water transport as well as for various forms of recreation. Competing users impose costs on other users and in extreme cases can render the resource unsuitable for other users. These costs are not controlled through the markets for water based products and uncontrolled use - uncontrolled competition - can lead to the depletion or destruction of the resource. This phenomenon is known usually as the 'tragedy of the commons'. p.9*

32. Paradoxically, arguments about the negative externalities associated with these industries (and the action required to address them) were used by both the proponents and opponents of utility privatisation to support their case. The Thatcher Government vigorously invoked the spectre of water-related externalities, and the need for private capital investment to correct them, in the months leading up to the flotation of the water

industry. This argument was reiterated, after water privatisation, by the then chairman of the Conservative Party:

*This year, the now privatised water industry is preparing to invest £28 billion over the next 10 years to improve the purity of drinking water and to clean up further our rivers and beaches..No one could have expected that as a nationalised industry the water authorities would ever have invested so much. Our environment will now directly be improved by our privatisation programme. Kenneth Baker in The Observer, 14/10/90*

33. In many instances, positive externalities are the mirror image of negative externalities.

34. Although, the confused policy position of the Thatcher Government on the environment reflected a marked reluctance to acknowledge that even a minimal degree of government intervention is necessary to deal with environmental problems. This was reaffirmed in the release of the Government's muted White Paper on the environment (*This Common Inheritance: Britain's Environmental Strategy*, Cm 1200) in 1990. In seeking an explanation for the ineffectualness of the White Paper, *The Guardian* (Comment, 26/9/90) stated:

*There is no inherent contradiction between conservatism and conservation, but it does pose problems for Mrs Thatcher and her philosophic objections to the three necessary mechanisms: public expenditure, regulation, and a national strategy.*

Even advocates of market-based remedies, like Helm & Pearce (1990) who describe the call for greater state intervention, as a "simplistic approach" (p.10), envisage a clear regulatory role for government:

*The presumption in favour of market-based policies does not, however, imply the unfettered operation of market forces. Rather, the market should be harnessed to generate the most efficient method of achieving desired pollution reductions. The role of the state is to regulate through command and control procedures, in setting maximum pollution levels. The role of the market is to find the best method of achieving them. p.14*

35. Evidence of the environmental holocaust wrought by state managed industries in Eastern Europe has considerably strengthened the voice of anti-statist policy makers and lobbyists.

36. The notion of 'regulatory capture' is, in some respects, a variant of the arguments of the 'public choice' school of political theory about the failure of democracy to control the executive branch of government.

37. Although, in practice, the use of market pricing measures does not negate the need for some form of government regulation. See, for example, Helm & Pearce (1990).

38. The distinction is useful only in that it identifies the point and possible means of tax collection, for in reality under either system, it will be the consumer who ultimately bears the cost. See Pearson & Smith, 1991, Chapter 4 for a discussion of the pros and cons of different systems of collecting carbon taxes.

39. But they may not necessarily be used for this purpose. Indeed the proposed European Community carbon tax is designed to be 'revenue neutral' and it is likely that the additional tax impost resulting from the collection of carbon taxes would need to be off-set by reductions in other areas of taxation (see Pearson & Smith, 1991, for a discussion of this).

40. On a continuum of precision in the apportionment of energy carbon dioxide costs, for instance, the "scattergun" end would be represented by a generic value-added tax on fuel, with the more closely targeted end comprising a tax on individual power station plants, according to volume of CO<sub>2</sub> emissions.

41. This was reflected in the absence of proposals for the introduction of a carbon tax in the Conservative Government's environment White Paper *This Common Inheritance* in 1990, despite the fact that the then Secretary of State for the Environment, Chris Patten, favoured such measures:

*..proposals by the former Environment Secretary, Chris Patten, to introduce carbon taxes were blocked by Mrs Thatcher, who was hostile to green pricing policies which would interfere with the operation of the free market. The Guardian, 30/12/90*

The British Labour Party gave broad, if rather hesitant, support to the introduction of "green taxes" in its policy review (*Looking to the Future*, 1990, p.20) and in its paper on the environment, *An earthly chance* (October, 1990). At the same time it rejected the idea of introducing a "carbon tax", in the immediate future:

*We have carefully studied this idea, but remain unconvinced that on its own it can achieve the cuts in emission required..*

*Studies suggest that a carbon tax would have to be set at an unrealistically high level if it were to have the desired effect of reducing demand..Without compensation, a carbon tax would fall very heavily on the poor.*  
*An earthly chance* (1990) p.21

42. Pearson & Smith (1991) Table 5.1, p.38

43. "Explicit or implicit cross subsidies can arise either as a result of different prices for a product by different consumers or because a uniform price is paid for a product regardless of different costs of delivery to different consumers." Industries Assistance Commission (1989) p.F-1.

The use of government subsidies to attenuate utility charges for particular groups of consumers has been the conventional way of financing "community service obligations"



and is the approach favoured by both economists and the utility industries themselves.

44. This is a quite different conclusion from that drawn by Frankham & Webb (1977), for after defining the 'benefit principle' they go on to argue:

*This principle is thus consistent with the proposal (informational requirements and metering costs allowing) that consumers should pay charges related to the costs which they impose on the water supply system. p.198*

This conclusion, however, does not naturally follow from the way the 'benefit principle' has been defined.

45. As the Electricity Consumers' Council report on the standing charge (1982) shows in the case of electricity, if this were to result in an overall increase in the unit rate, it would be likely to have a deleterious impact on certain groups of low-income consumers, such as families with children and council tenants with all electric homes. Schemes introduced in Britain in the past to abate energy standing charges have also been found to be of major benefit to second home owners (see Endnote 51).

46. Most states in Australia, for example, presently provide some form of pensioner rebate for winter energy charges.

47. It will be recalled from Chapter 1, that in 1985 the then Secretary of State for Energy used the uniform pricing argument as part of the reason for retaining the unitary structure of British Gas:

*The major structural change would, as in the past, mean far greater regional diversities in prices..At the end of the day, the idea is that a therm of gas could be obtained at such and such a price in the north-west as opposed to London or the south-east. HoC, 10/12/85, col. 776*

48. Commenting on standing charges for water, the Office of Water Services stated:

*The proportion of costs recovered through standing charges is, on average, about 30%, but in some cases is as much as 60%. Varying the size of the standing charge results in significant differences of incidence of charges between customers, and the current range is difficult to defend on either equity or cost grounds.*

Charging Policy Consultation Document: Synopsis, May 1990, p.2.

49. "From April 1985 all Area Boards withdrew the domestic standing charge rebate scheme which had reduced standing charges for certain domestic consumers whose quarterly consumption were very small. About 2 million customers had benefited from the scheme, including a small number on low incomes; however many more rebates related to second or holiday homes, empty premises etc. and the scheme had not benefited customers on low incomes with high electricity consumption" (Electricity Council, *Annual Report 1984/85*, p.12).

## CHAPTER 3: PUBLIC UTILITIES AND REGULATION

### INTRODUCTION: THE TERRAIN OF PUBLIC UTILITY REGULATION

Water and energy services are characterised by features which, in combination, differentiate them from other commonly-purchased and consumed goods and services. Importantly, much of their distinctive character appears to amount to more than simply a temporally-specific set of factors, which will dissolve with time or technology. These differences are also not merely artifacts of the way that the industries concerned have been traditionally structured and organised. For the domestic consumer, over the foreseeable future at least, the relatively inelastic demand for essential and life-enhancing quantities of water and energy services will continue to be met within monopoly supply conditions; with its concomitant impact upon access and choice.

The social and economic dimensions of public utility services, outlined in Chapter 2, form the substantive basis for arguing that the provision of water and energy services is subject to *market failure* (Norton, 1984; Helm & Yarrow, 1988). That is, that the market is apparently incapable - left to its own devices - of efficiently and equitably supplying water and energy services to domestic and other consumers; and that the intervention of the state is required, in some form, to counteract the endemic deficiencies of the free market system in the supply of utility services. Kling (1988, pp.198-9) makes this point within the perspective of orthodox welfare economics theory:

*The traditional theory of competitive markets yields strong statements about the efficiency of the market outcome. While providing an argument for relying on free markets, it also suggests the limitations of markets. For when certain ideal conditions do not hold, or when efficiency is not the primary concern, market theory itself suggests that intervention is appropriate. Thus, instances of externality, monopoly power, and inequity are cases of market failure justifying extra-market decision-making by an enlightened state authority.*

The existence of market failure in the production and provision of public utility goods has, in the past, provided the rationale for a policy of state ownership and nationalisation of the utility industries. However, the emergence over recent years, of the theory of *government failure* (Helm & Yarrow, 1988; Vining & Weimer, 1990) as a form of conceptual and ideological counterpoint to the well-documented case for market failure, has ostensibly weakened the credentials of *dirigiste* policy making (see Chapter 4).

The symptoms of government failure in the management of utility industries, in the eyes of its proponents, include an inherent inability to achieve productive and allocative efficiency outcomes <sup>1</sup>, and to provide effective stewardship of both the public, and the consumer, interest (Demsetz, 1989).

Nevertheless, despite the strong reservations shared by many orthodox welfare economists about the dynamics and impact of government intervention in the industrial economy, it is generally acknowledged that a government-led regulatory regime of some sort is required in the management of utility services. In large part, the tentative support for public utility regulation, has its origins in an empirically-based concern over the potential for monopoly exploitation <sup>2</sup>. Sherman (1989, pp.10-11) captures the essence of this anxiety about monopoly power, when he says:

*Without competition in the form of free entry, a single supplier must be expected to follow many understandable tendencies of monopolies. To*

*raise revenues, prices may be adjusted so that markets with less elastic demands will have prices proportionately farther above marginal costs; and more subtle discrimination by price may be attempted, again because it allows more revenue to be raised. Unless quality is clearly defined and easily monitored, it may be altered. Reliability of service may suffer, for example, when there is no threat from alternative suppliers, and consumers may be forced to wait for service. Costs rise too as managers shirk or avoid difficult decisions. Innovation may not occur either, for the enterprise has no great incentive to make its own ways of doing things obsolete.*

The disincentives to efficiency and the barriers to consumer sovereignty implicit in monopoly enterprises (particularly where demand elasticity is low), necessitates the introduction of a regulatory system that provides a set of proxy market conditions and 'disciplines', and affords a level of protection both to the public interest generally, and to consumer interests specifically. In this sense regulation is, to adapt a popular advertising slogan, "...a means of reaching those parts of industries which competition cannot reach" (Gibson and Price 1988, p.42).

Public utility regulation consists of two primary dimensions: economic and social regulation (Swann in Button & Swann, 1989). Economic regulation centres around firstly, the role of the utility industries in the economy (e.g. monopoly practices, competitive structure, contribution to economic growth) and secondly, the financial management of the utilities (e.g. rate of return, pricing and productive efficiency), and most academic attention has been directed at this dimension of regulation. Social regulation is a somewhat more amorphous concept, but is generally seen to encompass (i) those areas of utility activity directly related to interactions with consumers (e.g. information provision, standards of service, consumer redress), and (ii) areas of utility practice which intersect with environmental and social policy (Swann, 1988). Social

regulation involves, in some instances, the placing of duties on the public utilities, which if left to their own commercial devices they would not necessarily choose to undertake; these are sometimes described as "community service obligations" <sup>3</sup>. The demarcation between economic and social regulation is not clear-cut, nor should it be; for in practice the two dimensions of regulation are intertwined. An example of this can be found in the way that utility prices and standards of service are invariably linked.

Social regulation has become a primary theme in US regulatory practice over recent years (Kling, 1988; Swann, 1988); and its emergence as "new style regulation" (Swann in Button & Swann, 1989) has been directly attributed to the failure of economic regulation alone, to promote societally-important objectives:

*Initially, economic regulation was introduced for genuine public interest reasons with the intention of combatting specific distortions in the economic system. It was seen at various times as a measure capable of dealing with such diverse problems as monopoly exploitation, environmental damage, inadequate service provision, excessive competition, and potential health hazards. One of the reasons..for the retreat from this position has been the realization that regulation of prices and market entry is a blunt and indirect instrument for ameliorating such problems. With the retreat from economic regulation has come the need to develop alternative, more sensitive policy tools to tackle these problems directly.*  
(Button & Swann, 1989, p.325)

Regulation premised on an explicit recognition of the social and economic characteristics of water and energy services must perforce move beyond the relatively circumscribed terrain set by classical welfare economists, who have thus far dominated the debate on public utility organisation and regulation:

*The creation of regulatory agencies was bereft, as the Americans would say, of policy analysis. Not, note, bereft of academic advice. But the advice supplied, notably by Professor Stephen Littlechild, now himself the Director General of the Office of Electricity (sic!), has come from a*

*single discipline, economics, and had a dogmatic, prescriptive, rather than analytic flavour.* Walker (1990) p.150

Consideration of the equity implications of general utility policy, and of the distributional impact of utility industry re-structuring more particularly, have been, by and large, only cursorily addressed in past work in the field using orthodox methods of economic analysis. This neglect of the social dimension is hardly a recent phenomenon, as evidenced by Bradshaw's conclusion (written in 1983) that an "...underlying theme of energy policy-making has been that 'sensible' energy policies should not be adapted to serve social purposes".

In part, this derives out of the fundamental nature of the 'frame of reference' used in welfare economics; where equity considerations are either seen to be incompatible with efficiency imperatives (e.g. Demsetz, 1989), or at best, problematic and requiring some form of 'trade-off' between efficiency and equity objectives (e.g. Vining & Weimer, 1990; Le Grand, 1991). Helm in an essay on "The Economic Borders of the State" in the *Oxford Review of Economic Policy* encapsulates the poverty of welfare economics theory when he states, that "[on] all the really interesting distributional questions, however, neo-classical theory is silent" (p.xxii).<sup>4</sup> Le Grand (1991) concludes similarly, if less categorically, when he says:

*Equity considerations have often sat rather uneasily within the discipline. Although much of the literature on welfare economics currently brackets equity with efficiency as one of the principal aims of policy, it is almost invariably efficiency that receives the lion's share of the analytic attention.* p.176

In his essay on *Equity and Choice* (1991), Le Grand directly challenges the common belief that public policy-making is inevitably confronted with the problem of achieving

a balance between efficiency and equity objectives. The 'trade-off' question is in Le Grand's view a *non sequitur*, for equity objectives, in the sense of promoting distributional fairness and justice, are of a different normative order to those relating to efficiency. Efficiency, in the sense of optimising the deployment and use of scarce resources, is a means to the achievement of major social ends, of which equity is one:

*..efficiency can be defined only in relation to the ability of forms of social and economic organization to attain their primary objectives and therefore efficiency cannot itself be one of those primary objectives..Efficiency is not an objective in the sense that equity is an objective; rather it is a secondary objective that only acquires meaning with reference to primary objectives such as equity. p.29*

Goodin (1988, pp.247-255) makes a similar argument when he defines efficiency as "an instrumental means" of achieving the "meta-principle of want-satisfaction".

In a powerful assault on what she describes as the "new regulatory economics", the former commissioner of the Colorado Public Utilities Commission, Edythe Miller (1990, pp.728-30), calls for the interweaving of efficiency and equity principles in public utility regulation. The substance of her critique of how the concept of efficiency has been conventionally applied in regulatory economics is worth quoting at length:

*The failure of vision..stems, however, from the narrow focus of contemporary orthodoxy upon efficiency, to the exclusion of equity considerations. The question of power is one of relative standing in the social and economic hierarchy. A view of humans strictly as resources to be optimally allocated to their "highest" uses is a mechanical perspective that leaves out of account such complex questions..*

*The idea of public interest should not be narrowed, but broadened, and the use of collective action in its service reintroduced.. Today, collective action is seen simply as interference. Moreover, it is seen as interference that can result only in intrusion or encroachment, and never as restraint on the acts of the bully on the block..*

*Moreover, efficiency should be seen in its systemic as well as in its individualistic sense. In its systemic sense, efficiency has to do with*

*socially provided foundations and connections, the social and economic underpinnings and framework of a society that gear it to work for its members, that discourage fragmentation and polarization, for example, and encourage participation, interaction, and coordination; that enhance the links between humans that are the essence of humanity itself.*

An approach such as this, which explicitly identifies public utility policy and regulatory practice as a site for the enactment of equity outcomes on a collective and individual scale, extends the frame of analysis well beyond the usual one-dimensional formulations of productive and allocative efficiency, and bland definitions of a generic consumer interest. Among other things, it requires a recognition of the fact that traditional injunctions towards efficiency may disguise policies and actions which foreclose access and choice for consumers, and certain groups of consumers in particular <sup>5</sup>. It also presents a challenge to the utilitarian view, which pervades much of the literature on the subject, that domestic consumers are more or less an homogeneous 'class', with unitary interests and common bargaining power <sup>6</sup>. Attention to the 'social division' of utility goods is all the more important under changing conditions, for as the National Consumer Council (1989, p.19) cautions:

*The introduction of competition, and changes in the regulatory regime, will alter the balance of power between..groups of customers, as well as between customers in general and other groups.*

The discussion of regulation in this Chapter is premised on a recognition of the importance of questions of social distribution, in addition to consumerist and efficiency considerations, in the formulation of public utility policy.



## PART 1: MODELS OF PUBLIC UTILITY REGULATION

Regulation is viewed, almost unanimously, as an inevitable structural concomitant of natural monopoly industries. Even in the outer reaches of economic liberalism, a form of regulatory oversight of natural monopoly utilities is seen as necessary; if only until such time as more functional competitive mechanisms can be introduced into these areas of the economy (Veljanovski, 1989a, 1989b). Much of the substance of the debate over regulation and the public utilities lies not around the question of whether regulation *per se* is required, but rather around 'second order' issues such as, the most appropriate form that regulation should take, and the scope that should be given to regulatory intervention. And, intertwined yet distinct, are an additional set of issues relating to the efficacy of different models of regulation and the problems implicit in the regulatory task.

Most definitions of regulation tend to focus on its negative, restrictive function, for example, "the imposition of controls and restraints and the application of rules" (Button & Swann, 1989, p.3), or "prevent[ing] 'abuse' of market power" (Glynn, 1988). But whilst the 'power to constrain' is unequivocally a central element of regulation, the exercise of regulatory influence can also encompass more positive dimensions. Along with setting and enforcing the parameters for commercial behaviour, regulation can act *inter alia* to provide financial stability for the utility industries, to create opportunities for industry development and innovation, to extend the scope of consumer power, to promote access and equity in the provision of utility services, and to stimulate industry-wide 'best practice'; all of which serve the long-term interests of both the utilities and their consumers alike.

Additionally, regulation can contribute to strategic management of vital infrastructural resources. Without some measure of policy overview and direction via the regulatory machinery, the operation of the utility industries is likely to be characterised by disparateness, conflicting objectives and insular commercial behaviour premised on short-term planning horizons. Under this latter scenario, public utilities are unlikely to be able to respond to the macro-economic, social and environmental imperatives implicit in the contemporary and future management of water and energy resources.

As a system of controls and inducements, designed to optimise the economic, social and environmental performance of the public utilities, regulation can take a number of forms. The figure below presents a 'regulatory continuum', which illustrates the range of regulatory options; each of which demands a different level of public policy intervention in the activity of the utility industries. It is unlikely, however, that all of the five options will be equally efficacious in achieving economic and social objectives.

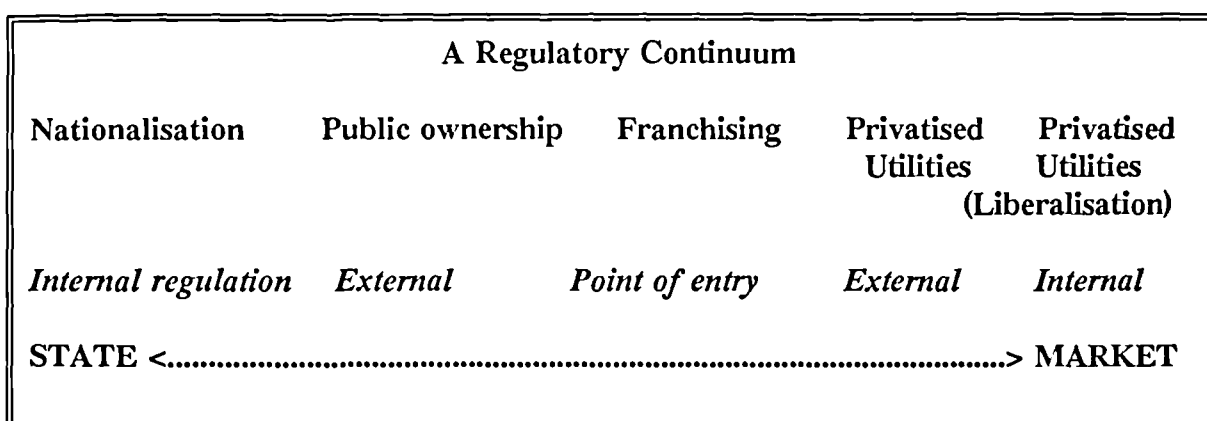


Figure 3.1: A Regulatory Continuum

The classical dichotomy between state control and market freedom is found at the ends of the continuum, with the other three forms of regulatory structure occupying an intermediate position between these two extremes. Each of these will be briefly considered in turn.

While they are structural opposites, the nationalised and free market forms of public utility organisation have one feature in common; namely, their reliance on what might be described broadly as 'internal' systems of regulation. In the case of nationalised utility industries, this will be in the form of direction and monitoring by the relevant minister and sponsoring department (i.e. effectively by the owners of the industries); whereas in the utility free market situation, regulation - beyond the conventional structures for the enforcement of competition and "fair trading" law - would occur through the 'natural' workings of the competitive market place (i.e. by the owners, competitors and consumers).

(i) Deregulation

In a substantive sense, because of its focus on the self-regulating behaviour of the industries themselves, the free market option might more accurately be viewed as a form of 'deregulation' rather than regulation. It is important to recognise though, that in the context of natural monopoly utilities, it contains an inherent contradiction. For as it is fundamentally premised on the existence of active competition, the free market approach is likely to be singularly incapable of responding to the regulatory challenge

of natural monopoly industries, where competition is, to all intents and purposes, non-existent. Nor, arguably, is its intuitive reliance on the power of unfettered market forces to balance the supply and demand for utility services, consistent with the particular characteristics of these services themselves i.e. their 'merit goods' status, their inelasticity of demand aspects, their strategic importance, and the existence of externalities.

But, in the view of advocates of the de-regulated model, most of these constraints are more transitional than permanent in character. The natural monopoly constraint on competition, in particular, is seen as a transient shackle which could be broken through the dismantling of utility functions (e.g. the separation of distribution and supply) and through the use of new technologies such as electronic metering. In this context, regulation is perceived as a necessary temporary measure, designed to facilitate restructuring and competition. Having achieved this, it should then wither away. This view is shared, to some extent, by a number of the utility regulators themselves:

*..when change is managed properly there need be no fears and if regulation is seen as a process for managing change it should be welcomed as a temporary phenomenon. We at OFGAS see regulation in that way and we aim to get out of the way of business operations as soon as a self-sustaining competitive market gets on its feet. We will measure our success by the speed with which we can withdraw from situations where competition is developing. Director General's Statement (OFGAS, 1992) p.8*

*My job is to promote competition where it is feasible and sensible to do so, bearing in mind that it was not possible at the time of privatisation to move in a single step from a state-owned monopoly to a privately owned, fully competitive industry. My task is therefore to help complete this transition: not merely to monitor competition but actively to promote it. Littlechild in Veljanovski, ed. (1991) p.108*

(ii) Regulation and public ownership

As a mechanism for gaining maximum policy leverage over the utility industries, **nationalisation** appears to have a significant advantage over most alternative systems of regulation. Yet, as the history of nationalisation in Britain shows (see Annexe 1), the public utilities have been generally characterised by a domination of producer interests over those of consumers and an acute vulnerability to the shifting policy preferences and financing rules of successive governments. These features have been seen as major inhibitors of industry performance and as a barrier to successful regulatory management of the industries. Helm et al (1988, p.58) underline this when they state:

*Though it has been thought that nationalisation 'solves' natural monopoly by replacing profit maximisation by the pursuit of social welfare, it must now be relatively uncontroversial to claim that it in fact 'solves' very little in itself. The naive view which dominated thinking in the early post-war period was clearly mistaken, and the painful attempts at control in the 1960s and 1970s reinforced this observation. Only effective regulation can mitigate the abuse of natural market dominance.*

As a result of the apparent failure of nationalisation as a system of utility regulation, academic and political attention internationally has been increasingly directed towards the three forms of regulation occupying intermediate positions on the continuum in Figure 3.1. While the *privatised industry - external regulator* option has attracted the most interest (particularly in Britain and North America), the other two options represent potentially viable regulatory alternatives. However, as neither has immediate relevance to the current regulatory environment in Britain, and as they are usually articulated in quite imprecise terms, they will only be referred to in passing here.

The notion of building a system of external regulation onto the framework of **publicly-owned and managed** utility industries has become a significant part of the Left's reconceptualisation of public ownership in contemporary Britain. This is reflected in the Labour Party's policy review documents in the early 1990s (i.e. *Looking to the Future*, *An earthly chance*, *Labour: Opportunity Britain*, *Labour's better way for the 1990s*). Figure 3.2 overleaf provides a synopsis of the main features of Labour Party policy related to the public utilities.

In the view of its proponents this revised approach represents much more than the simple grafting of a form of independent regulation onto the old nationalised utility industry structure. In combination with the introduction of an integrated and more powerful set of regulatory agencies (i.e. a Consumer Protection Commission and an Environmental Protection Executive), it is envisaged - albeit in rather vague terms and only in relation to water - that the utilities would operate in a more publicly accountable way than they have in the past (under a form of regional government), and with a far greater consciousness of consumer interests. Essentially, the *public ownership with external regulation* model seeks to find the public interest and consumerist middle ground between producer-oriented nationalised utilities and profit-oriented private utility companies.

Other variants of the public ownership model of utility management and regulation can be found in the small-scale municipal or community-owned public utility enterprises advocated by Sloman (1978) and Jones (1992), amongst others. Interestingly, the privatisation of the electricity supply industry - in particular the separation of generation,

distribution and supply and the provision for "second tier licences" - potentially provides significant openings for the development of local-level, community-managed alternatives to monopoly provision, in the form, for example, of combined heat and power and district heating schemes.

*Looking to the Future (1990):*

- \* **Water:** - restoring public ownership (no indication of how this will be implemented!), under control of regional authorities p.17
- \* **Consumer Protection Commission** (amalgamating current regulators, with stronger powers) pp.17; also see *An earthly chance* p.22
  - consumers charter p.23
  - utilities 'customer service contracts' (including no disconnections without court order & none at all if young child or elderly person in household) p.23

*An earthly chance (1990):*

*Extensive regulations are required to supervise natural monopolies such as the utilities to ensure that they are harnessed to the achievement of environmental goals and are serving the consumer. p.10*

*Social considerations must be built into energy policy from the start. Putting up energy prices so that the elderly and vulnerable could no longer afford to keep warm might help reduce pollution but is unacceptable on social grounds. p.22*

- \* **Environmental Protection Executive** p.17
- \* **Energy privatisation & commitment to taking over National Grid** p.22
- \* **Water privatisation & commitment to public ownership** p.27

*Labour: Opportunity Britain, Labour's better way for the 1990s (1991):*

*We will also establish a Consumer Protection Commission to cover all utilities, in both public and private ownership, with divisions for transport, energy, water and communications. It will monitor prices, quality and service provision, giving firm backing to consumers who have been treated unfairly and who find themselves in dispute with the utilities. The commission will report annually. p.27*

*The House of Commons must also have the power, through a new Select Committee, to examine and monitor the performance of these industries and to call management to account for pricing and service decisions. p.27*

**Figure 3.2: Labour Party policy on the public utilities**

### (iii) Franchising

The concept of **franchising** can be viewed as both an alternative to the conventional ownership dichotomy of 'public' and 'private' (for it can involve elements of both), and as a substitute for continuous external regulation. Franchising was originally advocated by Edwin Chadwick in the mid-nineteenth century (Weimer & Vining, 1989, p.130) as a means of introducing a measure of competition into natural monopoly industries, which he termed "competition for the field" (as opposed to "competition in the field"). In its simplest terms, franchising is analogous to competitive tendering, where potential utility services suppliers compete to gain the contract for monopoly supply within a given geographical area. In contrast to orthodox competitive tendering however, the utility services contract is awarded not on the basis of the sum each competing company is willing to pay for the franchise, but on the basis of "..the prices that the franchisee would charge and the services the franchisee would provide the public on award of the right to be the exclusive seller" (Hanke, 1989, p.199). The franchise would be awarded for a set period of time, and after the expiration of this period, the open competitive tendering process would be, theoretically at least, re-activated.

In the mind of its most influential contemporary supporter, Demsetz, the advantages of franchising are that it provides an alternative to publicly-owned natural monopolies and that uniquely, it virtually eliminates the need for on-going public regulation and confines the regulatory exercise to those occasions when the franchise is being re-issued (see, for example, Demsetz, *Why Regulate Utilities?*, 1989). <sup>7</sup> Dnes (1989) characterises



franchising as "...the state setting the rules of an appropriate market place for natural monopolies".

However, franchising also offers scope for pursuing a joint public ownership-private provision approach to the management of utility services. Under this scenario, the capital infrastructure (e.g. the pipes, drains, treatment plants etc. in the case of water) would be publicly owned, with the operational management and supply function being awarded to the private firm that could provide the service at the best quality/price combination. This would also obviate the major problem implicit in franchising of dealing with 'sunk costs' and capital investment (see, for example, Roper & Wright, 1987, pp.165-70; Vickers & Yarrow, 1988, pp.111-114; IAC (1989) p.F-27, for a discussion of this and other problems with franchising, such as the specification and monitoring of contracts). A variant of franchising, as a mix of public ownership and private management, is used in the water industry in France.

The Major Government's plans for privatising British Rail, as outlined in its White Paper published in July 1992 (Cm 2012), are partly framed around the franchising model. It is proposed that passenger services will be run by private companies, operating under franchises issued by the new Franchising Authority, with the rail infrastructure being retained in public ownership under the aegis of the new track authority, Railtrack. The franchises issued to private passenger service operators will contain specific standards of service targets, including an obligation to meet the requirements of the Passengers Charter (devised as part of the *Citizen's Charter* reforms). However, it is

clear from the White Paper that the Government views franchising as merely an intermediate step on the road to full privatisation of the British rail system:

*In the longer term the Government would like to see the private sector owning as much as possible of the railway. Powers will therefore be taken to allow the future privatisation of all BR track and operations.*  
Department of Transport (1992) p.4

Franchising has also been identified as a possible option for the restructuring of the Scottish water industry, in the consultation paper published by the Government in mid-November 1992 (*The Guardian*, 18/11/92).

#### (iv) The British Model of Regulation

The recent British model of utility regulation, involving the establishment of an independent regulator's office (with government department status) to supervise the operation of **privately-owned** utility industries, has been developed through the selective adaptation and, in a number of key respects, the substantial modification of traditional American systems of utility industry organisation and regulation.

The American experience of utility organisation - with its private ownership/public regulation configuration <sup>8</sup> - has patently influenced the British Conservative Government's thinking with respect to the re-structuring of the water and energy industries. Yet the development of the regulatory framework, in tandem with the de-nationalisation of the utilities, has departed in a number of significant ways from American practice. These departures represent, to borrow a phrase from Sir Geoffrey

Howe's influential attack on the late Thatcher Government, differences of both *substance and style*.

The promotion of competition and the control of monopoly profits are the building blocks of economic regulation of the public utilities, and one of the more fundamental differences between the British and American systems is the way that the financial and pricing structure of the industries is regulated. In Britain, a price-based formula tied to the retail price index and making provision for efficiency savings - i.e. RPI-X - is employed as the principal device for ensuring that the utilities are not exploiting their monopoly power, while at the same time providing an incentive for productive efficiency. In contrast, American regulators have conventionally used rate of return ("cost-based regulation", Vickers, 1991) as the vehicle for controlling utility profits and pricing. Littlechild (1988) describes the system as follows:

*Under the US system, a regulated company that wishes to change its tariff puts forward a proposal to the regulatory authority. The total revenue which the proposed prices are expected to yield is compared with the total revenue requirement. The latter is defined as operating expenses plus depreciation plus allowed rate of return on capital. p.55*

Rate of return controls had previously formed part of the British government's financial management of the nationalised industries (Crew & Kleindorfer, 1979), and this may have been partly instrumental in the Thatcher Government's rejection of rate of return as an appropriate system for the regulation of the privatised utilities. Of even greater significance perhaps was the generally acknowledged limitations of rate of return (or 'cost plus') regulation (see Carney, 1991 for a summary of this critique). In particular, rate of return regulation is seen to provide no in-built incentive for efficiency or the

reduction of costs, and because it is directly based on return on capital, it is said to encourage profligate capital expenditure (described as the 'Averch-Johnson effect').

In contrast, the strengths of the Littlechild price cap formulation are seen to lie in the fact that (a) it acts as a stimulus to productive efficiency both through the operation of the *X* factor (where the utilities are required to reduce prices at a rate normally below the level of inflation) and because the regulated companies are allowed to retain as profits any efficiency savings made in addition to the designated *X* target, and (b) that it is neutral on the question of capital expenditure.

In practice, however, the delineation between these two approaches to economic regulation has been nowhere as clear cut as it appears in theory, and over time the British regulators appear to have increasingly applied rate of return calculations in their analysis of the financial and pricing structure of the utility industries. The methodologies used by OFGAS in the 1990-91 review of the gas tariff formula and OFWAT in the upcoming Periodic Review, illustrate the importance that the regulators attach to the question of what constitutes an appropriate rate of return for the regulated utilities (see Chapter 6). This serves to reinforce the scepticism of a number of commentators about the extent to which the British price control instrument differs markedly from the much-denigrated American approach (e.g. Helm et al, 1988; Weyman-Jones, 1990; Vickers, 1991; Stelzer, 1991).

As was seen in Chapter 1, the attention given by the Government to the regulatory framework of the utility industries appeared to accelerate with each successive privatisation. And indeed this 'filling in' of the detail of the regulatory regime continued after the completion of the privatisation schedule for the three utilities, with the enactment of the *Competition and Service (Utilities) Act (CSUA)* <sup>9</sup>.

A developmental approach to the elaboration of a regulatory system more directly relevant to the monopoly conditions under which the utility industries operate (at least as it applies to 'captive' domestic and other consumers), might be seen as a conscious expression of a pragmatic and incrementalist philosophy of policy-making, where the learning of the past informs the practice of the future. Alternatively, it could be viewed as a belated attempt to compensate for the deficits of earlier policy-making. In this latter vein, Vickers (1991) adjudges the supplementation of regulatory powers in the later privatisations and beyond as evidence that the Government underestimated the problems of market failure in the utility industries.

In terms of their scope, the powers progressively ceded to the regulatory bodies in the privatisation legislation and in the *Competition and Service (Utilities) Act 1992 (CSUA)*, look broadly similar to those that are available to the regulatory commissions in America. The energy and water regulators in Britain have strong residual powers in relation to economic regulation and weaker, but still potentially quite potent, leverage in the area of social regulation. Figure 3.3 overleaf sets out a schema of British public utility regulation, indicating the domains and instruments of the regulatory system in this country.

REGULATORY DOMAINS	REGULATORY INSTRUMENTS	SOURCE OF POWERS
<p><u>ECONOMIC REGULATION:</u></p> <ul style="list-style-type: none"> <li>* Competition</li> <li>* Financial viability of companies</li> <li>* Efficiency</li> <li>* Capital investment</li> <li>* Price protection (monopoly sectors)</li> <li>* Diversification - protection of core business</li> </ul>	<p>Policing &amp; promoting restructuring &amp; market entry, 'Yardstick competition', Price controls/Tariff review            Price controls/Tariff review            Monitoring regulatory accounts            Price controls/Tariff review            Monitoring regulatory accounts</p>	<p>Legislation (primary &amp; CSUA)/licence            Licence            Licence            Licence            Licence            Licence/legislation (CSUA)</p>
<p><u>SOCIAL REGULATION:</u></p> <ul style="list-style-type: none"> <li>* Obligation to supply</li> <li>* Service quality</li> <li>* Protection of "vulnerable consumers" e.g. elderly, disabled</li> <li>* Tariff protection for rural consumers</li> <li>* Debt &amp; disconnection</li> <li>* Consumer representation</li> <li>* Occupational health &amp; safety</li> <li>* Quasi-environmental protection e.g. energy efficiency</li> </ul>	<p>Determinations            Performance standards/complaint handling/Tariff reviews              Codes of Practice            Price controls            Codes of Practice            Consumer committees              Codes of Practice/performance standards</p>	<p>Legislation            Legislation (primary &amp; CSUA)/licence              Legislation/licence            Legislation/licence            Legislation/licence            Legislation            Legislation            Legislation (primary &amp; CSUA)/licence</p>

Note: A few of these provisions are not applicable to all three regulatory bodies

Figure 3.3: A schema of British public utility regulation

There are, however, six major features of the British system which sets it apart from the regulatory structures in America, namely (a) the importance attached to competition, (b) the functions ceded to the regulators in respect to industry policy and capital investment (c) the primacy given to shareholder interests, (d) the informal and discretionary nature of the regulatory system, (e) the emphasis on personality, and (f) the closed structure of regulatory decision making. Each of these are briefly considered below.

*(a) Competition*

Somewhat ironically, the British approach directs greater attention to the pro-competition function of the regulatory agencies than appears to be the case in America. Despite their long history of public regulation of privately-owned utilities, and the claim of Stelzer (1991, p.60) that the "US favours competition", the Americans have only recently begun to examine how greater competition might be introduced into the gas and electricity industries. The ostensible heterogeneity of the public utility structure in the US, with its mix of publicly- and privately-owned utilities, is deceptive, for to all intents and purposes the utilities operate as geographical monopolies. The restructuring of the ESI in Britain and the explicit powers given to the Director General of Electricity Supply to facilitate the development of competition across the primary sectors of the industry - including the eventual dismantling of geographical monopoly provision for all consumers - have no extant equivalent in the American regulatory environment. And the injunctions on the Director General of Water Services to extend competition where possible in the

highly naturally monopolistic terrain of water services look positively radical by comparison with the situation in America.

*(b) Industry policy and capital investment*

The planning and investment decisions of the public utilities impact not only on the quality of utility services provided directly to consumers, but they have substantial 'ripple effects' throughout the economy as a whole. Equally, the issue of continuity and security of supply of energy and water supply involves important questions of national interest. In addition, decisions taken about current and future methods of producing and distributing electricity, gas and water often have major environmental implications.

None of these macro-effects necessarily makes the effective development of utility policy incompatible with a structure of private ownership. But, at a minimum, they underscore the need for a strong Government policy framework for the industries, coupled with vigorous and far-sighted public regulation.

The capacity of the existing regulatory framework in Britain to deal with these broader policy issues, as opposed to narrow economic regulation (based around prices and competition), is still largely to be determined, but the industry regulators, in general, have been ceded extremely muted powers in this important domain of public policy.

The Government's rejection of a substantive role for the regulatory agencies in utility industry policy and development was illustrated, at the outset, in their refusal to admit the North American device of 'least cost planning' into the regulatory arena. Since the



middle of the 1980s, least cost planning has been adopted by the majority of American state regulatory commissions as a mechanism for encouraging a longer-term planning approach by the energy utilities (Berry, 1992):

*New economic institutions are currently evolving in the electric utility industry to expand the scope of long-range planning. Regulatory commissions have spurred this evolution through requirements for least cost planning that take into account improved load forecasting, conservation and other demand management measures, consideration of alternative technologies for supplying electricity such as solar power, and the environmental impacts of power production and consumption. p.783*

In Britain, the emphasis on competition and market forces as the drivers of energy policy, in combination with the operation of the price control formula (which unlike rate of return regulation, gives the regulatory bodies little formal scope for adjudicating on the capital structure of the industries) has meant that the electricity and gas regulators have only limited and indirect leverage over the investment and demand management practices of the energy utilities. While the water regulator has been given a more significant role to play in supervising the large capital works programme in the water industry, this role is primarily confined to a monitoring and auditing function (i.e. ensuring that the companies are meeting their specified capital investment targets), rather than involving an active and leading contribution to water services policy.

The limited policy function of the regulators, in tandem with the amorphous role of the executive and legislative branches of government following privatisation (made more so by the abolition of the Department of Energy and the Select Committee on Energy <sup>10</sup>) suggests that there is a very real danger of a deep and destructive policy vacuum being created in the field of utility services in Britain.

*(c) Priority to shareholders*

It was shown in the previous chapter that the model of regulation constructed in Britain gives clear and unambiguous **priority** - in statute at least - to the interests of utility company **shareholders**:

*..to secure that licence holders are able to finance the carrying on of the activities which they are authorised by their licences to carry on  
Electricity Act 1989 s.3(1)(b)*

*..to secure that companies holding appointments..are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of the functions of such undertakers  
Water Industry Act 1991 s.2(2)(b)*

The regulators' duties with respect to the protection of consumers are secondary and subject to the fulfilment of primary duties such as those cited above. Under the American system, regulators are mandated to seek a balance between shareholder and consumer interests, "to ensure reliable service at just and reasonable rates" (O'Leary & Smith, 1989, p.224). The thrust of the American approach is outlined by two Commissioners on the New Mexico utility commission:

*Regulators understand their duty to balance the interests of rate-payers [i.e. utility consumers] and shareholders when making a decision. They understand they have an economic function to set price, but they act in an environment of inputs, constraints, and concerns that are not economic in nature..in performing the task of balancing the interests of the ratepayer and the investor, [the regulators] are responding to the mandate given them by their state legislators. This mandate of "balancing" implies that the criterion of fairness be considered. This objective may not make it possible for the economic criterion of efficiency to be achieved.*

O'Leary & Smith in Nowotny et al eds. (1989) p.224

In contrast, the British model requires the regulators to give primacy to shareholders in the event of conflicts of interest arising between the stakeholders in the utility industries. In this sense, regulation for consumer protection has been treated very much as a secondary and contingent dimension in the structure of utility regulation in Britain.

While the "just and reasonable" test used by American regulators is manifestly subjective and open to quite different interpretations (and hence has been criticised on the grounds that it gives rise to regulatory uncertainty), it does provide a means of building equity and distributional considerations onto the framework of utility regulation, and it has apparently been used in this way by some utility commissions in America.

In addition to a requirement to give precedence to shareholder interests, the British regulators are bound by the stricture that no "undue discrimination" or "undue preference" be given to particular classes of consumers in the fixing of tariffs. This has the effect of circumscribing the scope for regulatory intervention aimed at assisting groups of consumers who experience specific problems in accessing, or maintaining access to, utility services and it effectively forecloses the option of pursuing equity objectives as a part of regulatory policy-making.

Theoretically, an attempt by one of the regulators to intervene in this way would be open to legal challenge; although the position of the courts in Britain on "undue discrimination" is largely untested and ambiguous (Sharpe, 1992). Certainly, the prospect of a legal challenge is likely to have the effect of deterring the regulatory bodies from taking action which positively discriminates in favour of low income consumers,

irregardless of the equity merits of doing so. This was evidenced in the Director General of Gas Supply's position on the use of funds generated through the 'E factor' in the British Gas tariff review (see Chapter 6).

It can be seen in Figure 3.3 above, that the regulators have a duty to give particular attention to the needs of certain sections of the population - namely elderly and disabled consumers, and in some instances, customers living in rural areas. Although action on behalf of elderly and disabled is also limited by the "undue discrimination" in tariffs constraint, this statutory mandate gives the regulators a formal point of leverage over the utility companies on their policies and practices vis-a-vis these groups of consumers. If these provisions were introduced on the basis of 'vulnerability' and special needs, it could be argued, from an equity perspective, that low income customers generally should have been included under this protective net (Fitch, 1992). Measures to include similar provisions for low income consumers in the *Competition and Service (Utilities) Bill* in 1991-1992 were rejected by the Government (see Chapter 7).

*(d) Emphasis on informal processes and discretion*

Despite the scope for the use of discretion in determining "just and reasonable" rates, the US system of regulation is highly formalised, rule-bound and legalistic in its approach to regulatory decision making (Stelzer, 1991). By comparison, the British model of regulation is seen to be rather more informal, fluid and discretionary in character. Indeed in the view of one commentator at least, the British approach stands

the danger of "evolving into an informal system of rule-making which operates through negotiation and bargaining in the shadow of the law" (Veljanovski, 1991, p.9).

The distinguishing ambience of the British regulatory system arises firstly, from the largely non-statutory mechanisms used to regulate the privatised utilities and secondly, from the highly personalised style of regulation that has been employed.

Although the privatisation legislation, and more latterly the *Competition and Service (Utilities) Act*, provide the structural outline of regulation, much of the working machinery is to be found in secondary legislation (regulations) and most importantly, in the licences issued to the utility companies. But even the licences do not provide the sort of operational detail needed to build a functioning regulatory system, and much of this has had to be established *in situ* by the regulators themselves. Following Swann in Button & Swann (1989), the British approach might be defined as essentially *de facto*, as opposed to *de jure*, regulation; with its absence of a precise statutory framework and its attendant reliance on quasi-legal instruments and negotiation.

The fact that, under the British model, the regulators have considerable room for manoeuvre and scope to determine much of the shape of the regulatory regime is likely to be both a strength and a weakness. The substance of its strength resides in the ability of the regulators to shift the focus of regulatory attention into fields not originally envisaged, or overlooked, by the Government at the time of privatisation, and to quickly adapt to changing circumstances and conditions. There is evidence that this has happened, to the benefit of domestic consumers, in the regulation of the gas industry,

and some initial indications that this may happen in the water industry as well (see Chapters 6 and 7). The excursions of the regulators into domains beyond those originally included in their orbit has led to claims that the regulators have breached the terms of the "regulatory bargain" struck between the government and shareholders at the time of privatisation (Veljanovski, 1991).

The primary weakness of the discretionary, evolutionary model of regulation lies in the fact that the rules and decision-making criteria can be opaque, elusive and ever-shifting; with a consequential negative effect on 'due process' and a denuding of the ability to externally monitor regulatory activity. It can also give rise to arbitrary styles of regulatory policy making. This interacts closely with the issue of style.

*(e) Personality-driven model*

At the level of **style**, the British model of regulation differs most notably from its American progenitor in its reliance on, what could reasonably be described as, 'personality-led regulation'. In other words, much of the focus, and certainly the character, of the public bodies set up to regulate the privatised public utilities in Britain, imitates the persona of their respective directors.

The general *modus operandi* of the Office of Gas Supply, Office of Water Services and Office of Electricity Regulation - which simplistically might be categorised as confrontation, suasion and laissez faire respectively (see Chapters 6 & 7) - mirror the interventionist philosophies and personalities of their Directors General at least as much

as the different structural arrangements and environmental conditions of the three utility industries concerned <sup>11</sup>. This contrasts with the way that the state public utility commissions operate in the US, where the legal and structural framework of regulation practice, rather than the predilections of individuals, determines the shape and substance of regulatory control. In America, of course, the apex of the regulatory agency is usually occupied not by one individual but by a number of elected or appointed commissioners.

The emphasis on personality in the emerging British model of regulation may reflect the relative novelty of external regulation in British public policy and hence be simply a transitional phase. Thus in line with a Weberian thesis of organisational development, the charismatic/individual leadership model of regulation may shift over time towards a more formal and institutionalised approach. Or alternatively, as Walker (1990) hypothesises in his amusing article *Enter the Regulators*, it may have arisen as a result of the imprecise brief given to the first generation of utility regulators, as well as being somehow consistent with the way things have been traditionally done in the British polity <sup>12</sup>. 'Regulation as individual rather than system' might also have been seen as somehow more expressive and symbolic of the independence and autonomy of the regulatory regime. Whatever the reason, the individually-centred nature of the regulatory system is enshrined in the original legislation:

*The Acts of Parliament which carried out the privatisations and established the powers of the regulatory agencies lay the various duties upon the Directors of the various industries [sic] and not upon the regulatory agencies as corporate bodies. Each agency is there to assist the Director and not legally to share in the decision-making process.*  
HoC Library Research Division (1991) p. 1

Clearly, to be effective, regulation needs to be a dynamic and adaptive process, with scope being given to the regulatory body to make changes in the regulatory regime in line with changing conditions and with strategic shifts in the behaviour of the regulated companies. Swann (in Button & Swann, 1989, p.7) implies as much when he says:

*Regulatory structures tend to be capable of considerable flexibility of interpretation, and their actual impact in particular cases is very much in the hands of the regulatory agency..Because of this, de facto regulation may change even though the regulatory statute (the de jure element) may not have been modified.*

Yet whether this should involve the centralisation of regulatory decision making power around individuals to the extent that has occurred in Britain is another matter. The highly personalised style of the utility regulatory structures is likely to mean that the system of controlling and monitoring the behaviour of the privatised utilities will be idiosyncratic, and even arbitrary. The individualistic style of the regulatory machinery will invariably lead to problems of succession, with possibly disruptive philosophical shifts in emphasis following a change in regulator.

It could also act to constrain public access to, and understanding of, the arcane workings of the regulatory system and might create "some worrying gaps in the lines of public accountability" (Walker, 1990, p.158). There is a particular danger of this happening in the relatively closed decision making environment of British utility regulation.



*(f) Closed structures for regulatory decision-making*

In America, a quasi-judicial process, involving public hearings and formal opportunities for consumer input and advocacy, is used for determining pricing and other major regulatory decisions (Waterson, 1988; Stelzer, 1991):

*In all cases the PUC [State Public Utility Commission] reaches a decision after a series of public hearings, in which the utility must present its case, and at which intervenors can present countervailing views, and indeed can cross examine the utility representatives. This process allows consumers, either directly, or more commonly through their representative bodies, to have a direct input into the decision making process. [author's emphasis]*  
Brown (1986) p.10

The American system has been criticised on the grounds that it is expensive, litigious and leads to interminably protracted decision making. On the positive side, however, it has clear advantages in terms of transparency of decision making and potential openness to a plurality of interests and viewpoints.

The American 'rate hearing' approach to the setting of tariffs and performance standards was spurned by the Government as an appropriate way of regulating the privatised utilities. The quinquennial tariff review process, centring around closed negotiations between the regulator and the industry, with provision for public consultation at the discretion of the regulator, was instituted in its stead <sup>13</sup>. Weyman-Jones (1990, p.70) explains the rejection of public hearings in the regulation of the electricity supply industry as follows:

*It is clear that minimizing the burden and transaction costs of regulation has been the dominant factor in the choice of mechanism for UK electricity distribution, and one of the main arguments used is the need to avoid prolonged enquiries into the nature of the utility's costs. Hence, any mechanism which required the regulator to duplicate in public the*

*cost calculation and optimization procedures of the utility has been rejected.*

The absence of a formal public arena for the determination of major regulatory policy could be offset, to some degree, by the regulator adopting an inclusive strategy on information dissemination and decision making. Though, the problem with this, as with the British model generally, is that it places an untoward reliance on regulatory fiat, for to paraphrase Beesley (1991, p.154), the reasoning of the regulators is disclosed at their choice.

On paper at least, the British model of regulation looks less substantial than that used in America. It could be argued, however, that the emphasis in the British model on informality, flexibility, discretion and expedition in decision making, might be to the ultimate advantage of utility consumers; for in the hands of the 'right' regulator these attributes could be exercised to better effect than would be the case using the more belaboured and legally constricted American approach. But the fundamental dilemma is that in its strength lies its weakness; for the British model appears to be all-too-heavily reliant upon tapping a continuous supply of dominant regulatory personalities of capacity and goodwill.

## PART 2: ISSUES AND PROBLEMS IN REGULATION

Regulation is a means of exercising social control (Dugger, 1989) over strategically important and publicly sensitive areas of the economy; and the characteristics of the public utilities are such that irrespective of the structural and ownership changes effected - including the advent of competition - a degree of regulation will always be required. The model of regulation introduced in Britain in the wake of the privatisation of the public utilities has a set of features which give it the appearance of being a rather fragile instrument for social control and consumer protection.

But even if the regulatory approach were quite different, there are a number of seemingly endogenous problems in the regulatory task, which in themselves present formidable barriers to the exercise of effective control over the utility industries.

Two of the most salient and discussed aspects of regulatory failure are the **principal-agent dilemma**, and the related problem of **regulatory capture** and these issues, central to the theory of regulation, are considered below. The best defence against the problem of regulatory capture lies in the superstructure of accountability devised for the regulatory bodies, and the Chapter concludes with a discussion of this important matter.

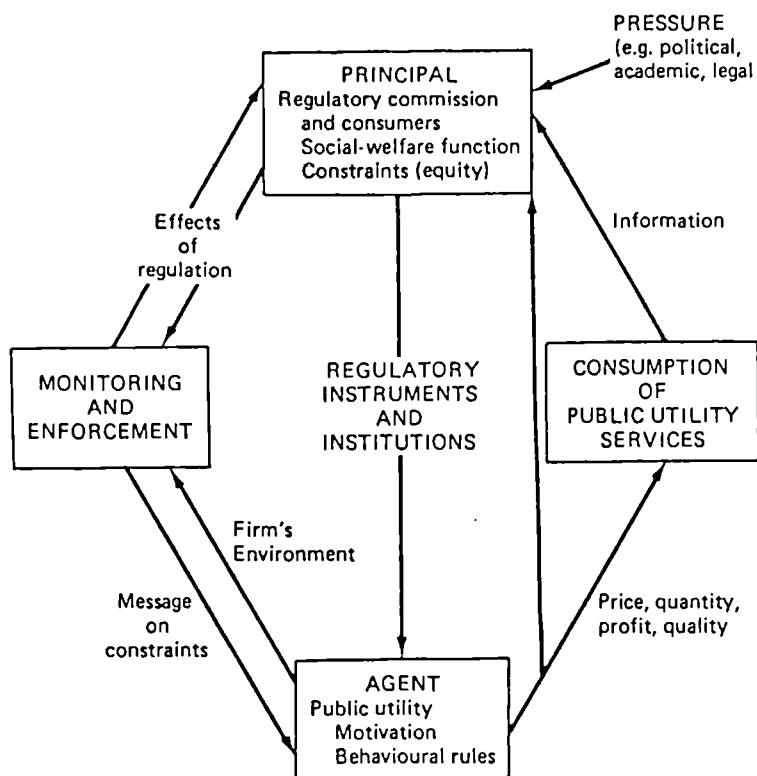
(i) The principal-agent problem

The principal-agent construct as it relates to the field of regulation was first elaborated by Crew & Kleindorfer (1979), and it attempts to provide a broad analytical framework for understanding the relationship, interaction, and points of tension and conflict between the major organisational participants involved in the production of utility services. Under normal competitive conditions, the distinction between 'principal' and 'agent' in the production and supply of goods is likely to be less important, as these functions are usually encompassed within the one organisation or firm <sup>14</sup>. However, because in natural monopoly industries there is a need to introduce a layer of regulatory control, which is separate and independent of the actual production of utility services, a clear delineation exists between the structure and functions of the 'principal' (be it a government department or a specific regulatory body) and those of the 'agent' utility industries.

In this context then, the central problem becomes one of devising a means of ensuring that the 'standard-setting principal' can exert leverage and influence over the behaviour of the 'service-delivery agent'. This is outlined succinctly by Crew & Kleindorfer (1979, p.129):

*The problem facing the principal is to choose appropriate incentives and set behavioural limits for the agent so as to balance the agent's better knowledge of uncertain states of the world against divergences in preferences between principal and agent.*

Crew & Kleindorfer (1979, Figure 9.1) have elaborated a model of the principal-agent relationship, under a regulatory scenario involving a utility commission, and this is illustrated in the figure below.



**Figure 3.4: Crew & Kleindorfer’s Principal-Agent Model**

It is apparent in the model that the regulatory body’s ability to exert influence over the behaviour of the public utility will be largely determined by its capacity to collect, and make sense, of a complex array of information about the utility’s financial and service-delivery performance. And yet it is in this domain that the regulator is likely to be at a considerable disadvantage. As Sir Gordon Borrie, the past Director General of Fair Trading has said the "problem facing any regulator is that he cannot be as well-informed as the business(es) he is regulating" (Borrie, 1991, pp.11-12).

The information asymmetry<sup>15</sup> that exists in the relationship between 'principal' and 'agent' arises, first and foremost from the utility's far superior operational knowledge of the industry; which carries with it the danger that the utility can, with virtual impunity, 'massage' the data that it is required to make available to the regulator. This is particularly likely to be the case in single producer markets, such as that presently applying in the gas industry in Britain, for as Helm & Yarrow (1988, p.v) state, "..the firm will be in a monopoly position with respect to the supply of relevant information to the regulator". The well-documented battles between the Director General of Gas Supply and British Gas over the release of information necessary for the former to carry out his regulatory functions, is illustrative of this problem. Although, according to the Director General, the flow of information from the company has improved over recent times:

*At the outset of our relationship with BG the company showed a natural reluctance to share information with us..In regard to our extensive review of the tariff price formula we are pleased to record that BG has made available information of the most sensitive kind of the type which it would never have considered providing five years ago. McKinnon (1991) pp.4-5*

In those utility sectors where there are a number of producers operating - which is the case in water and electricity - the regulators have an ability to tap multiple information sources and to carry out "yardstick comparisons" between different companies<sup>16</sup>. However, this can give rise to another set of problems related to information management and information overload.

The difficulty for the regulatory body in collecting and analysing the information it receives from sources within and outside the regulated organisation, is compounded by the fact that the field of public utility services is highly technical and complex. Another factor which contributes to the difficulties in information management is that there will inevitably be a marked inequality between the level of human, technological and financial resources available to the regulator and that of the utility companies. Figure 3.5 shows the staffing and budgets of the regulatory bodies. The number of staff employed in the three utilities over the same period was British Gas: 80,000, Water and sewerage companies: 53,000, ESI: 105,000 (rounded figures).

REGULATOR	STAFFING	BUDGET £M	NO. OF COMPANIES
OFFER	214	11.2	14 *
OFWAT	132	6.29	33
OFGAS	40	1.9	1
<b>TOTAL</b>	<b>386</b>	<b>19.39</b>	

\* Excludes generation and second tier supply licences

Note 1: Staffing - OFFER end 1991, OFGAS 1992 (post CSUA - previously 28), OFWAT end March 1992; Budgets 1991/92

Note 2: OFFER - around one-third in head office; OFWAT - around 90 in head office; all OFGAS based in central office

Note 3: In addition to their staffing establishment, the regulators also make extensive use of outside consultants.

**Figure 3.5 Resources of the public utility regulatory bodies**

The regulators' success in keeping pace with the regulated companies will also be conditioned by the expertise that they have at their disposal. Up to this point in time, the great majority of staff employed in the regulatory bodies in Britain have been from the civil service - most often from the Department of the Environment and the now-defunct, Department of Energy. Relatively few appointments have been made from within the utility industries (although there are indications that this is changing) and an even smaller number have been made from within the consumer and community sector.

Information asymmetry is identified by a number of commentators, as the underlying cause of regulatory failure, regardless of the model of ownership and regulation (for example, Weyman-Jones, 1989: UK nationalised industries; and Helm et al, 1988: US energy utilities). Significantly, Helm et al. (1988, p.57) suggest that the information asymmetry characteristic of successive British government's attempts to manage the nationalised utilities will become even more acute as a result of privatisation:

*Information necessary to assess efficiency appears, if anything, less readily available than before. If neither shareholders nor customers can monitor this, however, then the effectiveness of the RPI-X system will turn on whether or not the regulatory authority can determine what constitutes an efficient level of performance, and may design the regulatory price ceiling accordingly.*

The likely presence of major information blockages in the interaction between regulators and utilities, reduces the former's ability to exert influence and control over the operation of the industries. Yet paradoxically, the other most commonly cited problem in the principal-agent thesis is that 'principals' can be too assertive in imposing their preferences on 'agents', which in turn impacts negatively on the latter's performance and efficiency. This has been one of the major criticisms directed at the previously



nationalised industries in Britain; where the government as 'principal' has been charged with intruding upon the commercial prerogatives of the utility industries. Weyman-Jones (1989, p.286) summarises this critique when he says:

*..the fundamental breakdown of government-utility relationships in the UK is not based on questions of allocative efficiency but rather on principal agent problems of management, authority, and control.. the industries have always been seen as instruments of macro-economic policy; in the 1970s they were used to implement price and income policies against inflation, and in the 1980s they have been seen as a constraint on monetary policy, because nationalized industry borrowing for investment has impinged on the Treasury's ability to conduct open-market operations in government debt.*

The excessive - and what has been seen as illegitimate - use of influence and sanctions by governments and their functional departments in the past, prompted the call for the structural separation of the regulation and production functions in the public utility field; the clearest expression of which is privatisation.

The disjunction of regulation and ownership - or put another way, control and performance - might appear to further compound the principal-agent problem, but it is often asserted that the reverse of this occurs and that an "incentive gain" (Helm & Pearce, 1990, p.12) is achieved by both regulator and producer alike. This is attributed to the fact that on the one hand, an independent regulator is able to adopt a more vigorous and less partisan posture; while on the other, the utility industry is released from the invidious task of balancing commercial considerations with the ephemeral policy priorities of the government of the day.

Whether these incentive gains are sufficient to offset the possible increase in information asymmetry that will result from governments' relinquishing operational control of natural monopolies, is open to doubt, however. For, as Vining & Weimer (1990, p.5) point out, the privatised utility now "has an incentive to withhold information that would change the decisions of the [regulatory] parties". That is, the privatised utility has much to gain by restricting the flow of information to the regulatory body, particularly when this information might be used to moderate profit levels, or to enforce higher (and more expensive) standards of service provision. The likelihood of this occurring is acknowledged by Helm & Pearce (1990, p.12):

*On the other hand, access to the relevant information to monitor performance is much reduced [compared to public ownership] and there may be an offsetting cost created by the strategic behaviour of regulatees.*

The fundamental problem, under the principal-agent formulation, is how to institute a system of external control that is effective, but does not, at the same time, introduce perverse incentives into the operation of the utility agency. It is an open question at this stage as to whether the privately-owned utility/external regulation model will deal with this conundrum more satisfactorily than was the case under nationalisation.

Principal-agent analysis need not only be confined to regulator-utility organisation interaction. It could, for example, be applied to the relationship between consumers as a generic group and regulatory bodies, which purport to represent their interests. In this case, as Crew & Kleindorfer (1979) note in passing, consumers would constitute the 'principal' with the regulator being the 'agent' responsible for communicating and enforcing their preferences in the supply of utility services (with the utilities themselves being a form of 'sub-agency'). Aspects of this principal-agent relationship will be

explored in later chapters. However, it is relevant here to touch on two issues which impinge upon the likely character of the consumer-regulator relationship in contemporary public utility policy and management.

The first is that the symbiotic connection between consumers and regulatory body, under the arrangements introduced as part of the utility privatisation programme in Britain, is rather more ambiguous than the principal-agent metaphor above would suggest.

Whitworth (in PIRC, 1989, p.15) makes this point in relation to the water regulator:

*He or she is not, as many people believe, a consumer watchdog. The Director's role is to promote the public interest..this is by no means always the same thing as the consumer interest and there will frequently be conflicts between the points of view of the industry, the shareholders and the consumers.*

Of course, as the discussion in Part 1 showed, the public interest criterion itself is subject to the obligation on the regulators to ensure that, at the end of the day, the utility companies remain commercially viable. This, in conjunction with the multiple constituency basis to the mandate held by British utility regulators, means that the presumption about regulatory agencies acting incontrovertibly in favour of the consumer interest will not necessarily hold.

Secondly, experience in the US indicates that the notion of regulatory bodies as active 'agents' under the direction of consumer 'principals' is at odds with part of the reality of regulation. In his explication of "an institutionalist theory of regulation" based on US practice, Kling (1988) asserts that the empirical outcomes of regulation have often favoured the industries being regulated at the expense of consumers and the public

interest. Regulation which aids the regulated industries and possibly harms the public interest is dominant in his view because,

*..since it is prone to producing obvious and concentrated benefits but obscure and diffuse costs, [it] has a political advantage over [public interest-oriented] regulation. Asserting the public interest usually involves an extra information burden, and more substantial mobilization difficulties, relative to efforts on behalf of a special group.*

Kling (1988) p.206

An important aspect of the "mobilization difficulties" implicit in consumer-oriented regulation, is that domestic consumers have little of the organisational and collective power enjoyed by the producers of utility services or indeed, of large industrial and commercial users - yet the ability to take organised action is patently critical to the task of exerting influence as 'principals' <sup>17</sup>.

In order to be effective then, regulators need access to a comprehensive range of information sources on the performance of utility industries, along with an informed understanding of how the public interest (and consumer interest sub-sets of this) can best be served through the regulation-industry nexus. But considerable conceptual and practical barriers stand in the way of realising these pre-requisites to successful regulation.

The heavy dependence of regulatory bodies on the information provided direct by the utility industries, in order to carry out their control and monitoring functions; as well as their alleged inclination to define the public interest as a refracted image of the commercial interests of the industries themselves, has led to the assertion that they are vulnerable to regulatory capture.

### The regulatory capture thesis

The theory of regulatory capture was originally articulated by Stigler (1971). In essence, the theory asserts that regulators are likely to be subject to significant pressures from dominant interest groups (most notably from the industries being regulated) which can result ultimately in a reversal of the regulatory paradigm, where the levers of control are exercised not by the regulator but the regulatee. In its more extreme form, it is posited that the evolution of regulatory structures in the first place has been largely the product of a desire to protect and preserve the interests of monopoly and quasi-monopoly producers (Swann, 1988; Melody, 1989).

Most attempts to analyse the dynamics of regulatory capture do not start from the position that regulators consciously set out to collude with regulated industries (the conspiratorial view just cited above aside). Rather, the process of regulatory goal displacement occurs subtly and gradually, over time, as the regulators start to identify with the companies or as they become increasingly more reliant on the information output of the utility industries. So, although regulators may begin with a public interest or consumerist mission, this is said to dissolve progressively as their world view and operational bonds become interwoven those of the regulated industries.

The theory of regulatory capture draws attention to the implicit dangers in any system of regulation (i.e. goal displacement and co-option). Yet it is important to recognise that there is little empirical evidence to support the view that it is an inevitable feature of regulatory practice (Brown, 1986). It also has a tendentious edge, in that it has been

used by radical liberal theorists to buttress the case for deregulation and the universal application of free market regimes. Nevertheless, it does underline a potential problem in the public regulation of utility industries. The possibility of regulatory capture is likely to be substantially reduced, however, under arrangements which maximise the positional and informational independence of regulatory agencies.

Positional independence requires that the regulatory body be functionally and operationally separate from both the industry and government (for 'capture' can occur from both sides), and that the regulator have complete operational command over the management of his/her brief and resources. This does not imply, of course, that the regulatory body should be outside the machinery of government. In the opinion of Walker (1990, p.154), the fact that the current utility regulation bodies in Britain are part of the structure of government is a positive advantage:

*..the new regulatory offices are fully part of the state; their administrative culture is Whitehall's; regulatory 'capture' - a problem the economists have worried over - appears not much of a danger in the sense that Ofgas personnel do not come from and have no personal experience of the gas industry; the organizational culture of the OFT..gives the impression of being pre-Thatcherite, fully statist, in the sense that the staff consider they have a mission pro bono publico.*

Nor, more importantly, does it imply that the regulators should occupy a position of independence which removes them from conventional lines of political and public accountability. The dangers in this are considered in the conclusion to this chapter.

The development of informational independence on the part of the regulator will be contingent upon the degree to which he/she is able to secure the resources required (i) to collect data on the performance of the utility industry, separate from that provided by the industry itself ("..reliance on a single, interested source for information increases the risk of regulatory capture", McHarg, 1992, pp.390-1), (ii) to interpret, analyse and corroborate the information made available from industry sources and (iii) to compare the performance of individual companies across a wide range of economic and social indices. There is evidence that the regulators have become increasingly conscious of the need to do this, as exemplified by the Office of Gas Supply's extensive use of external consultants in the gas tariff review and in the Office of Water Services decision to employ "independent certifiers" to audit the financial and service performance data provided by the water companies. The Director General of Water Services has also initiated a number of surveys on customers views of the water industry (see Chapter 7).

The provision in the *Competition and Service (Utilities) Act 1992*, requiring the regulatory bodies to undertake research on consumer views as part of the development and monitoring of standards of performance, potentially strengthens the informational independence of all of the regulators. Yet, as Coote (1992, p.6) cautions consumer research should be used as a complement to, and not a substitute for, more active forms of consumer engagement:

*[hiring] a polling organisation to carry out market research..avoids any danger of individuals getting together as groups of citizens, or any obligation to enter into a dialogue or to negotiate with them. It keeps power in the hands of the body commissioning the research, which remains free to formulate the questions, interpret the answers and decide what to do about the results.*

The information requirements of the regulatory function demands a proactive information search strategy on the part of the regulators, for the "wider the range of sources, the greater the independence and effectiveness of the regulator" (Helm et al, 1988, p.59). Regular recourse by the regulators to the formal consumer bodies set up for each of the industries will form an important information source. But this, in itself, will not be sufficient, for as is shown in Chapter 7, the composition of these bodies does not reflect the broad cross-section of domestic consumers; and most notably low income consumers. Consequently, the regulators will need to obtain on-going access to the views of service deliverers who interact on a day-to-day basis with utility consumers (e.g. welfare rights and advice agencies) and with low income consumers themselves. Thus far the Director General of Gas Supply has displayed a rather stronger commitment to 'community outreach' of this sort than have his regulatory colleagues.

The absence of the equivalent to 'rate hearings' in the British system of regulation, which Brown (1986, p.10), assessing the American experience, sees as "a vital safeguard against 'capture' of the regulators by the regulated industries", is likely to be a substantial barrier, not so much to information gathering, but to information 'integrity'; and is one which the three Directors General will have to work hard to overcome.



## CONCLUSION: ACCOUNTABILITY IN THE BRITISH REGULATORY SYSTEM

*Another difficulty for regulators is that their decisions are taken in secret with outsiders in no position to judge whether or not consumer interests have really been protected. That may be inevitable in view of the need for commercial confidentiality but it also places everybody in an awkward position. Regulators are largely protected from political interference by Statute. Parliament has not really exercised accountability over them. Occasionally Regulators appear before Select Committees to describe their work, but the appearances are neither frequent nor detailed enough to constitute effective control. Even the public hearings organised by American regulators are completely absent from the UK scene. Yet in the long run it is unsatisfactory for such major decisions over such a large part of the economy to be taken by a small number of individuals so completely free from outside interference or accountability.*  
HoC Library Research Division (1991) p.2

As this and the previous chapter have shown, public utility regulation intersects directly and indirectly with major areas of public policy, for example, environmental policy and infrastructural planning. It also results in distributional outcomes which affect society as a whole and, in particular, impacts upon the quality of life of low income and other disadvantaged groups of consumers. Because of its importance and place in the polity, utility regulation should be firmly attached to the fabric of political and public accountability.

In America, the lines of regulator accountability appear to be rather more clear cut than is the situation in Britain, i.e. via democratically elected regulators and through structures for open decision making. In Britain, more weight seems to have been placed on the need for independence than on clarity of accountability.

At a superficial glance, the British regulatory model appears to provide an intricate and elaborate system of formal and informal accountability, as Figure 3.6 overleaf, outlining the major players in the British regulatory environment, seems to suggest. But this merely serves to disguise a reality where at best, the utility regulators' accountability is confused, and where at worst, the regulators stand the danger of being accountable to everyone and no-one.

The accountability problem in the British system is best illustrated through looking more closely at the primary formal line of political accountability. Each of the Directors General are technically accountable to Parliament, but beyond the presentation of their annual reports to Westminster, no mechanisms have been established to ensure that this actually takes place. The Select Committee system in the House of Commons is one obvious arena where the regulators might be made to account for their actions (Hawes, 1992), but outside the Energy Committee's examination of the Director General of Electricity Supply as part of its inquiry into the consequences of electricity privatisation, the regulators have been generally immune from investigation through this means. Indeed, the abolition of the Energy Committee in 1992 potentially widens the hiatus between parliamentary overview and regulatory action.

In reality, the most powerful political influence on the activities of the regulators is not Parliament but the respective Secretaries of State. Under the legislation, the relevant Secretary of State has the power to appoint the regulator and has residual powers in key areas such as the issuing of licences and references to the Monopolies and Mergers Commission.

## PLAYERS IN THE REGULATORY ENVIRONMENT

Effectively a microcosm of the contemporary State

### 1. LEGISLATURE:

Parliament: to whom regulators are notionally accountable, expenditure is voted by Parliament, annual reports presented to Parliament

Parliamentary Select Committees: ad hoc investigations of policy framework and regulatory machinery e.g. House of Commons Trade and Industry Select Committee, Environment Select Committee, ex-Energy Committee

### 2. EXECUTIVE:

Secretary of State: "the directors are appointed by and are answerable in broad terms to the appropriate Secretary of State. If the director does not carry out his duties satisfactorily, he can be replaced." Lord Ray, Lords debate on CSU Bill, 9/3/92, Col.1193

Treasury: approves expenditure of regulatory bodies (funds raised through licence fees)

### 3. JUDICIARY:

High Court - Judicial Reviews: review of legality and validity of procedures used in regulatory decision-making (but not of substantive policy/decisions)

### 4. ECONOMIC REGULATION AND AUDITING QUANGOS:

Monopolies and Mergers Commission: key institutional bulwark to utility regulators' powers - referral if actions of utility companies seen to be against "the public interest", settle disputes over licence modifications

Office of Fair Trading: enforcement of general competition law and consumer protection

National Audit Office: "The Comptroller & Auditor General has been given the financial audit of these bodies and the National Audit Office will soon need to investigate the efficiency and effectiveness of their operations." Beauchamp (1990, p.58)

### 5. OTHER GOVERNMENTAL AGENCIES: Environmental or "Quality regulators"; Department of Social Security, European Community, local authorities

### 6. MEDIA: primary non-institutional vehicle for regulator public accountability

### 7. INTEREST GROUPS, including consumer interest groups:

- \* source of external information and monitoring
- \* source of specialist policy advice on consumer issues
- \* point of additional leverage on the utility companies
- \* prompter of regulatory vigilance and action (aids regulator's evaluation of own effectiveness, accountability & independence)
- \* support in political arena re. strengthening regulatory powers, resources etc.

Consumer councils/committees: responsible for following up individual complaints, monitoring company practice, input into consumer policy

Public Utilities Access Forum: community sector-regulator forum on low income consumer issues  
Independent consumer & advocacy organisations e.g. National Consumer Council, Consumers' Association, National Right to Fuel Campaign, Age Concern

Community services organisations: e.g. citizen's advice bureaux, welfare rights & money advice groups

Figure 3.6: Players in the regulatory environment

The significance of the Secretary of State is clearly recognised by the Director General of Electricity Supply: "...in important respects the power that I have derives from or is constrained by the Secretary of State" (Littlechild, in Veljanovski, ed. 1991, p.116).

The apparent gap between the theory and practice of the regulators' political accountability may explain the hesitancy of the last Secretary of State for Energy when questioned on the matter during the Energy Committee's investigation into electricity privatisation:

*(Mr McAllion) Is the Director General accountable to yourself?*

*(Mr Wakeham) He is accountable, I think, to Parliament, if somebody can tell me if that is correct. He is accountable directly to Parliament, yes, but he publishes his reports and he certainly will-*

*(Mr McAllion) If he is directly accountable to Parliament, surely he will be directly accountable to Parliamentary Select Committees?*

HoC, Energy Committee, 1992c, paras 352-3

The evident danger in the rather confused lines of formal accountability is that it will result in an 'accountability vacuum', whereby the decisions of the regulators are not subjected to any form of political scrutiny at all. Alternatively, the scope for intervention by the Secretary of State potentially threatens the very independence upon which the edifice of British utility regulation centrally rests.

Outside the political arena, the primary institutional device for examining the actions of the regulators lies in the process of judicial review. But this is essentially confined to questions of procedure, i.e. whether or not the regulator has exceeded his/her legal powers or "remit" (Emery & Smythe, 1986, p.23f). It does not generally encompass the review of instances of substantive decision making, unless some breach of statutory power has occurred <sup>18</sup>.

The judicial review process is likely to be constrained also, in the view of a number of commentators (e.g. Beesley, 1991; Veljanovski, 1991), by a reluctance on the part of the courts to intrude too deeply into the terrain of the regulatory agencies, and by "the fact that, where discretion is so wide, there are few pegs on which to hang an application for review" (McHarg, 1992, p.392). The extent to which this may indeed be the case could well be tested in the near future, if the power and coal unions succeed in their application for a judicial review of the Director General of Electricity Supply's alleged failure to ensure that, in signing long-term gas-fired generation contracts, the RECs have been buying power economically (*The Guardian*, 16/10/92) <sup>19</sup>.

Ideally, of course, the regulators will be accountable to the consumers of utility services. Generally, however, this line of accountability is indirect and is refracted through intermediary bodies such as the consumer committees, interest groups and the media. As such, the strength of the accountability nexus between the regulatory agencies and utility consumers will be heavily dependent upon the capacity of these intermediary bodies to represent effectively the collective, and in some instances the divergent, interests of domestic consumers. The decision to establish consumer committees under the wing of the regulator, in the water and electricity industries, **potentially weakens** the degree to which these bodies can call the regulator to account (see Chapter 7).

But the most significant structural barrier to the regulatory agencies establishing a strong accountability relationship with ordinary consumers, lies in the fact, as shown earlier, that the regulators have, what might be described as, an 'antecedent set of accountabilities' to the shareholders of the private energy and water companies.

During the passage of the *Competition and Service (Utilities) Bill*, the National Association of Citizen's Advice Bureaux sought to include an amendment requiring the relevant Secretary of State to set standards of performance for each of the regulators. This was seen as a way of adding a measure of transparency and external accountability to the regulatory system. The amendment was opposed by the Government on the basis that:

*..if he is to perform his duties effectively, the director must, in our view, retain his independence of the political process. For the Secretary of State to set performance standards for the regulator as the amendment envisages would involve him in second-guessing the director and would compromise that independence. Lord Reay, HoL, 5/3/92, col.1097*

If, ultimately, the effectiveness of the regulators as 'principals' in the social control of the privatised utilities, and the solidity of their defence against 'regulatory capture' by the industries, is dependent upon the clarity of the lines of accountability that exist between them and their political and public constituencies, then the British system looks fundamentally flawed. As much as anything else, the British model of regulation seems to be founded on trust. This may turn out to be an unsound principle around which to build a structure of economic and social regulation in an area as vital as the public utilities.

### ENDNOTES TO CHAPTER 3

1. ".efficiency implies that the correct combination of goods will be produced and that each good will be produced with the minimum input of resources. The former is referred to as allocative efficiency. The latter may be termed productive efficiency." Swann (1989) p.48

2. *The aim of maximising social welfare is not usually pursued by a monopolist. The traditional motivation for a monopolist is the maximisation of profit, which, in the absence of competition, is typically inconsistent with economic efficiency.* Crew & Kleindorfer (1979) p.119

3. "a Community Service Obligation should be defined as arising when the Parliament or the executive government expressly requires a government business enterprise to carry out an activity which it would not elect to provide on a commercial basis, or which would only be provided commercially at a higher price." Economic and Budget Review Committee (1991) p.xvii.

4. Interestingly, Demsetz (who is a leading Chicago School neo-liberal theorist) alludes to the limitations of conventional economic theory when he says:

*The claim may be a bit strong, but what economic theory we possess is specialized to explaining the decentralized, private ownership economy. Even macroeconomics presumes private decentralized reactions to quantities that are supposedly controlled by central authorities, such as money supply, taxes, and government expenditures. Our theory not only takes wants and technology as given, it also takes decentralized private ownership as given. The theoretical role of the state, except for recent work on the theory of democracy, is largely normative and limited to resolving externalities, that is, to making the system work better from the perspective of underlying private demands for goods and services. It is not a predictive theory of the central management of "public" wants.* Demsetz (1989) "The Social Variable in Economic Analysis", p.41

5. Taylor (1990) touches on this in his essay on free market economic analysis and practice over the 1980s:

*What has been mobilized..is a political language which does not seem to recognise the idea of a social effect or social cost at all, but which is concerned to offer an alternative and differently focused account.* pp.7-8

6. Not only are there likely to be different sub-sets of utility consumers with possibly different interests, but as Pollitt (1988) suggests in his discussion of consumerism in public service provision generally, potential and future services users, as well as members of the public affected by the (positive or negative) externality outcomes of service provision, constitute important 'consumer constituencies' whose interests need to be taken into account in public policy.

7. Yet it is hard to see how contract compliance - beyond the re-issuing of the franchise every x number of years - could be monitored minus regular regulatory oversight. It would clearly be unsatisfactory for consumers to have to wait ten years or more before major service problems could be corrected.

8. "The vast majority of electricity, natural gas, television, and local telephone service, plus large amounts of water, public transportation, and other services are provided by privately owned and governmentally regulated public utilities." Sherman (1989) p.3. Although paradoxically, the overall structure of American utility industries now has a far greater public ownership component than Britain.

9. See McHarg (1992) for an analysis, from a legal perspective, of the *Competition and Service (Utilities) Act 1992*. On the overall impact of the Act, McHarg concludes as follows:

*On balance, the Act is a slight improvement on the current position as respects both competition and consumer protection. But its significance lies more in what it omits than in what it contains, which emphasises rather than remedies the flaws in the United Kingdom's regulatory policy.* p.396

10. The House of Commons Select Committee on Energy was disbanded following the abolition of the Department of Energy. The functions of the Department of Energy have been subsumed within the Department of Trade and Industry (with the exception of Energy Efficiency which has gone to Department of the Environment and is subject to the Environment Select Committee).

The Select Committee on Energy's role is now notionally encompassed within the Trade and Industry Committee. Dr Michael Clark (Conservative - Rochford), who was Chairman of the Energy Select Committee is the only member of that committee who is a member of the Trade and Industry Committee. The ex-Clerk of the Energy Committee, Dorian Gerhold, has been appointed Clerk of the Trade and Industry Committee. [Source: Trade and Industry Committee Press Notice, 15th July 1992]

Members of the Select Committee on Energy tried to resist the Government's disbanding of the Committee, including moving an early day motion signed by 88 Mps. In the debate in the House of Commons on 30th June 1992, Michael Clark and Alex Salmond (also an ex-member of Energy Committee) stressed the continuing need for the Committee in order to monitor the consequences of electricity privatisation.

11. The way that regulatory policy in Britain has become refracted through personality is illustrated in Rhodri Morgan's suggestion during the debate on the passage of the *Competition and Service (Utilities) Bill* that the ideal regulatory situation would consist of:

*..regulators who have the statutory powers that Stephen Littlechild has in the electricity industry, combined with Ian Byatt's brains and James McKinnon's teeth.* " HoC, 16/1/92 col.1151



12. "But this, it might be said, is the British, the small 'c' conservative way - you can, though you probably have no need to, extract rules ex post from the ongoing behaviour of people as they go about their business. Put that another way: the rules are implicit. Nowhere is it stated that gentlemen do not remove their jackets in the dining room at the club, but members know." Walker (1990) p.157

13. The clash between the American and British 'political culture' is reflected in Stelzer's comment that:

*..our British friends think we are quite mad to allow lawyers and intervenors to stretch hearings over years, perhaps decades. We, in turn, think they are quite undemocratic to rely on closed negotiations between the regulator and the regulated, to deny many parties an opportunity to be heard, and effectively to deny all parties the right to appeal decisions of the regulator - a single Director, not even a commission. Stelzer (1991) p.69*

14. Although the relationship between the owner/shareholders ('principal') of a firm and its managers and staff ('agents') might be seen as broadly analogous. And similar problems of communication and control have been identified in the separation of ownership and management by Vining & Weimer (1990).

15. "We believe that this information problem is at the heart of the economics of regulation." Vickers & Yarrow (1988) p.80

16. In relation to electricity, Weyman-Jones (1990, p.70) concludes that "[from] being a key part of the initial draft licences, yardstick regulation has been all but abandoned". The monopoly role of British Gas in the provision of gas negates, of course, the facility to undertake "yardstick regulation". The Director General of Water Services has expressed particular interest in the use of "comparative competition" as a surrogate for real competition in the high naturally monopolistic domain of water services (Byatt, 1990a, p.88). But the setting of substantially different K factors, along with the marked geographical and environmental variations between different companies, will serve to limit his ability to employ the yardstick method.

17. "Of the three different interest groups - the licensed water and sewerage companies, their shareholders and consumers - the consumers have the weakest voice. They are not organised, they have no economic power and frequently they are individuals who are ill-equipped to take on the machinery of business". Whitworth (PIRC, 1989) p.15

18. The three procedural areas that fall within the ambit of judicial reviews are outlined by Hoffland and Nicol (1992, pp.178-9):

*. An illegal decision is one where the decision-making body has not been given the legal power to do what it has done - ie, if it has gone outside its remit or what it was set up to do.*

*. An irrational decision is one which is so unreasonable that no reasonable authority could make it (in legal jargon this is 'Wednesbury' unreasonableness, named after the court case in which the principle was established.*

*. Procedural impropriety means procedural unfairness - ie, breaches of the rules of natural justice.*

19. Under the terms of their licences, the RECs have an obligation to purchase "electricity at the best price reasonably obtainable having regard to the sources available" (Condition 5). The Director General is responsible, of course, for enforcing the licence conditions.

## CHAPTER 4: THE POLITICAL ECONOMY OF PUBLIC UTILITY PRIVATISATION

### INTRODUCTION

*Before 1979 there was a general acceptance that what were then called public utilities - water, electricity, gas - are best provided for a society by one kind or another of public ownership. The New Right substituted and acted so far as it could on the ideal of shareholders, entrepreneurs, and in general what is called free enterprise. Honderich (1991) p.88*

The sale of the public utilities in Britain could be seen to represent the zenith or nadir, depending on one's point of view, of the privatisation programme carried out under the leadership of Margaret Thatcher. The privatisation of the utilities - particularly, water and to a lesser extent, gas and electricity - had been seen by many to take the Government, and in turn the public, into previously uncharted waters <sup>1</sup>. The denationalisation of the utilities overturned key dimensions of "the 1940s settlement" (Gamble, 1989, p.2) and directly challenged beliefs, built up over forty years, about the role of government in strategic areas of the economy and about the immutability of public control of the utility industries.

The privatisation programme began fairly unambitiously, with the National Freight Corporation being the sole industry specifically identified for sale to the private sector in the Conservative Party manifesto in 1979 (Conservative Central Office, 1979). It was only during the second term of the Thatcher Government's period of office that attention began to be directed towards the privatisation of the public utilities <sup>2</sup>. The culmination of the privatisation programme was achieved during Mrs Thatcher's third term, with the sales of the complex water and electricity supply industries.

While there is little evidence that the sale of the public utilities was carried out according to some pre-established 'blueprint', each of the three privatisations appeared to share a number of common policy objectives; although the weight and emphasis given to particular objectives seemed to vary from one privatisation to another. In this Chapter, the economic and political objectives explicit (and in a couple of instances, implicit) in the Conservative Government's utility privatisation programme will be outlined.

In addition to isolating the primary elements in the Government's political investment in privatisation - e.g. fiscal management, promoting dispersed share ownership and re-structuring trade unionism - there is another important dimension to the politics of privatisation which needs to be considered. This might be described as the ideological framework (or "macro-politics") of privatisation. The first part of the chapter will explore a number of the predominant themes on the New Right agenda of social change, as these form the contextual backdrop against which public utility privatisation has occurred.

## PART 1: THE IDEOLOGICAL FOUNDATION OF PRIVATISATION

*..it is futile to question the present economic policy framework solely at the instrumental level, without analysing the merits of the underlying value judgements and hence of neo-liberalism.*

Helm (1986) p.xviii

The political and economic environment within which utility privatisation is located, cannot be understood without an appreciation of the major tenets of New Right political philosophy, for as Gamble (1989, p.4) says "[o]ne of the sources of inspiration for the privatization programme was the ideas of the New Right". As well as being organically related to New Right theory, privatisation has become the 'flagship' of the New Right approach to governance, as advocates such as Veljanovski (1987), Pirie (1988), Letwin (1988) and Redwood (1988) have pointed out.

The prescriptions of the New Right have come to dominate political discourse in many Western post-industrial societies since the mid-1970s; although they have received their fullest airing (in a policy implementation sense) in Britain and the United States over the past thirteen years. The factors that have given rise to the ascendancy of New Right political and economic ideas during the 1970s are seen to include, the failure of Keynesian demand management to deal with the volatile mixture of high inflation and high unemployment ('stagflation'), the 'fiscal crisis' of the contemporary state (O'Connor, 1973) <sup>3</sup>, international economic instability following the OPEC oil crisis in 1973, the demise of US economic leadership, and the inability of 'social democratic' governments to adapt to national and global changes in economic and social development (Walker, 1984b; Gamble, 1988, 1989).

A combination of the apparent failure of social democratic/Keynesian policies (and their markedly more collectivist alternatives) and the beguiling simplicity of neo-liberal prescriptions for economic and social progress, has put New Right theory not only in the forefront politically in some countries, but has led, arguably, to it gaining an almost universal monopoly in the realm of political ideas. Governments across the globe and across the political spectrum have sought to import parts of the New Right "package", under various guises such as 'economic rationalism' and the 'social market', over recent years.

The body of theory encompassed under the definitional umbrella of the New Right often appears to lack a sense of unity and internal consistency (King, 1987; Dunleavy & O'Leary, 1987; Gamble, 1988, 1989). Among the major intellectual strands of the New Right are, eighteenth century *laissez faire* economics, public choice theory, libertarianism, and authoritarian conservatism. The interaction between these disparate elements is not always harmonious; and this provides a creative dynamic in New Right thought as well as a potential source of internecine dispute.

The extent to which New Right theory represents a qualitatively different *weltanschauung* from that shared by right-wing theorists in the past need hardly concern us here (see, for example, Willetts, 1992 on this question); except to acknowledge that it offers a more potent attempt to articulate a sustainable anti-collectivist theory than has hitherto been the case. In part, this is the result of the New Right's ability to forge an effective coalition (and to some extent, dialectic) of radical liberal and conservative thought. It is also because the intellectual rigour of their arguments is ostensibly superior

to that which pertained in the past (naturally this excludes figures like Adam Smith, Edmund Burke and John Stuart Mill). Dunleavy & O'Leary (1987 p.74) capture the essence of this latter attribute of the New Right when they state:

*What makes the New Right distinctive is its philosophical and theoretical sophistication. Its supporters have fully accepted that liberal and socialist ideas need to be combated with all the available arguments mustered by the social sciences. When they justify traditions, as they often do, New Right authors appeal to social science research and argument, not simply to received wisdom or eternal verities.*

What then are the central precepts of this more elaborate intellectual counter to the various manifestations of collectivism (on a continuum from social democracy to communism) which have dominated political thought and action for much of the first seventy years of the twentieth century? In this discussion, which is of necessity more synoptic than comprehensive, the following elements of New Right theory will be considered:

- \* Core values
- \* The role of the market
- \* The role of the state

(i) Core values

*The links between private property, markets and liberty is a strong one and is the primary defence of privatisation.*

Veljanovski (1987) p.206

Like their socialist opponents, New Right theorists frame their political and economic prescriptions around a set of core values concerning the human condition. This constellation of values is a combination of libertarian and conservative positions; and for all the elaborate phraseology used, they amount to a number of relatively straightforward (if largely untestable) propositions about the nature of human behaviour and motivation. The 'values centrepiece' in the New Right world-view concerns a radically re-defined concept of **citizenship rights** (Gamble, 1988), built upon the trinity of individualism, freedom and property rights.

As might be expected in a reactionary body of thought (in the literal rather than ideological sense), the New Right vision of citizen rights is premised upon a critique of the way that the notion of citizenship rights has been expressed and enacted in dominant social democratic regimes over much of this century - and reaching their apotheosis in the three decades after the Second World War.

Of particular concern is the way that basic economic rights (such as the individual right to own and control property) have been complemented with, and even subordinated to, an array of political and social rights (Marshall & Bottomore, 1992; Roche, 1992).

The extension of political rights to traditionally powerless groups in society such as women and ethnic minorities, and the evolution of social rights - embodied primarily in post-war Welfare State (King, 1987; Esping-Andersen, 1990; Roche, 1992) - has led



to both the accretion of claims and expectations and the growth of state power. For New Right theorists like Hayek, many social programmes, particularly those with any sort of distributional intent, lead to the extensive use of state coercion (e.g. taxation) and results in the infringement of individual property rights. Inequality in their view, is a fundamental staple of the free economy (and by extension, the free society), for without it the structure of property rights as well as the basis for economic growth and social advance is undermined:

*The range of what will be tried and later developed, the fund of experience that will become available to all, is greatly extended by the unequal distribution of present benefits; and the rate of advance will be greatly increased if the first steps are taken long before the majority can profit from them. Many of the improvements would indeed never become a possibility for all if they had not long before been made available to some. If all had to wait for better things until they could be provided for all, that day would in many instances never come. Even the poorest today owe their relative material well-being to the results of past inequality.*  
Hayek (1960) p.44 <sup>4</sup>

The New Right alternative to a set of values emphasizing collectivity, social rights and entitlements, is their concept of citizenship in the free market economy. Here the dimensions of citizenship are conceived in a highly circumscribed form, with a strong emphasis on economic and legal rights (both of which are encapsulated in the concept of 'civic rights'). A rather more ambiguous position is taken to political rights, reflecting traditional conservative distrust for democratic institutions (Honderich, 1991 asserts that conservatives have "never or very rarely indeed been democratic by choice", p.124), as well as the empirically-based critique of the performance of the political system by public choice theorists. What is noticeably - and in their view, justifiably - absent is the dimension of social citizenship <sup>5</sup>.

The point of central reference in New Right political philosophy is the **individual in society** rather than the 'society of interdependent individuals' position characteristic of opposing political ideologies. In fact, the notion of society itself is markedly problematic for radical liberal theorists. While the bald "there is no such thing as society" view expressed by Margaret Thatcher may represent an over-simplification of the New Right stance (Willett, 1992), the treatment of society as an autonomous entity, or organising principle, is explicitly dismissed. As Dunleavy & O'Leary (1987 p.90) state, for the New Right, allusions "to collectives, or collective behaviour, which suggests that there are entities other than individuals which have goals, purposes or needs are 'holistic' fallacies". In the intellectual 'patchwork quilt' of New Right theory, however, this negative and relatively incoherent formulation of society, is partly offset by the ascendent place that society - of a hierarchical, almost feudal kind - is given in traditional conservative thought. The importance of this fusion of ideas will be seen in the discussion of the role of the state below.

Not only does the individual - and by implication the prerogatives of the individual - occupy the focal point in the lens through which all human behaviour and social action should be judged, but he or she is accorded a particular set of attributes in New Right philosophy. The way that these attributes determine individual behaviour and express themselves in relationships between individuals, is central to the intellectual superstructure of New Right thought; so it is necessary to briefly expound these propositions here.

Fundamentally, the individual is seen as essentially **self-interested** - or to use the more value-neutral terminology of economics, utility maximising - and **rational** (the "homo economicus" of the public choice theorist Buchanan <sup>6</sup>). In unison, these characteristics make for self-conscious and purposive action on the part of individuals designed to further their own personal interests. Individual interests, however, cannot be satisfied in isolation and they inevitably require a degree of interaction with other self-interested and rational actors. Within a social context made up of such individuals then - according to the logic of radical liberal theorists - the maximisation of personal interests will be best achieved through an explicit form of voluntary exchange and co-operation. Put another way, human beings are selfish rather than altruistic by nature; yet ironically, through pursuing their own self-centred ends they are required to engage in co-operation and accommodation, which can further everyone's interests and result in socially constructive outcomes. This, in simple terms, is the logic that underpins the concept of the free market. It also provides its legitimation, for the validity of the marketplace as the most functional form of social organization, is centred around, as Veljanovski (1987 p.36) says:

*..the paradoxical assertion that a spontaneous order will arise as a incidental by-product of what on the face of it appears an antisocial motive (greed)and an anarchical system (competition) without conscious direction.*

The individual in interaction with others then, is (like the market) largely **self-regulating**. Hence there is little need for externally-imposed constraints and controls - with the exception of the maintenance of a system of rule compliance in order to ensure that everyone 'plays fair'. While law and order is integral to the effective

operation of individual voluntary exchange (particularly with respect to the preservation and protection of property rights), the emphasis must invariably be on maximising personal **freedom**. For radical liberal theorists, the operation and allocational efficacy of the free market - which for them is very much a metaphor for life generally - is likely to be profoundly retarded, if the scope for individual action is unnecessarily constrained.

Freedom (or liberty <sup>7</sup>) is a concept which occupies a salient place in the pantheon of liberal values. Yet as many critics of New Right philosophy (and indeed, opponents of 'old Right' philosophy, such as Tawney, Titmuss and Marshall) have asserted, for all its rhetorical importance, freedom is perceived in an extremely limited and negative way. Freedom, in the sense of **absence of coercion**, rather than freedom as opportunity to participate (economically, politically or socially), is the paramount objective of liberal politics <sup>8</sup>. In the view of Hayek, other interpretations of the concept of freedom amount to a very dangerous form of intellectual quibbling:

*It has been with the help of this equivocation that the notion of collective power over circumstances has been substituted for that of individual liberty and that in totalitarian states liberty has been suppressed in the name of liberty. Hayek (1960) p.16*

Yet even categorising the New Right position as 'freedom against', is to over-simplify; for the notion of the absence of coercion is often confined to the economic sphere of life, as opposed to other domains of human activity. Arguably, for instance, the centralised and interventionist use of state power in the area of civil liberties by the Thatcher Government (Hillyard & Percy-Smith, 1988; Honderich, 1991, pp.122-3) stood

in stark contrast to its unremitting attempts to liberalise economic relations in Britain in the 1980s.

Be that as it may, the negative view of freedom articulated by the New Right is substantially consistent with the internal logic of their social vision. Essentially, the onus is on the individual to create her/his own opportunities (or 'freedom to') through market-related exchanges and as long as she/he is free from unjustifiable constraint in accessing the market, the allocation of rewards in this process is seen to be fundamentally fair, despite the fact that they will generally result in quite unequal outcomes:

*It cannot be denied that the Rule of Law produces economic inequality - all that can be claimed for it is that this inequality is not designed to affect particular people in a particular way Hayek (1986) p.59*

The suggestion then, that the outcomes of the "invisible hand" of the market should be moderated through external action, in order to create opportunities for particular groups in society, is perceived as a direct threat to the inviolable freedom of others to maximise their return from market exchanges, as well as a basic infringement of **property rights**.

The right to hold, use and dispose of property (physical, human, informational or otherwise) is the central dynamic in New Right's social order. Private property in its various forms, constitutes the 'currency' for exchange and reward in the economic and social system, and it provides at the same time "a guarantee of individual autonomy" (Gray, 1986, p.66). Because of its centrality in the social order, any attempt to interfere with the individual's right to accumulate and use the property they legitimately acquire through market interactions (apart from basic levels of taxation to finance law and order,

defence and the provision of "public goods") is generally viewed with abhorrence by members of the New Right.

New Right theorists also draw, what is for them, an important distinction between 'common property rights' and 'private property rights'. Private property, based on exclusivity and transferability of use, should form the dominant form of tenure in a free market economy; with as little recourse to common property as possible. Almost by definition - and this is relevant to the New Right's position on nationalisation - common property is intrinsically inferior as a mode of ownership to private property. Seldon (1990 p.127) expresses this view as follows:

*Socialists have persistently avoided acceptance of the truth that public property destroys the essence of property. By diffusing nominal but ineffective public ownership it changes real ownership into paper ownership. Changing private identifiable property into public un-identifiable property is to destroy the incentives to protect, conserve, improve and render it productive by using it profitably in making goods and services for which consumers will pay.*

In the context of the argument about property rights, privatisation serves two important purposes. First, it shifts the locus of ownership away from 'dysfunctional' state forms and second, through the public sale of shares in the utility companies, it extends individual property rights (Redwood, 1988).

(ii) The role of the market

*..the competitive market has several features which render it uniquely congenial to a liberal individualist society. The coordination it effects among human activities is, firstly and above all, non-coercive. Each agent adjusts his plans to the plans of others by reacting to the information about others' preferences and resources that is transmitted to him through price signals. The outcome of these adjustments is the tendency to coordination or equilibrium which is a feature of unhampered market activity..It is a form of coordination which is finer than any achievable by central planning and one which at no point abrogates the liberty of individuals. Gray (1986) p.69*

There is a danger in presenting a synoptic account of the New Right's position on the roles of the state and the market, to do so in an almost caricatured black and white way. Indeed the analogy of a music hall melodrama, where the black-cloaked and unredeemably evil figure of the state incessantly seeks to steal the virtue of the white-garbed, beautiful and all-too-innocent free market heroine, often seems to be present in the minds of some advocates of the New Right position themselves (e.g. Clarke, 1987 and Veljanovski, 1987). However, while it may appear possible ultimately to distil the essence of New Right thought as "the market, good", "the state, bad"; the substance of their views are rather more sophisticated and complex than this.

Although the New Right's position on the free market is relatively clear and unequivocal (but the nexus between the free market model and contemporary capitalism is less so); their view on the role of the state - particularly from the perspective of practical politics - is ambiguous and at times, ostensibly contradictory. The benefits of moving from clarity to apparent imprecision are perhaps dubious, but it may be useful to begin with the New Right's clearer conception first.

The market - built on a foundation of voluntary exchange, competition and open and unrestricted access - is universally viewed in New Right thought as an unrivalled mechanism for efficient production, distribution and consumption. Its intrinsic efficiency lies in the fact that through actively facilitating competition it ensures that a close relationship exists between (i) the need for goods and services and their production and (ii) the cost of producing goods and services and the prices charged for them. Remarkably, according to free market advocates, this complex pattern of preference communication and 'signalling' is achieved naturally and spontaneously, without the need for highly elaborate and formal systems of co-ordination and planning (Adam Smith's "invisible hand"):

*There is perhaps no single factor contributing so much to people's reluctance to let the market work as their inability to conceive how some necessary balance, between demand and supply, between exports and imports, or the like, will be brought about without deliberate control.*  
Hayek (1960) p.400

The virtues of the market are held to reside not only in its unique efficiency, but also in its impartiality. As a conduit for the allocation of opportunities and rewards, the free market is seen as neutral, in that it doesn't discriminate amongst actors in the market on anything other than economic grounds (e.g. the saleability of their product). As suggested earlier, the outcomes of market processes (i.e. individuals in competition) will often be unequal, but this is seen to have little to do with the internal working or logic of the market itself. The essential 'amorality' of the free market in New Right thought is outlined by Gamble (1988):

*A significant feature of these arguments is the abandonment of the claim that the pattern of rewards and incomes which is the outcome of markets is in any sense just. Hayek denies that the question has any relevance. The set of general rules that define the market order can be considered*



*just but not the outcomes themselves, because these depend on luck, chance, accident, effort, skill, inherited wealth, inherited talents and many other factors. For Hayek and many of the New Right the market is a lottery. p.53*

The claim that the operation of the free market is aloof from questions of morality or justice, is used as a defence against the critique that the market produces and reproduces inequality. It is also used as an argument for the intrinsic merit of the 'spontaneous order' of the market, relative to value-driven (but misguided) alternatives, such as state intervention aimed at influencing distributional outcomes<sup>9</sup>. Intruding upon the value neutrality of the market not only disrupts the incentive structure, which acts as the dynamo for competition, efficiency and economic growth. But it also 'politicises' the market by coercing it to discriminate in favour of particular groups, on the basis of some externally-imposed set of moral criteria (see Hayek, 1960, Chapter 6). The denial of endogenous market injustice represents a significant divergence of New Right theory from traditional conservative thought, at least of the "One Nation" kind, for the latter recognises the need for ameliorative action to offset instances of market failure.

The consonance between this highly idealised model of the free market and the working model of contemporary Western capitalism, is substantially under-explored by New Right theorists. Yet clearly the issue is an important one; for the unfettered, insular world of small business undertakings envisaged by Adam Smith and the recent inheritors of his world-view is, in both a temporal and structural sense, a long way removed from the transnational, corporate oligopolies that dominate the international economy in the late twentieth century. Despite their expressed anxiety over the influence of monopoly power (see below) in the marketplace and the frequent nostalgic glances back to a previous era of primitive capitalism, New Right theorists largely approach the issue as

an act of faith. That is, capitalism in whatever guise is seen as somehow expressive of free market principles. The fact that this is patently not the case in many instances is either blithely ignored, or tendentiously argued away by the assertion that, for all its flaws, contemporary capitalism still represents a vastly superior mechanism for production and distribution than any extant alternatives.

The existence of monopolies or single producer markets acts as a clear constraint on the free play of market forces, and this is recognised by New Right theorists.

The enforcement of competition law and the proscription of monopoly practices by the state is viewed as necessary in order to protect the integrity of the market economy.

The existence of natural monopolies in areas such as electricity distribution and water supply is seen in orthodox economics as an example of market failure, and this has been often used as the justification for public ownership. Not so though, with most New Right theorists, who argue that confronted with the unenviable choice (or "evil", Friedman, 1962, p.28) of public or private monopoly, private monopoly is to be preferred because,

*..a state monopoly is always a state-protected monopoly - protected against both potential competition and effective criticism..*

and that the

*..machinery of monopoly becomes identical with the machinery of the state, and the state itself becomes more and more identified with the interests of those who run things than with the interests of the people in general.*

Hayek (1986) p.146 and p.147

It is generally accepted, however, that private monopoly provision of essential services would be likely to require a degree of public regulation <sup>10</sup>.

(iii) The role of the state

*Privatisation is at the vanguard of a world-wide movement in thinking and politics about the legitimate role of the state in an industrial society of the 1980s. Socialism in whatever form has both lost the battle of ideas and has been forsaken as a practical solution to the immediate industrial problems that most economies are now confronting.*

Veljanovski (1987) p.204

*There is a conventional picture of British history as the steady, and apparently inexorable, spread of state involvement in the economy and society, at least until the 'extremist' Conservative government in 1979 uniquely committed to reversing this trend..This is bad history. One could identify a series of turning points in British history when men of property, representing our tradition of individualism, have resisted the encroachment of the state. Willetts (1992) p.7*

The New Right's articulation of the function of the state is altogether more ambiguous than its concept of the market. Although the Hobbesian leviathan never appears to be far from mind, a variant of the Minotaur would perhaps be a more appropriate metaphor for the state in New Right thought; for it is clearly seen to have two parts - one of which is considerably less terrifying than the other.

In order to understand the nuances of the New Right position on the role of the state, it is first of all necessary to summarise their critique of the post-War social democratic state. The primary ingredients of the **critique of the state** are outlined by Dunleavy & O'Leary (1987 p.47):

*State intervention is criticised on three main grounds: because in practice it produces worse results than do market solutions; because administrative and bureaucratic methods are inherently inferior to markets as a means of allocating resources; and because it is objectionable on moral grounds.*

Given the New Right's deification of the market, it is hardly surprising that any alternative to market-based production and distribution - particularly one involving active interference with the market organism and private property relations - would, almost by definition, be seen to be less efficient and effective. And much of the case against the involvement of government as a producer is built, almost in its entirety, around this central belief. However, some analyses of the detrimental effects of state involvement in the economy - either as a central planner or producer - adopt a more developed position. In particular, they draw attention to (i) the problems of planning, (ii) the absence of competition, and (iii) the comparative performance of state-run enterprises.

The notion of centralised planning is anathema to most New Right theorists, with much of the intellectual assault against it led by the Austrian School under the leadership of the late Friedrich Hayek. Planning is viewed with abhorrence not only because it intrudes upon the natural workings of the market and reduces entrepreneurial freedom ("planning against competition", Hayek, 1986, p.31); but also because it assumes a level of cognitive skill that human beings generally don't possess (and it is here that the Hayekian thesis intersects with 'disjointed incrementalist' approach of Lindblom, 1959, and others). Given the finiteness of human knowledge then, any attempt to apply planning solutions amounts to little more than the tyrannical imposition of the views and vested interests of the few (e.g. senior bureaucrats) on the majority. Dunleavy & O'Leary (1987 p.131) encapsulate the New Right position on planning when they state:

*Economic activity should remain private, because markets are a powerful 'discovery system' which achieve co-ordination and social learning without coercion and without trying to attain the kinds of impossible synoptic knowledge of how a whole economy works which state planning demands.*

In conjunction with their dismissive attack on the planning ambitions of post-War social democratic governments (which in their assessment includes the Macmillan and Heath governments in Britain), New Right theorists have been highly critical of the corporatist processes through which this planning was attempted. The formulation of public policy via the triad of government, business and unions resulted essentially, in their view, in the institutionalisation of inefficient practices and the promotion of short-term, ineffective policy responses (such as prices and incomes policies) aimed largely at satisfying elite vested interests.

The non-existence of competition, which is characteristic of much state production (whether it be in the industrial or social welfare arenas), substantially inhibits efficiency and productivity. The effective monopoly that many state-based enterprises enjoy, enables them to remain unreceptive to preference and price signals; hence they place both consumers and potential competitors in a highly disadvantaged position. This according to New Right advocates is in direct contrast to the open, consumer sovereign nature of the private market.

This absence of competition and the ability to persevere with inefficient management practices, minus the sanction of bankruptcy or 'hostile takeover', is adjudged to be the cause of the poor performance of public enterprises relative to private sector firms. Although the evidence on the comparative performance of public and private enterprises in sectors like utility services is inconclusive (these studies are cited in Part 2), this does not inhibit critics of the public sector from using this line of reasoning as a supposedly empirical buttress to their more *a priori* arguments.

The second major element of the case against the state, namely that administrative and bureaucratic methods of allocation are inferior to market processes, has a more empirically hard-edged basis, i.e. public choice theory.

The public choice approach "is a perspective on politics that emerges from an extension and application of the tools and methods of the economist to collective or non-market decision-making" (Buchanan, 1989, p.13). While the public choice school, is not the exclusive preserve of the New Right (as Dunleavy & O'Leary 1987, Dunleavy, 1991 make clear), its insights have been utilized to greatest effect by opponents of state provision.

The starting point for public choice analysis is that actors in the public sphere - officials and politicians - exhibit the same rational, utility-maximising behaviour as that expressed by individuals in the private market. Hence, in contrast to classical public administration dictums, public sector actors are seen to be essentially motivated not by obscure notions of public service, but by self interest.

Due to the absence of a direct financial profit motive, the public choice argument runs, the utility-maximising behaviour of public sector actors will be expressed in perverse ways. That is, rather than productivity and efficiency being the reference point against which performance is judged (for there is little reward for these, it is suggested, in the public sector), factors such as size of organisational territory and budget become the performance criteria. Dunleavy & O'Leary (1987 p. 114) amplify this interpretation of bureaucratic behaviour as follows:

*The key difference between firms and state agencies concerns what it is that their managements try to achieve. In private firms (even those which are inefficiently run), decisions are still made with a view to increasing profits, since managers' earnings are often profit-related. But in government agencies bureaucrats' welfare is more likely to be closely linked with the size of their budget than the earnings of their bureaux. Increased appropriations create more jobs for government officials, improve promotion prospects, strengthen demand for their services, make it easier to run agencies and improve their prestige and patronage abilities..Hence the central objective of all government officials is to maximize their agency's budget.*

Not only does the capacity to secure resources effect the fortunes and standing of officials in government departments, but it also influences the progress of ministerial careers as well. And even if a government minister actively sought to reduce the scope and size of his/her departmental domain, the control that officials exercise over information would seriously retard their ability to do so. In this "Yes Minister" world of bureaucratic imperialism then, political accountability through the democratic process is almost non-existent.

Alongside these inherent difficulties in controlling the supply side of government, are the deficiencies in the demand side of democratic governance. For public choice theorists, politicians as utility-maximisers, purchase electoral support through trading ever-escalating promises, minus serious consideration of their public expenditure impact:

*..why did the economists of the thirties, forties, fifties, and into the sixties take the Keynesian theory of policy seriously? Why did they fail to see the elementary point that elected politicians will seek any excuse to create budget deficits? Buchanan (1989) p.21*

Voters, who are also utility-maximisers, effectively conspire with politicians in this fiction that the 'ante' can continually be raised, because they don't directly relate the costs of the promised additional programmes to the taxes they pay. Or if a section of

the electorate do, they are likely to be out-voted by a majority coalition of interests who stand to gain by the introduction of new programmes. Hence the affection in New Right circles for public financing devices - such as the now-discredited community charge - that draw a stronger nexus between consumption and taxation.

The conclusion that many public choice theorists arrive at from all this is that the failings of democratic governments as managers of the public purse are so deeply entrenched and pervasive that they should be entrusted with as few responsibilities as possible. At a minimum, it demands that the taxation powers of governments and the administrative fiat of state bureaucracies should be circumscribed within tight constitutional boundaries:

*When persons are modeled as self-interested in politics, as in other aspects of their behaviour, the constitutional challenge becomes one of constructing and designing framework institutions or rules that will, to the maximum extent possible, limit the exercise of such interest in exploitative ways and direct such interest to furtherance of the general interest. Buchanan (1989) p.22*

For the New Right, public choice theory adds a dimension to its critique of the state that it otherwise would not have; a dimension that is at the one time, ostensibly empirically-based and morally satisfying. The latter benefit is derived from being able to 'tunnel under' the moral high ground traditionally held by advocates of collectivism, i.e. that public sector activity is informed by an overriding commitment to public service and the pursuit of the public interest. Public choice theory (it is believed) has not exactly revealed the state Emperor to be without clothes, but it has shown, damagingly, that the garb worn is not distinctly different from that found on any entrepreneur walking the streets of the City on any given day.



The empirical validity of public choice insights into the political and administrative process has been subjected to increasing challenge by political scientists in recent years: "the great majority of empirical researchers are by now agreed..that the hypothesis concerning the predominant role of self-interest in Western politics cannot be upheld" (Lewin, 1991, p.98), "..the appeal of budget-maximizing models has not been grounded on detailed empirical support" (Dunleavy, 1991, p.223 - see also Orchard, 1989) <sup>11</sup>. Yet this has not appeared to diminish its use in the counterattack against *dirigiste* models of the state.

The final aspect of the New Right's critique is its fundamental **moral objection** to state intervention as an infringement of individual liberty and freedom. In addition, state involvement in the allocational process tampers with the reward structure (through equality-oriented measures) and undermines individual responsibility. The basis for this moral angst over state incursions into the market place was summarised earlier and therefore does not warrant repetition here. However, the legitimacy of state intervention in areas outside the economic market, is a matter of some debate within the New Right itself; with radical liberals and conservatives adopting somewhat different stances. It is to these apparent tensions in the New Right conceptualisation of the state in a free economy that attention will now be turned.

Much has been made, in the extensive literature on the New Right, of the differences between its two dominant strands - radical liberalism and conservatism - over the appropriate role of the state [see for example, Johnson, 1987; Gamble, 1988, 1989; Hill, 1990; Willetts, 1992 <sup>12</sup>; Heywood, 1992; Hayek also articulates the major lines of

division in his famous Postscript to *The Constitution of Liberty*, "Why I Am Not a Conservative"]. What then are these contrasting viewpoints on the state and are they significant sources of internal tension for governments influenced by New Right ideas, such as those led by Margaret Thatcher and John Major in Britain?

Put simply, the logic of the purist radical liberal view of the centrality of the free market in society would suggest that the state has a very marginal role to play. Because the market in its free and unfettered form is the most efficacious vehicle for production and distribution, the presence of the state in the market should be minimal, if evident at all. Equally, most of the current set of so-called non-market functions performed by the state (such as social welfare, environmental protection and corrections) could quite easily be converted into market transactions by handing them over to the private sector. The primary legitimate role for the state under this view is that of protecting private property through the provision of law and order:

*In no system that could be rationally defended would the state just do nothing. An effective competitive system needs an intelligently designed and continuously adjusted legal framework as much as any other.* Hayek (1986) p.29

*Its major function must be to protect our freedom both from the enemies outside our gates and from our fellow-citizens: to preserve law and order, to enforce private contracts, to foster competitive markets.* Friedman (1962) p.3

Yet even the maintenance of a framework of rules for fair trading in the market - which many New Right theorists would see as a state function - would be more satisfactorily performed via the self-regulatory behaviour of market institutions in the opinion of some advocates of the radical liberal position. Clarke (1987, p.89) conveys the spirit of this

extreme end of the anti-statist position when he says "I believe that nothing now done by the State could not be more successfully done by the market" <sup>13</sup>.

The fact that it is possible to talk about the "extreme end" of a set of views, in itself of course, suggests that the radical liberal position on the state ranges over a continuum. But, by and large, radical liberals are united in their belief in a minimalist state; although the detailing of the specific functions of the minimal state varies.

As a conceptual model of an idealised role for the state in contemporary Western society, it is grossly under-developed and its lack of intellectual substance can, with some validity, be parodied as 'the state is the collector of residue activities spurned by the market'. The theoretical edge to the New Right's formulation of the state is provided, as King (1987) suggests, by the classical conservative political tradition.

In the **conservative** world-view, the state occupies a clear and unequivocal position as the defender of traditional values, authority and social order. Without a strong and omnipresent state, representing ruling class interests, society would dissolve into anarchy and chaos.

As the preserver of tradition and values, the state provides both the continuity and structure necessary for the ordered functioning of human society; as the residual holder of the accumulated wisdom of historical precedent, the power and legitimacy of the state is unassailable. This conception of the state in conservative thinking goes back at least to the end of the eighteenth century and was probably most coherently and eloquently

expressed by Edmund Burke in his famous attack on the French Revolution and the nascent British 'left' (*Reflections on the Revolution in France*, 1790).

In practical terms, the conservative conception of the role of the state may not appear to be markedly different from the less anti-statist end of the radical liberal continuum.

The core function of the state in both perspectives is to protect property rights:

*The state's authority must be especially exercised to maintain property relations and the rights of property owners. Authority and discipline must also be reasserted in schools and in families. The egalitarian consequences of post-war social citizenship rights must be reversed: social hierarchy should be accorded its 'proper' role in society.*  
King (1987) p.22

What makes the conservative formulation of the state fundamentally different however, is the fact that it is accorded a dominant, positive role (as opposed to its peripheral and reactive position in radical liberalism) and the way that the state is given entry into the private domain of relationships and values (such as the family) even at the expense of individual liberty: "In general, it can probably be said that the conservative does not object to coercion or arbitrary power so long as it is used for what he regards as the right purposes" (Hayek, 1960, p.401).

While the conservative position provides a sense of legitimacy for the presence and operation of a strong state, is this sufficient in itself to explain away the obvious tensions that exist in the New Right approach to the state? For as Gamble (1988) states:

*The idea of a free economy and a strong state involves a paradox. The state is to be simultaneously rolled back and rolled forward. Non-interventionist and decentralized in some areas, the state is to be highly interventionist and centralized in others.* pp.28-29

Finding a solution to this paradox involves more than the unpicking of a theoretical puzzle; for it relates directly to the development of an understanding of the mechanics of Thatcherism and its seemingly ambiguous use of state power.

In seeking to explain how the tension between free market principles and an interventionist state - reflected in the practices of recent Conservative Government in Britain - has been 'resolved', three possible (and not necessarily, mutually exclusive) hypotheses present themselves:

1. That centralised and assertive intervention is required in the short-and medium-term to clear the way for the full flowering of the free market economy.
2. That interventionist state activity is a necessary and inevitable corollary of a free market economy.
3. That the paradox is not really a paradox at all.

Brief consideration will be given to each of these hypotheses.

The **first hypothesis** is suggested by Gamble (1988) in his analysis of the first eight years of the Thatcher Government and runs roughly as follows. Because the Thatcher Government took office in an economic, social and political environment dominated by the precepts of social democratic regimes developed over the preceding thirty-odd years (which he describes as "social democratic hegemony"), a sustained period of clearing out was required. In this context, the Government had to intervene quite heavily in order to open up the free market, to remove the vestiges (and vested interests) of social democracy and to transform individual attitudes and behaviour. This latter imperative is summarised by Gamble when he says, "It [Conservative Government] seeks to reshape

the institutional framework of the free economy. The citizens have to be forced to be free and enterprising, otherwise there is no guarantee they will be so" p.35. The implication of this hypothesis is that after the period of re-education and reassertion of the primacy of the market is completed, the firm hold of government will be relaxed, thereby enabling the liberal minimalist state to be achieved.

The second hypothesis, in contrast to the previous one, suggests that regardless of the ambitions of radical liberals, a strong state is virtually endogenous in free market capitalism. The following comment by Polanyi in his study of the history of modern capitalism (quoted in King, 1987 p.87) expresses this view:

*..the introduction of free markets, far from doing away with the need for control, regulation and intervention, enormously increased their range. Administrators had to be constantly on the watch to ensure the free working of the system. Thus even those who wished most ardently to free the state from all unnecessary duties, and whose whole philosophy demanded the restriction of state activities, could not but entrust the self-same state with the new powers, organs and instruments required for the establishment of laissez-faire.*

The infrastructure of state regulatory bodies established in tandem with the privatisation of the public utilities, seems to support the validity of this assertion. Although, as shown in the previous Chapter, the character of the regulatory agencies is such as to suggest an air of impermanence and transience - i.e. muted regulatory structures and formal statutory protections in favour of an individualistic and discretionary model of regulation, and an emphasis on creating a competitive market environment. If this is so, it would add weight to the first proposition rather than the second.

The **third hypothesis** challenges whether a paradox in the free market/strong state relationship exists. While it is true that there is an apparent conflict between radical liberal values and conservative statism, this is only because the state is viewed as a unitary, homogeneous entity. Clearly, where there is little differentiation between the disparate roles of the state, a tension exists between the "more state" and the "less state" positions of the conservatives and radical liberals respectively. However, in reality neither strand of New Right thought views the state in this unified way. Rather, to put it somewhat simplistically, the state is perceived in two parts, i.e. the pro-free market dimension of state activity (e.g. monetary control, law and order, defence, monopoly regulation) and the anti-free market dimension (e.g. economic and energy planning, public ownership and production, state-dominated social welfare provision). And all New Right protagonists, despite some differences in emphasis, are united in their objective of seeing the former role of the state enhanced at the expense of the latter.

What each of these hypotheses have in common is a recognition that the state performs an important function as a facilitator of, and residual support for, the market economy. The practice of the Thatcher and Major governments suggests that this is also recognised by the power-brokers in the Conservative Party. King makes a similar point when he concludes:

*The theoretical contradiction between liberal minimalism and conservative activism has never been resolved intellectually but its success electorally and programmatically is sufficient for the Government. p.27*

From this review of New Right theory, it can be seen that the privatisation of the public utilities is likely to occupy a centrally important place in the New Right project for structural social change. For it, at the one and the same time, enshrines the principle of 'commodification' as the basis of individual interaction in society (i.e. premised essentially on market-based exchanges), extends individual property rights, promotes the ascendancy of the market, and crystallises the shift in the role of the state from producer to 'enabler'.

The extent to which aspects of this agenda has been translated into explicit political and economic objectives in the British privatisation programme will now be considered.



## PART 2: THE ECONOMIC AND POLITICAL OBJECTIVES OF THE PRIVATISATION PROGRAMME

### INTRODUCTION

In Part 1, the ideological context of privatisation was discussed. The tenets of neo-liberal political philosophy underpins the 'intellectual logic' of privatisation, just as the prescriptions of the New Right theory on the roles of the market and the state might be seen to form the 'meta-objective' of privatisation. At the level of practical policy-making, the privatisation programme has been motivated by a set of broadly related, but rather more concrete, political and economic objectives, such as promoting wider share ownership, reducing the Public Sector Borrowing Requirement (PSBR) and improving the operational efficiency of public utility industries.

The existence of a set of 'second order' policy objectives, founded on a strong ideological thesis about the respective roles of the state and the market, does not necessarily mean that the privatisation programme has been directed according to a pre-determined and coherent agenda. Indeed in the view of most commentators, the privatisation policies of the Thatcher and Major Governments have been characterised less by consistency and coherence than by heuristic and adaptive responses to political and financial exigencies (Kay et al, 1986; Gamble, 1989; Marsh, 1991) <sup>14</sup>. Certainly, it is apparent in retrospect that the emphasis given to the achievement of particular economic, financial and political outcomes has shifted at different stages of the programme (see Figure 4.1 overleaf).

<b>THE BRITISH PRIVATISATION PROGRAMME</b>	
<u>PUBLIC SECTOR SALES</u>	<u>MAJOR OBJECTIVES</u>
"Competitive industries" (e.g. Amersham, National Freight, Cable & Wireless)	* Disposal of market-based industries * Revenue-raising
-----	
"Market dominant enterprises" (e.g. British Telecom, British Airways)	* Efficiency/competition * Revenue-raising
-----	
"Natural monopolies" (e.g. water authorities, regional electricity companies, British Gas)	* 'Popular capitalism' * Free market hegemony

**Figure 4.1: The British privatisation programme**

The seemingly fluid nature of the arguments used by Conservative governments over thirteen years of privatising endeavour is possibly deceptive, however. For regardless of the different weight given to economic objectives in particular instances of privatisation, it is possible to discern, over the life of the programme, a dominant strand of political imperatives. In the earlier phases of the programme, the financial, but quintessentially political issue, of fiscal management and public expenditure occupied a prominent place in the Government's motivation for denationalisation. This was displaced in the 1986-1990 period by an explicit elaboration of the "popular capitalism" and "share-owning democracy" thesis <sup>15</sup>, which had been little more than a sub-text in earlier privatisations. Finally, there is evidence that the core motivation for the programme in more recent times has reverted back to PSBR-management objectives. The over-riding

political theme of the programme is noted by a number of commentators, for example:

*Privatisation originated as a political and financial strategy, the economic rationale was appended later.* Whitfield (1992) p.128

*..the government's aims in relation to privatization have changed substantially over time. As they have changed, and the political aims have become more important, so the government has offered incentives to ensure successful asset sales and broader share ownership.* Marsh (1991) p.461

The nature, balance and congruence of the objectives of the privatisation programme also raise important questions at the level of political theory. In particular, whether the dominance of political factors indicates, ultimately, that the privatisation programme is a classic expression of "statecraft" (Gamble, 1988) driven by short- and medium-term political objectives, or alternatively, a "hegemonic project" (Hall & Jacques, 1983; Hall, 1988; Jessop et al, 1988) aimed at long-term ideological domination. This is a field of inquiry substantially beyond the scope of this thesis, however, the question of the hegemonic character of the privatisation programme is considered in the conclusion to this Chapter.

The multiple objectives of the privatisation programme will be discussed in this part of the Chapter. The objectives that will be examined are:

#### Economic

- # consumer sovereignty
- # efficiency

#### Political

- # fiscal management
- # creating a share-owning democracy
- # reducing trade union power
- # defeating collectivism

### **a. Privatisation - the economic arguments**

The core economic arguments used to justify the privatisation of public utilities and other public enterprises take as their starting point a critique of the defects of public ownership, and revolve centrally around two major issues: (i) the constraints on economic freedom arising from the existence of government-run monopolies and the associated failure of these industries to treat the interests of consumers as paramount and (ii) the seemingly endemic inability of public enterprises to optimise allocational and productive efficiency. These arguments have been articulated in varying forms by representatives of the Government (e.g. John Moore, in a series of speeches to the City in 1983 and 1985, John Redwood, 1988 and the water and electricity privatisation White Papers), as well as by academic economists such as Beesley & Littlechild (1986), Curwen (1986) and Veljanovski (1987, 1989b).

#### **(i) Economic freedom and "consumer sovereignty"**

*..the main prize, if competition can be increased, is for the consumer.*  
Moore (1985) p.90)

In the view of the proponents of privatisation, the existence of large nationalised industries, with effective monopoly power over demand and supply, acts as a severe brake on the exercise of individual economic freedom. This constraint on freedom is manifest in two major ways; firstly, it inhibits the ability of "corporate individuals" (i.e. private sector firms) to gain a market share of the those parts of the production and service economy controlled by the nationalised industries and secondly, as a result of this absence of a free market (or even a marginally open one), the individual consumer

has no capacity to exercise choice in the purchase of goods and services supplied by public sector enterprises.

Choice is reified as the passport to consumer sovereignty and ultimately, service quality. Therefore, in the absence of choice the consumer is 'captive' and exposed to the vagaries of a producer-dominant service system. Producer domination in turn engenders an insensitivity towards, and a disinclination to respond to, the needs and predilections of consumers. This is perceived to be one of the most pervasive features of the nationalised industries:

*The nationalised industries have also unfortunately not been very good at satisfying their customers..Services often did not seem to match needs or expectations. Moore (1983) p.83*

Juxtaposed against this metaphor of a complacent set of public monopoly providers (which, it should be said, has some basis in fact - see Annexe 1) is the inherently responsive and customer sensitive facility of the private sector: "privately owned companies have a greater incentive to produce goods and services in the quantity and variety which consumers prefer" (Beesley & Littlechild, 1986 p.38). The introduction of similar incentives - related to the existence of competing sources of supply and the requirement of profit-maximisation in the interests of shareholders - into the erstwhile nationalised industries would secure a framework of rights and protections for consumers unattainable under public ownership.

As with the characterisation of the free market economy generally, the concept of consumer sovereignty has as much untruth to it as it has truth. In order for consumer sovereignty to have practical, and not just rhetorical, meaning a set of pre-conditions are necessary. These include (i) the existence of a range of product choice, conditioned by the actual preferences and needs of consumers (rather than, as is often the case, both preference and product being 'manufactured' by the producers themselves <sup>16</sup>), (ii) the absence of significant levels of information asymmetry between producers and consumers, (iii) the sensitivity of price to consumer demand (producers as 'price takers' and not 'price makers') and (iv) the ability for consumers to exit without financial or other loss. Only rarely, in most commodity markets, do these pre-conditions apply (see Forbes, 1987, Table 4-1 pp.69-70 for an assessment of the "theory and reality of the exchange environment").

(ii) Improving efficiency

*Public enterprises perform relatively poorly in terms of their competitive position, use labour and capital inefficiently and are less profitable.*  
Moore (1985) p.83

*What hampers the [electricity] industry is its structure and its position in the public sector.* Electricity privatisation White Paper Cmnd. 9734

The market as facilitator of consumer sovereignty has carried the most symbolic potency in the economic case for privatisation (as reflected in the way that it has been frequently invoked by the Government in support of privatisation initiatives <sup>17</sup>) but the case for denationalisation is built substantially around the efficiency argument.

For advocates of privatisation, the efficiency performance of public enterprises is almost invariably overshadowed by that of their private sector counterparts, or in the absence of counterparts (as in the case of monopolies), by the prospective private businesses that should displace them. This is despite the fact, that the empirical evidence accumulated over a quarter of a century of research - particularly in the US - is anything but clear-cut. Studies which have compared the economic performance of public utilities under different ownership conditions fall almost equally into two camps: with approximately half concluding that there is little discernable difference in performance, and the other half split evenly between those that conclude marginally in favour of publicly-owned utilities and those that conclude marginally in favour of privately-owned utilities.

For an overview of public/private sector comparative performance studies see Yarrow, 1986; Waterson, 1988; Vickers & Yarrow, 1988; Weimer & Vining, 1989; Donahue, 1989 and Nelson, 1990; for specific studies see Meyer, 1975; Pryke, 1981, 1986; Millward, 1983, 1986; Dunsire et al 1988, 1991; McGowan, 1988; and Thompson et al, 1991.

The putative inefficiency of public enterprises - particularly as manifested in low rates of return on capital investment relative to that obtained within the market generally - is said to be the result of two factors.

Firstly, their monopoly or quasi-monopoly position within the public sector affords them protection and insulation from the economic rigour of market forces. Hence poor management practices, bad investment decisions and low levels of worker productivity escape the sanctions that apply to firms in the private sector; namely, takeover or

bankruptcy. Even under a regime not characterised by these deficient commercial practices (and many critics of the nationalised industries concede that the performance of these industries improved substantially from the mid-1970s onwards), the monopoly character of public sector enterprises has a propensity to give rise to productive and allocative inefficiency because - in the absence of competition - they can effectively regulate supply and price. The similar criticism, it should be said, is levelled at private sector monopolies by economic theorists; albeit often without the same degree of vehemence.

Secondly, the fact that the industries lie within the province of government is viewed as detrimental to their economic performance. A good part of the failure of the nationalised industries had been attributed to (i) the lack of congruence between long-term investment planning and short-term political and fiscal priorities, (ii) the constraints on the nationalised industries gaining access to investment capital from the private sector, and (iii) the sheer incapacity of politicians to be able to make good business decisions. Notwithstanding the framework for the operation of the nationalised industries developed by Herbert Morrison - i.e. controlled by 'public spirited' businessmen and bureaucrats theoretically at arm's length from the government of the day - a review of their forty year history tends to confirm the view that repeated incursions into the operational decision-making of the nationalised utility industries by successive governments acted to the detriment of their economic performance (see Annexe 1).



The economic viability of the nationalised industries has been also affected, it is often asserted, by the burden of "non commercial objectives" that they were traditionally obliged to meet:

*The most likely explanation for the poor performance of the public enterprise activities is that they are in public ownership. It could have had a harmful effect by inducing the belief that the activities should act as social services and take the national interest into account. Pryke (1986) p.117*

One manifestation of this is the cross-subsidisation of costs from commercially viable to less-commercially viable sectors (for example, the urban subsidisation of rural electricity costs), and it has been viewed with particular abhorrence by economists and advocates of denationalisation alike as it confounds the principle of allocative efficiency.

Generally it is held by all but the most partisan of privatisation proponents, that the mere transfer of monopoly industries from the public to private sectors is insufficient in itself to achieve either the consumerist or efficiency outcomes attributed to the free market, for ownership is not the key variable (Helm et al, 1988; Dunsire et al, 1988; Cullis & Jones, 1989; Parry, 1990; Parker & Hartley, 1991; Bibby, 1992). In order for these outcomes to be realised, privatisation should be accompanied by the disassembling and restructuring of public monopolies, with a view to stimulating competition in production and supply:

*The long-term success of the privatisation programme will stand or fall by the extent to which it maximises competition. If competition cannot be achieved, a historic opportunity will have been lost. Moore (1985) p.92*

The effective promotion of competition is pivotal, as John Moore attests, to the success of the privatisation programme. Competition is the engine by which the force of change, in the structure and output of one-time public sector activities is to be driven. The advent of competition in hitherto closed and insulated enterprises, it is asserted, will lead to a veritable chain reaction of positive effects, like increased productivity and efficiency, greater public accountability and enhanced consumer power. Without competition the linch-pin between the promise and delivery of privatisation is broken:

*The evidence is overwhelming that where corruption, negligence, or the nature of the service itself undercuts competition, the benefits of privatization shrink or vanish. Efforts to compensate by other means for the missing discipline of competition will seldom be fully successful. Those public services for which it is technically or politically impossible to keep contractors in a state of healthy insecurity offer, at best, limited potential for privatization. Donahue (1989) p.218*

#### **b. The political objectives of the privatisation programme**

In reviewing the history of the Conservative Government's privatisation programme, it would seem that economic objectives have been largely subordinate to political ones. Although, there has been an attempt to achieve a greater degree of balance between these two sets of policy objectives in the more recent privatisation of the electricity supply industry.

From the sale of British Telecom onwards, Ministers of State, other government spokespersons and external supporters of the programme (e.g. the Institute of Economic Affairs) increasingly drew attention to the non-economic benefits of denationalising the

utilities; such as the promotion and dispersal of share-ownership and the permanent overturning of dirigiste and socialist conceptions of the role of the state. Equally, the economic rationale for denationalisation - competition, efficiency, lower prices etc. - which seemed tenable in the earlier privatisations, became (until the ESI privatisation at least) more and more difficult to sustain and to justify as the framework and mechanics of utility privatisation evolved. Four of the major elements of the political agenda of privatisation - fiscal management, "popular capitalism", reducing trade union power and the defeat of collectivism - will be discussed in the following section.

(i) Fiscal Management

*As elsewhere in the world the difficulties in reconciling revenue with expenditure in the government accounts provided considerable impetus to those of us arguing for a large [privatisation] programme and helped by enabling it to be built into the framework of the national budget. It became something all wings of the Conservative Party could agree on, left and right, as it made available more money both for spending programmes, and for the tax cuts dear to the hearts of both sections of the party. Redwood (1988) p.147*

Throughout the 1980s and early 1990s, the development of a secure revenue stream from public asset sales has formed an integral part of the Government's fiscal management strategy (Heald, 1984; Hogwood, 1992). The growth in privatisation receipts contributed to the reduction in the Public Sector Borrowing Requirement (PSBR) during the decade of the 1980s<sup>18</sup>. During the Chancellorship of Nigel Lawson, it also afforded the Government some scope for making tax cuts, without the concomitant necessity of making politically unpopular cuts in public expenditure (Johnson, 1992).

The "accounting conventions" (Kay et al, 1986) employed by the Government to use privatisation proceeds as an offset against current expenditure and the failure to set this income against future loss of revenue (that would have been derived from the industries had they remained in public ownership) has drawn considerable criticism (see Levacic, 1987; Heald & Steel, 1986; Curwen, 1986; Vickers & Yarrow, 1988).

To the end of September 1992, proceeds from the privatisation of state enterprises totalled in excess of £46 billion, with over £43 billion of this being generated from the period 1984/85 (sale of British Telecom) onwards. Figure 4.2 overleaf illustrates the growth in privatisation receipts between 1979 and 1992. Figure 4.3 shows the annual level of the PSBR over the same period.

It can be seen from the chart that from 1987/88 to 1990/91 the PSBR was a negative figure (effectively a Public Sector Debt Repayment), which is attributable, in part, to the substantial revenues obtained from asset sales. For example, privatisation proceeds in 1988/89 contributed over half of the PSBR of -£14.7 billion <sup>19</sup>. It could be hypothesised that the comparatively healthy state of the PSBR during these years gave the Government financial manoeuvring room to further other political objectives. Helm & Powell (1992, p.91) allude to this in relation to the ESI privatisation in 1990-91: "The maximisation of revenue from the sale was less important than in telecoms and gas, as the public sector borrowing requirement became a public sector debt payment."

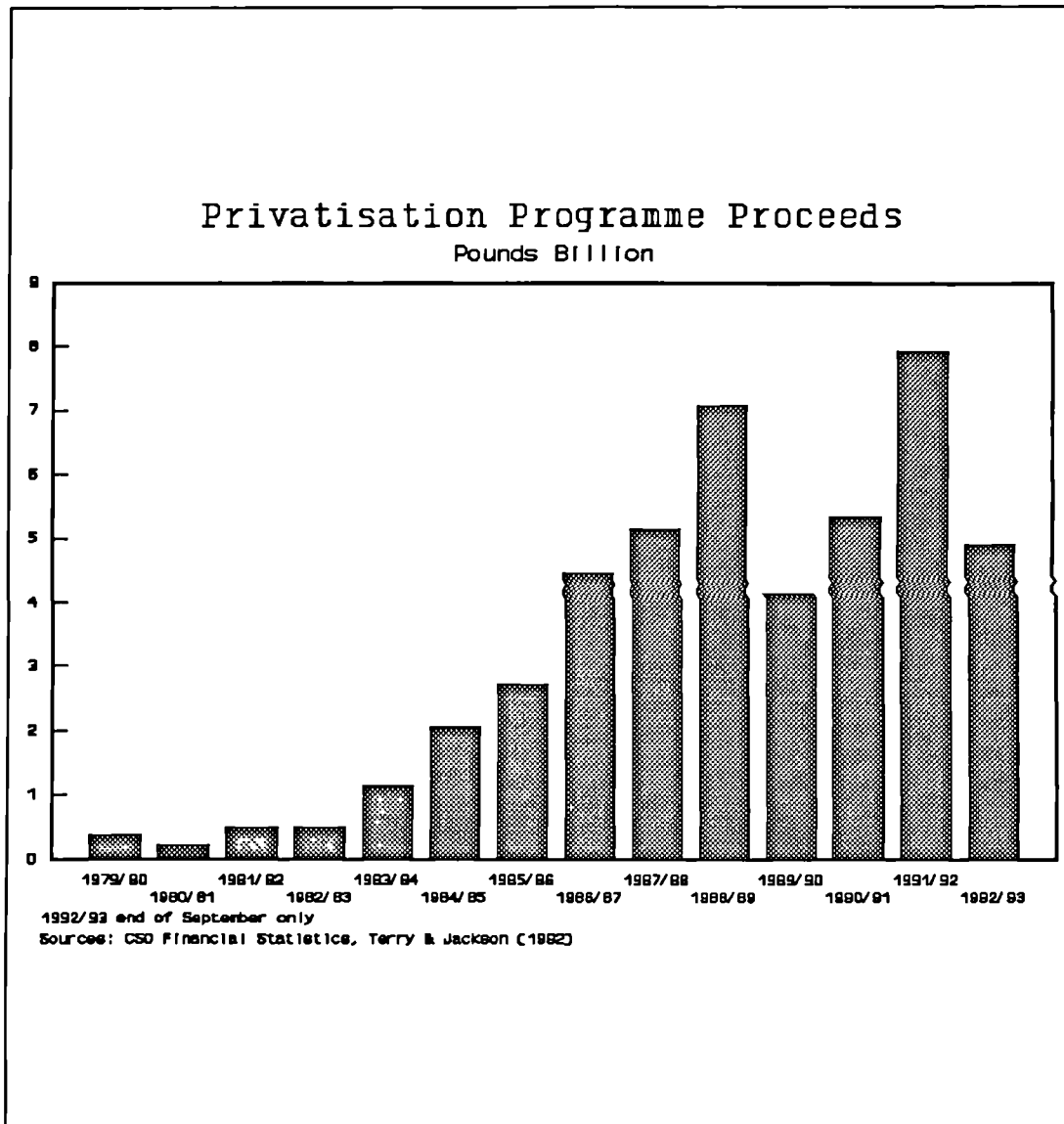
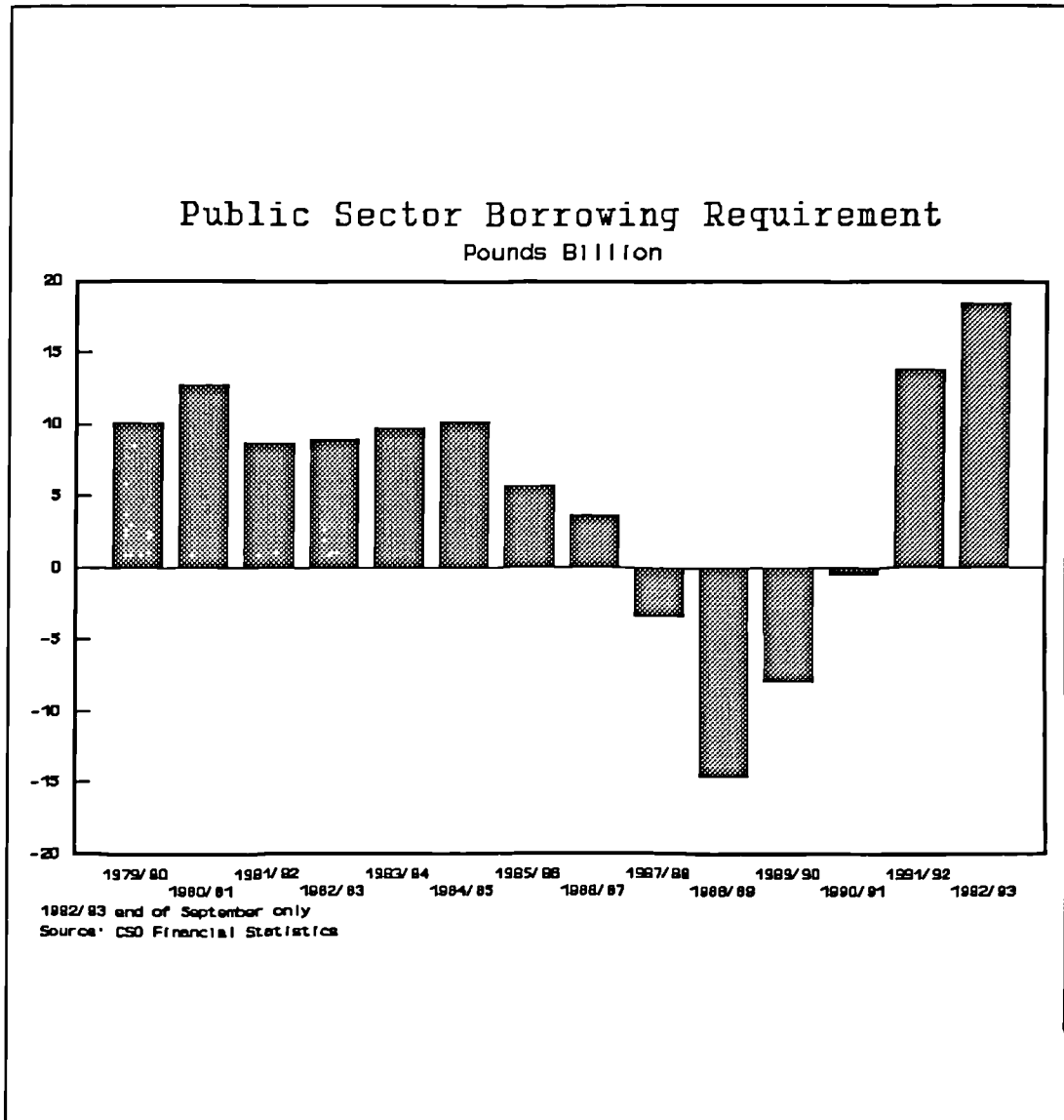


Figure 4.2: Privatisation proceeds 1979-1992



**Figure 4.3: Public Sector Borrowing Requirement 1979-1992**

In particular, the temporary release from the PSBR-related concerns would have enabled the Government to focus more directly on the objective of widening of share ownership, which could only be progressed at some financial cost (e.g. providing incentives and discounts to attract new entrants to the equity market). It also took the pressure off the Government to maximise revenue returns in the sale of the water and electricity supply industries.

The recent return to high PSBR levels reflects the impact of the economic recession (Johnson, 1992), as well as the abandonment of strict monetarist approaches to fiscal management (a process started under Chancellor, Nigel Lawson in the mid-1980s). But in common with its predecessors, the Major Government is heavily dependent upon maintaining the level of privatisation receipts - £5.5 billion in 1993-94 and 1994-95 (HM Treasury, 1992, Table 1.1)) - to notionally reduce public expenditure. As the supply of nationalised industries dries up, these revenue targets will become increasingly harder to attain (Hogwood, 1992).

Beyond the short-term expedient of raising revenue, it was argued by the Government, that eliminating the ex-nationalised industries' call on government loan finance (for capital works), through changing ownership and facilitating the industries' access to private capital, would reduce the "crowding out" of private sector investment by the public sector. As a process of re-locating the source of investment capital demand, privatisation of the ex-nationalised industries has indeed achieved this end. However, the overall effect of this change in the locus of demand on the capital market generally is probably insignificant, for as Kay et al (1986) suggest:

*Traditional crowding-out arguments are clearly not applicable here and to the extent that there is an effect it is to change the composition, rather than the total, of private sector borrowing. p.29*

The more tangible, and politically relevant, effect of shifting the locus of investment demand is that it removes the capital debt of the newly-privatised companies from the Government's fiscal balance sheet. This was particularly important to the Government in the case of the water industry and was, arguably, the crux of its motivation for selling the industry. In the absence of privatisation, the projected ten-year capital investment

requirement (£26 billion at 1989 prices) would have been added to public sector debt and would need to have been financed through increases in charges, or out of taxation revenue, or both <sup>20</sup>. Through privatising the water industry the Government has been able to relieve itself of a debt-heavy sector, as well as distance itself from the inevitably adverse popular reaction to annual real-term increases in water charges related to the capital investment programme.

(ii) Creating a Share-Ownning Democracy

*The British Telecom issue did more than just enable Britain to establish the world's first large scale privatisation programme. It also led by chance to the invention of part of popular capitalism..the only way to be sure of a great success in the market place was to attract a new wave and generation of investors. The idea of seeking a large new generation of small savers came out of the exigencies of a marketing campaign to sell the world's largest ever equity offering..It was only after this the full significance of what had been done became clear..At last the prospect opened up, not merely of individuals owning a direct stake in the country through the ownership of their own land and houses, but also through direct ownership of a part of industry itself.*

Redwood (1988) p.147

The use of the privatisation programme as a means of extending share ownership within the workforce of the ex-nationalised industries and amongst the public at large, has become more explicit as the programme has progressed. The "Tell Sid" marketing of British Gas shares heralded a new agenda in the privatisation process and a desire to widen share ownership was given as part of the rationale for water and electricity privatisation in the relevant White Papers. More recently, the National Audit Office reports on the sale of these industries (1992a, 1992b), elevates share ownership as a primary objective in both cases.



The emphasis given by the Government to stimulating public interest in the sale of the nationalised industries began in relative indifference and concluded, in the case of the later public utility sales, in high fervour. Amongst the means used by the Government to engender public interest in the sale of the public utilities were (i) the substantial **discounting** of shares at flotation, the use of customer **incentives** such as bill vouchers and bonus shares, and the orchestration of slick and **expensive publicity** campaigns.

The political benefits for a Conservative government in broadening the individual shareholder base of the equity market are reasonably self-evident. In establishing "a rentier interest in the market" (Clarke, 1987, p.71) it is probable that members of the electorate who hold shares would be more receptive to the pro-market policies of the Conservative party:

*The political dimension of this [privatisation] has not escaped Conservative Party Central Office. TSB created about 1.5 million shareholders; 1.2 million retain shares in BT and another 5 million in BG.. This suggests that the average constituency electorate will have about 20,000 shareholder voters, which could make a difference in marginal seats. Veljanovski (1987) p.68*

McAllistar & Studlar (1989), in an analysis of voting patterns in the 1987 General Election, lend empirical weight to the thesis that the Conservative party is likely to be the electoral beneficiary of share ownership in the privatised industries. In this study, the researchers concluded that the Conservative party "gained 10 per cent more of the vote among new share owners, compared to those who had never owned shares, while Labour lost 9 per cent of the vote, net of other things" (p.172). Although the aggregate net gain for the Tories from the privatisation shareholder vote was relatively small - 1.6 per cent <sup>21</sup> - it would constitute, as McAllistar & Studlar acknowledge, a not

insignificant factor in a tight electoral contest; such as that which occurred in the 1992 General Election.

The political advantage accruing to the Conservatives from dispersed share ownership would also be in evidence in a situation where the Labour Party (or any other party with a prospect of winning government) sought to renationalise privatised industries where a substantial level of equity is held by individual investors; as this would "[threaten] not only the gentleman in the pin stripes but the voter in the bus queue" (Redwood, 1988, p.39). So, even if the direct political pay-off for the Conservative party is relatively small in terms of additional votes, dispersed share ownership has the effect of applying a brake on the range of alternative policy options available to future governments and effectively places re-nationalisation and public ownership in the "no go area" of politics.

Short-term electoral advantage aside, broadening share ownership might also be viewed, along with the sale of council housing (under the rubric of "popular capitalism") as a project aimed at longer-term ideological objectives. The inculcation of an anti-state, pro-market and entrepreneurial culture was manifestly part of the agenda of Thatcherism (Keat, 1991) and the extension of property relations through equity and home ownership was seen as a primary mode of achieving this. Empirical studies into the values and attitudes of British population suggest, however, that the impact of this ideological project has been limited (Jowell et al, 1990, 1991; ICM 'State of the Nation' polls *The Guardian* 17/9/90, 14/9/92) and that "the hold of this ideology on the population at large seems no better assured now than it did ten or more years ago" (Hill, 1990, p.32).

Despite the transparency of its political motivations, the Government vigorously denied that it was seeking partisan advantage through the sale of public utilities. While the stimulation of entrepreneurial attitudes was acknowledged, the need for this - if Britain was to remain prosperous - was seen to be so self-evident as to be beyond questions of party politics.

Part of the case buttressing the Government's share-owning objective also revolved around the notion of consumer sovereignty. The consumer is most 'sovereign', it was asserted when she/he can influence the policies and practices of producer firms as a shareholder and 'owner'. Ironically, the powerlessness of small shareholders vis-a-vis management in monolithic corporations, has been used as a metaphor for the failings of the contemporary democratic state by some neo-liberal public choice theorists. But the impotency of minor, individual shareholders in the corporate domain was never acknowledged by the Government. Nor was the fact that a highly dis-aggregated form of equity control is held to be less effective in promoting management efficiency compared to more concentrated forms of equity holding:

*A large number of unorganized shareholders is much less effective in keeping managers up to scratch, because each shareholder has only a minor stake in the firm and confronts large costs in trying to make himself/herself expert in the firm's affairs. The 'residual income recipients' become inactive because they are so internally fragmented, and each shareholder confronts a collective action problem in doing anything about declining performance. Collectively shareholders are better off if they can impose their wishes on the firm's managers, but individually it is irrational for any one shareholder to try to improve matters. Dunleavy & O'Leary (1987) p.113*

(iii) Reducing Trade Union power

*They are using their power in a manner which tends to make the market system ineffective and which, at the same time, gives them control of the direction of economic activity that would be dangerous in the hands of government but is intolerable if exercised by a particular group. They do so through their influence on the relative wages of different groups of workers and through their constant upward pressure on the level of money wages, with its inevitable inflationary consequences.*

Hayek (1960) p.272

*The [nationalised] industries' performance on both productivity and manpower costs has also been disappointing. Public sector trade unions have been extraordinarily successful in gaining advantage for themselves in the pay hierarchy by exploiting their monopoly collective bargaining position.*

Moore (1983) p.82

The weakening of the power of the trade union movement had been a major policy goal of the Thatcher Government over the decade of the 1980s (King, 1987; Gamble, 1988; Hill, 1990; Metcalf, 1991). The policy instruments which the Thatcher Government used to debilitate the industrial and political strength of trade unions included, the use of state power to suppress strike action (reaching its apotheosis in the miner's strike of 1984-85), the introduction of a range of legislative measures to control the power of union leadership, the termination of the corporatist relationship between government and the Trades Union Congress which had existed over much of the post-war period, and the privatisation of the nationalised industries.

Traditionally, the nationalised industries had been a stronghold for the trade union movement; with a proportionally high membership relative to employees in the private sector and a capacity, due to their strategic location in key industrial sectors of the economy (for example, energy, transport and water services), to negotiate successfully

substantial improvements in wages and working conditions (see Harris, 1983 for a discussion of this in relation to the NUM). Importantly, the conditions achieved by workers in the nationalised industries often had a vanguarding effect, where the benefits they achieved ultimately flowed on to employees in other sectors of the economy. This nexus between monopoly union negotiating power (with a concomitant ability to win award changes without necessarily any increase in productivity) and the general escalation of worker demands throughout the economy, was one that the Thatcher Government was keen to sever. Privatisation of the major strategic industries potentially provided a platform from which to achieve this.

The Thatcher Government was, arguably, at its strongest and most assertive in the industrial relations field and the ability of successive governments under the leadership of Mrs Thatcher to moderate the claims of the trade unions has been one of its most noteworthy achievements (Gamble, 1988; Vane , 1992). The union movement was placed very much on the defensive throughout the 1980s and its failure to marshal significant public support in the face of a sustained assault upon its traditional prerogatives, was paralleled by a decline in its own membership base. In 1979, union members made up 54.4% of the eligible population, whereas in 1984, this had fallen to 45.8%. Even accounting for unemployment, union membership as a proportion of the working population had dropped by around 5% over this period (Halsey, ed. 1988 pp.188-189). The membership of unions affiliated with the TUC fell by almost a third between 1979 and 1989 (Metcalf, 1991) <sup>22</sup>.

Trade union power in Britain has patently declined since 1979, but the part that the privatisation programme has played in this is by no means clear. A number of commentators have argued that the effect of privatisation on the trade union movement has been relatively minor (Thomas, 1986; Marsh, 1991). Yet there are at least three areas where privatisation could be seen to have had some impact.

First, the process leading up to privatisation - the 'liberalisation' stage - where nationalised industries have been obliged to introduce more efficient, commercial regimes has led to the rationalisation of work practices and the shedding of labour in some industries (Pint, 1990). In the water industry, for instance, the number of workers employed across England and Wales between 1985 and 1989 fell by around 11 per cent; over three-quarters of which were craft and manual jobs (Water Prospectus, 1989).

The 'down-sizing' process in a number of the nationalised industries has also been used as a form of role model to encourage other parts of the public sector to adopt a more streamlined and productivity-conscious approach:

*The government appear to have cleverly used the threat of privatisation to reduce wage demands, restructure public industries and push through voluntary and compulsory redundancies. Cox (1987) p.163*

Second, evidence suggests that some sectors of the work force in the privatised industries, particularly the low-skilled, are being negatively affected by the privatisation process (Thomas, 1986). And this has certainly been the case in the different, but associated arena of "contracting out" (PSPRU, 1992). If as Thomas claims, the nationalised industries tended to equalise the working conditions of skilled and low skilled workers in this sector (through collective bargaining), then it is probably not surprising that the eradication of what might be seen as a form of 'wage cross-

subsidisation' would become an early target of a profit-conscious management in the newly privatised industries.

Third, the emphasis that successive governments have given to the equity participation of employees in the privatisation of their own industries, through free and discounted shares, suggests that the promotion of 'worker capitalism' has become an important dimension in the battle to eradicate trade union militancy. Workers, it could reasonably be held, would be less likely to make 'irresponsible' demands for improved wages and working conditions and would be less receptive to the idea of industrial action, or even union membership, when they have a direct investment in the profitability of their company. The way that the Thatcher Government promoted the National Freight Consortium as the 'new wave' worker-management concept lends support to the hypothesis that the shop floor itself formed part of the battleground in the fight against collectivism.

The provision of "transfer payments to the employees of the privatised firms" (Pint, 1990, p.283) via employee share ownership schemes, has also been an effective strategy for weakening trade union resistance to the privatisation programme. Outside the issue of individual equity, the trade union movement at a central level is substantially implicated in the privatisation programme as large corporate equity holders, as Veljanovski (1987, p.69) points out:

*Trade unions are also major institutional investors. The control of pension funds ensures that the trade unions themselves have a vested interest in the performance of the stock market. Since BT and British Gas now make up significant sections of the quoted stock, prudent portfolio management requires that trade union pension funds hold a number of BT and British Gas shares.*

(iv) Defeating Socialism and Collectivism

*..privatisation will be the technique finally to neutralise all socialist ideas. If liberal politicians (which in our country means Tories) have the flair, they can employ privatisation and deregulation policies to dissolve their political opponents' intellectual coherence and interest group bases. Clarke (1987) p. 67*

More than any other British government in living memory, the Thatcher Government made a concerted and conscious attempt, not only to undermine the electoral base of the major opposition party (which is presumably the object of all governments), but to demolish the moral and philosophical edifice of the Left in Britain.

*Thatcher made no secret of her wish to see socialism destroyed as an effective political force in Britain, and a two-party system organised in which both parties fully accepted the legitimacy of capitalism and markets. Gamble (1988) p.221*

- The privatisation programme occupies a critical place in the challenge to the legitimacy of collectivist solutions to economic and social problems in contemporary British society. The development of a pro-market constituency through the policy agenda of "popular capitalism" is aimed explicitly at this end.

Equally importantly, the denationalisation of public enterprises strikes - both symbolically and literally - at the very heart of "the socialist objective", expressed through the original Clause 4 of the Labour Party Constitution (public ownership of the means of production, distribution and exchange). The intellectual and physical momentum of the privatisation programme over the past eight years, not only served to reinforce the belief that governments should not be entrusted with a direct role in industrial production - it has helped to elevate this belief to the status of a 'political



truism'. And the Labour Party's rather anxious attempts to re-define its position on nationalisation and the public utilities, initially via the muted concept of "social ownership" and later, by its proposals to strengthen the public regulation of privatised industries (*Looking to the Future*, 1990; *Labour Opportunity Britain*, 1991), underlines the extent to which the anti-collectivist idea has become a dominant feature of the macro-political landscape. It was more than simply partisan optimism that led Veljanovski to conclude in 1987:

*We are, it seems, witnessing not only a change in the terms of the political debate but the re-emergence of a consensus in Britain revolving around the ideas of the right rather than the radical left. p.208*

Apart from the problem of breaching the anti-collectivist 'ideological consensus', future governments of a socialist persuasion are likely to encounter significant practical problems if they attempt to re-nationalise the privatised industries<sup>23</sup>. The options, for a hypothetical radical socialist government of the future, in returning the privatised industries to the public sector would be:

1. To renationalise without compensation
2. To renationalise with the payment of compensation on the basis of original price paid for shares
3. To renationalise with compensation based on current share value

The first option would probably be politically suicidal; the second would, in the light of the windfall increase in the value of most privatised company shares, be only marginally less so; and the third would be extremely expensive<sup>24</sup>. The difficult economics of renationalisation was not lost on the Labour Party in the 1992 General Election campaign; as evidenced by the ever-receding time frame for fulfilling the

party's manifesto commitment to bring the water industry back into public ownership.

In effect, through discounting the share price of most of the privatised enterprises, the Thatcher Government effectively stymied the ability of future governments to renationalise without huge financial, and probably political, costs. This dimension of the politics of privatisation, is highlighted by Vickers & Yarrow (1988):

*..renationalisation on less than fair terms would be a process in which the losers would know that they had lost but the gainers would not know that they had gained in relative terms. The Chairman of the Conservative Party, Mr Norman Tebbit, probably had these considerations in mind when writing to BT shareholders in 1986 asking them to think how much a Labour Government would cost them. This suggests that a side effect of the privatisation program has been to make more visible some consequences of various electoral outcomes for the distribution of wealth in the U.K. p.181*

## CONCLUSION: PRIVATISATION AS STATECRAFT OR HEGEMONY?

*Traditionally British governments develop their ideas whilst in opposition and then stay in office until they run out of steam, or do a U-turn and collapse through their internal tensions. Mrs Thatcher's government was attempting in-flight refuelling - a distinctly tricky task. Willetts (1992) p.60*

Taken individually or collectively, the factors influencing privatisation policy could be seen to represent a fundamentally pragmatic approach to government, or what Gamble (1988) refers to as "statecraft". That is, the privatisation programme was framed around a set of short- and medium-term political and economic objectives designed essentially to retain Conservative Party control of government. The major implication of this view is that given that the privatisation agenda has evolved from a set of short-term political

exigencies, it is likely to be adhered to only as long as these exigencies hold. Put another way, privatisation is an expression of pragmatic politics and it will be pursued as a policy framework by the Government while it is in its interests to do so. However, as soon as the political costs begin to outweigh the political benefits, privatisation policy will be abandoned.

An alternative to the analysis of privatisation as an expression of "statecraft", is the view that it forms a core position in the ideological and political vanguard for change in Britain - change aimed ultimately at establishing New Right **hegemony** over the British polity<sup>25</sup>. Hence in contrast to the previous formulation which suggests a heuristic and almost accidental origin and 'career' for the privatisation programme, it is perceived here as part of an explicit and concerted attempt to re-structure the role of the state and indeed, to restructure social relations generally. This view does not rule out the influence of political pragmatism in the history of the privatisation programme, but would largely see this as modifying the timing and marketing of change (for example, in the gradualist 'liberalising' incursions, by successive Conservative governments, into the National Health Service) rather than substantially altering the dominant precepts and objectives of the re-structuring programme.

Whether the public utility stage of the privatisation programme has been indicative of either the process of Tory statecraft or a manifestation of a hegemonic project (aimed at complete ideological, political and economic domination), is not only a question of theoretical interest but one of practical importance. It is theoretically interesting in that it seeks to explain the motivational basis of the Conservative Government and to provide

an understanding of the way that New Right ideology and government policy-making interact. It is of practical importance because it may provide insights into the way that privatisation policy is likely to proceed in the future; as well as potentially giving clues as to how a counter political strategy might be developed. For example, if privatisation is essentially being driven by pragmatic imperatives (like enhancing electoral popularity), it could be suggested that the course of the privatisation programme will be determined by the extent to which the immediate political benefits of the programme outweigh the political costs. Conversely, if a more hegemonic purpose exists, short-term political costs may, within limits, be tolerable (and hence, largely irrelevant) in order to achieve longer-term, structural change.

Setting the question is considerably easier than actually answering it! And like the question itself, the explanation for this has both a theoretical and practical part. Theoretically, there is a distinct problem in determining where statecraft ends and hegemony begins (i.e. how can the two be delineated in practice). A problem not resolved by Gamble (1988) for instance, in his statecraft-cum-hegemony conclusion on Thatcherism. The conscious effort of the Thatcher Government to expand share ownership, for example, could clearly be viewed as an illustration of statecraft; in that it was oriented at broadening the constituency of support for the Conservative Party, thereby potentially extending its tenure in government. Equally, this means of broadening political support, in conjunction with an apparent attempt to re-shape attitudes and values, could be seen as part of a drive towards hegemony. If a hegemonic project can be identified by the way it seeks to displace a pluralist set of values in society by a monopoly of dominant values, then the efforts to inculcate an

entrepreneurial, market-driven culture over the course of the 1980s could be taken as evidence that such a project was in place under the leadership of Mrs Thatcher.

An additional, if related, theoretical problem lies in trying to locate the temporal - as well as perhaps, the physical - origin of hegemony. That is, is a political regime only hegemonic if it commences with a hegemonic project in mind, or can it begin with a statecraft-orientation but become hegemonic over time? In other words, in order to be seen as hegemony is it necessary for the Thatcher Government to have been founded **at the outset** on a clear programme of domination (of which privatisation formed an instrumentally important part), or can this programme evolve over the period of its governance?

If the former, then despite the bravado of some of its New Right supporters, it would be difficult, on the basis of its electoral platform and its initial policy positions, to conclude that the Conservative Government led by Margaret Thatcher was an example of a hegemonic project: "The manifesto for the 1983 election was bland and vague. Those who imagine that Mrs Thatcher believed in some sort of Maoist permanent revolution will find their views refuted by that anodyne document" (Willets, 1992, p.58). If the latter, then there is a case to be made for the use of the word hegemony in conjunction with the term Thatcherism.

It could be argued, of course, that any explicitly reformist government, if in power long enough, is likely to display, over time, hegemonic characteristics. The more secure and extended a government's hold on political office becomes - particularly, governments

operating from a relatively coherent ideological base - the more its *weltanschauung* is likely to permeate the institutional and value fabric of society at large.

From a practical (or more precisely, empirical) perspective, providing an answer to the question of statecraft or hegemony, is limited by the relatively short history of the privatisation programme. The interpretation of political forces in history is invariably sounder when it is based on a long lens of retrospective vision, and this is necessarily even more so with a concept as elusive as hegemony. The judgement that a social democratic hegemonic project was being established (which is often held to be the case concerning the post-war consensus, e.g. Hall & Jacques, 1983; Jessop et al, 1988; Gamble, 1988), could hardly have been made with any precision during the time of the Attlee Government, or indeed during the early years of the Churchill Government which succeeded it.

The core part of the Government's privatisation programme (i.e. from the sale of British Telecom onwards) has a history of only eight years. And the resilience over time of the major structural changes effected in the public utility sector remains to be tested. Equally, the continuing zeal of the Conservative Government, under a change of leadership, for the task of redefining the role of the state has yet to be fully determined. The Major Government appears to have eagerly taken on the mantle of privatisation it inherited from Mrs Thatcher and has continued to extend the programme into new domains, e.g. British Rail and British Coal.

Mrs Thatcher's Government successfully resisted popular opposition to the utility privatisation programme, most notably in the sale of the water authorities, which in itself could be taken as evidence against the statecraft thesis. The outcome of the current attempt by the Major Government to restructure British Coal, involving a combination of privatisation and demolition by market forces, will in the face of strong popular dissent, provide a test of whether its commitment to the reform agenda is anywhere near as strong as that of its predecessor.

All this may appear to be leading up to an equivocating and inconclusive "let history decide" approach to the question of the driving motivation in the Conservative Party's privatisation programme. However, it is possible in the author's opinion, to be a little more suggestive than this.

To argue that the privatisation programme is no more than an exemplar of pragmatic politics or statecraft is to ignore both the way that New Right ideology has informed successive Conservative governments' conception of the role of the state in a free market economy and the depth to which this re-structuring of the state in Britain is being implemented <sup>26</sup>. Obviously, the emergence of privatisation as an essential element in the re-casting of state relations, has been partly heuristic in nature. And patently at times, the Government has acted pragmatically in the manner in which it has approached the programme. But this strain of pragmatism should not be equated with malleability of purpose. The privatisation programme, it is suggested, has been, and continues to be, driven by a coherent and integrated ideological agenda; although the timing and detailing of its implementation is likely to be essentially situational.

To this extent, the programme could be viewed as one dimension of an incomplete hegemonic project.

In the next chapter, an attempt will be made to evaluate some of the outcomes of the programme in the light of the government's political and economic objectives. Primary emphasis will be given to an appraisal of the public utility asset sales (relevant to the issue of fiscal management), share ownership and the financial performance of the private utility companies. The substantive issue of the direct outcomes of energy and water privatisation for domestic consumers forms the basis of Chapters 6 and 7.



## ENDNOTES TO CHAPTER 4

1. Prior to 1947/48, there had been extensive private sector involvement in the electricity and gas industries and up to 1989 and beyond, a quarter of households in England and Wales received their water supply from private water companies.
2. The 1983 Conservative Party manifesto referred to the Government's intention to sell the majority holding of British Telecom. However, no specific commitment was made regarding the privatisation of British Gas (Conservative Central Office, 1983).
3. Under the 'fiscal crisis' thesis, governments were said to be confronted with contradictory and irresolvable claims, in particular the demand for greater public expenditure (to meet rising public expectations) in tandem with a resistance to increased taxation (which was needed to finance new fields of state provision).
4. Seldon (1990) in his panegyric on capitalism makes a similar argument:

*The history of Europe demonstrates that inequality is necessary to reveal progress by different people and reward those who take the risks of the unknown by exerting effort and initiative to discover new ways of solving known tasks or new tasks to solve, but it is also essential to stimulate emulation, from which all eventually gain. p.153*

5. "'Social citizenship' refers to those rights and duties of citizenship concerned with the welfare of people as citizens, taking 'welfare' in a broad sense to include such things as work, education, health and quality of life" (Roche, 1992, p.3). Honderich, 1991, refers to these as "social freedoms", pp.119-20.
  6. "Individuals are modelled as behaving so as to maximize utilities subject to the constraints they face..Individuals must be modeled as seeking to further their self-interest, narrowly defined in terms of measured net wealth positions, as predicted or expected." Buchanan (1989) p.20
  7. Hayek uses the two interchangeably (1960, endnote 1, p.421)
  8. "The time-honoured phrase by which this freedom has often been described is therefore "independence of the arbitrary will of another." Hayek (1960) p.12
- "As liberals, we take freedom of the individual, or perhaps the family, as our ultimate goal in judging social arrangements." Friedman (1962) p.12
9. "Here, however, Hayek makes an important distinction between 'the competitive order' and 'ordered competition'..for he wishes to emphasize that the aim of social policy should not be to order (i.e. restrict) competition so as to achieve *particular* economic or social goals but to define the rights and duties which make competitive markets possible. The ills that the critics of the market attribute to it stem from the failure properly to define the institutions necessary for its operation and the reliance on

(macro-economic) policy which hinders rather than helps the working of the 'competitive order'. Kukathas (1989) p.95

10. *The probability is that wherever monopoly is really inevitable the plan which used to be preferred by the Americans, of a strong state control over private monopolies, if consistently pursued, offers a better chance of satisfactory results than state management. This would at least seem to be so where the state enforces a stringent price control which leaves no room for extraordinary profits in which others than the monopolists can participate. Even if this should have the effect (as it sometimes had with American public utilities) that the services of the monopolistic industries would become less satisfactory than they might be, this would be a small price to pay for an effective check on the powers of monopoly.* Hayek (1986) p.147

*If the technical monopoly is of a service or commodity that is regarded as essential and if its monopoly power is sizable, even the short-run effects of private unregulated monopoly may not be tolerable, and either public regulation or ownership may be a lesser evil.* Friedman (1962) p.29

11. Letwin provides a thorough review of the empirical evidence on the three leading public choice questions: does the voter mainly follow the dictates of his pocket-book?, do politicians mainly strive to maximize their votes? and do bureaucrats try to maximize their budgets? Although he challenges a number of the major insights of public choice theory, Dunleavy believes that "it is too powerful an analytical tool-kit to neglect or abandon" (p.5). His application of the public choice approach emphasises the "bureau-shaping" and "preference-shaping" characteristics of the political system.

12. Willetts (1992 p.52) claims both these traditions for the Conservative Party: "Those who try to identify what is singular about Thatcherism by presenting it as a rejection of traditional conservatism are, quite simply, wrong." Heywood (1992, p.77) seems to concur "...liberal doctrines, especially those about the free market, have been advanced by conservatives since the late eighteenth century and can be said to constitute a rival tradition to conservative paternalism."

13. The British liberal academic Gray (1986, p.77) sees the conception of the minimum state as advocated by Nozick as "undefensible and, indeed, only partly coherent", and goes on to argue that:

*Advocacy of the minimum state is, in any case, not to be found in most liberal writers. Most liberals, acknowledge that the liberal state may have a range of service functions, going beyond rights-protection and the upholding of justice, and for this reason are not advocates of the minimum state but rather of limited government.* pp.73-4

14. Although this is denied by one of the Government's leading spokesmen on privatisation during the mid-1980s:

*The privatisation programme is coherent and well thought-out...Privatisation hands back to the people of this country, industries that have no place in the public sector.* Moore (1985) p.93

15. "In his 1986 Budget Speech, the Chancellor reaffirmed the Government's aim 'to create a popular capitalism in which more and more men and women have a direct personal stake in British business and industry'." Lee & Saunders (1988) p.38

16. "For this to be so [consumer sovereignty], consumer preferences would at the very least have to be generated independently of the plans and activities of producers. Yet in reality, it might be argued, the reverse is increasingly the case, given the massive resources available to modern capitalist enterprises in their attempts to shape and control the 'choices' of consumers, including the growing sophistication and effectiveness of marketing and advertising techniques. It is production that determines consumption, and not vice versa: the sovereign consumer is a fictitious being." Keat (1991) p.7

17. "private water authorities will have greater incentive to ascertain the needs and preferences of customers, and to tailor their services and tariffs accordingly.." Water privatisation White Paper Cmnd. 9734

"Customers will be given new rights, not just safeguards."  
Electricity privatisation White Paper Cmnd. 322

18. Which was part of the Government's monetarist strategy aimed at reducing interest rates (Johnson, 1992).

19. "Privatisation receipts peaked both in real terms and as a ratio to net public expenditure in 1988/89, when privatization receipts were the equivalent of 4 per cent of net public expenditure" Hogwood (1992) p.122. Hogwood also points out that income from sales and land (primarily local authority housing) has been an important part of the Government's fiscal strategy over the 1980s. Receipts in this area also peaked in 1988/89 at £2.45 billion.

20. Lord Gilmour identifies this as a key motive of the Government in privatising British Telecom:

*..British Telecom were faced with the difficulty of financing its vital investment programme of expansion. To increase the PSBR by over £1,000 million was unthinkable, yet the Treasury would not allow British Telecom to raise the money from the market on the grounds that as it was government owned it would be borrowing on privileged terms. Given Treasury obduracy, the only way out was to sell British Telecom.*  
Gilmour (1992) p.96

21. Mc Allistar & Studlar also calculated that the sale of council houses netted the Tories just under 1% of the total vote.

22. From 12,173,000 in 1979 to 8,405,000 in 1989. Metcalf, 1991, Table 1, p.20

23. Beyond the obvious financial problems, the House of Commons Library Research Division (1991) point out the considerable legislative hurdle, which would particularly inhibit a minority government: "The privatisation legislation was designed so that an incoming Government with [a] different view of the objectives of public utilities could not implement major changes without further primary legislation." p.29

24. At the end of August 1992, the market capitalisation of the water and regional electricity companies was £9.7 billion and £8.5 billion respectively. This represented a 85% (water) and 64% (RECs) increase in their value compared to that at the date of sale. See Chapter 5.

25. "..hegemony means 'moral and philosophical leadership', leadership which is attained through the active consent of major groups in society" Bocock (1986) p.11. A more explicit definition is given in the editor's foreword to the same volume:

*At base, hegemony is all about ideology. But it is ideology writ large: the idea of an all-encompassing dominant ideology whose scope extends throughout all social, cultural and economic spheres of society. p.7*

Writing in the mid-1980s, Bocock questions the belief that the Thatcherite project was hegemonic:

*Mrs Thatcher's position appeared vulnerable in electoral terms, but more importantly, in the context of the problematic of hegemony, she had lost the capacity to lead in moral and philosophical terms - even if it is supposed that 'Thatcherism' was ever really hegemonic. p.128*

26. Public utility, or physical service sector, privatisation is but one manifestation of this re-design of state-market-citizen relations. In some ways, the changes being effected in the health services, personal social services (particularly community care), and the machinery of public administration (e.g. creation of quasi-autonomous agencies under the "Next Steps" initiative) constitute even more profound expressions of the ideological project.

## CHAPTER 5: POLITICAL AND ECONOMIC OUTCOMES OF THE PRIVATISATION OF THE PUBLIC UTILITIES

### INTRODUCTION

The character of the political and economic objectives of the privatisation programme, representing as they do, a set of diffuse and shifting policy priorities, would suggest *a priori* that the Government's success in meeting these objectives would be likely to be mixed.

If for no other reason, the privatisation programme will result in variable outcomes due to the fact that a number of the objectives upon which it is premised appear to be incongruent, or even in conflict. One example of this, which has drawn the most comment, is the inherent conflict between the objective of obtaining the best price for the industries at the point of sale and the objective of creating a competitive framework for the operation of the privatised utilities:

*The aim of selling public enterprises to raise revenue and that of privatising them in order to maximize efficiency, by placing the firms in a competitive environment, are in conflict. The greater the market power of a newly privatised firm, the higher are likely to be its profits and so the greater its stock market valuation. If a public enterprise has its market power reduced by being broken up into several parts and has its protective regulations dismantled, it will be unable to earn monopoly profits. As its share value on the Stock Exchange will be lower it will fetch less for the state coffers.*

Levacic (1987) pp.266-7

Other examples of tension between the disparate policy objectives in the programme include, trying to encourage wider share ownership (inevitably involving a degree of

discounting) at the same time as attempting to maximise the returns to Treasury, and seeking to release essential service industries from state intervention in tandem with promising consumers new rights and protections.

Another factor complicating the attainment of the Government's preferred outcomes is that in some instances - notably in the natural monopoly sectors of the public utilities - the predominant economic objective (i.e. the creation of a vigorous competitive environment) is simply incompatible with the existing, and, for the medium-term at least, future structure of the industries themselves.

In this Chapter, the outcomes of the privatisation of the public utilities in relation to three core objectives will be assessed: (i) maximising revenue from the sale of the three utilities, (ii) extending share ownership, and (iii) improving the economic performance of the utility industries. In doing this, data is presented on the macro-distributional effects of utility privatisation; which will contribute towards answering the fundamental question of "who have been the winners and the losers in utility privatisation?"

The direct impact of privatisation on domestic consumers is considered in Chapters 6 and 7.

## 1. REVENUE FROM THE SALE OF THE PUBLIC UTILITIES

The extent to which maximum proceeds were generated from the sale of the utilities is an issue of considerable importance; not only for the limited evaluative reference point of whether the Government's stated objectives were achieved, but for the broader public interest perspective of how historically accumulated and publicly-funded assets have been valued and sold.

In the earlier utility privatisations - British Telecom and British Gas - the Government was heavily criticised for selling these industries for substantially less than their actual worth (Vickers & Yarrow, 1988; Bishop & Kay, 1988; Buckland, 1989; Chapman, 1990; Whitfield, 1992). The aggregate loss (including flotation costs) in these two sales has been estimated, conservatively, to be in the order of £2.5 billion <sup>1</sup> (Vickers & Yarrow, 1988). Writing in 1988, Bishop & Kay concluded that:

*The flotation process is the subject of much self-congratulation between Government and its financial advisers. We are less impressed. The fact that there is excess demand for a product which can be sold tomorrow at a substantial premium on today's price is not a measure of the product's popularity. Still less is it a testimony to the skill of the retailer. The fixed price issues have been sold at substantial - in some cases absurd - discounts.. p.35*

While being less explicit in its criticisms of the sale process, the official Parliamentary auditors, the National Audit Office, concluded in relation to British Gas that "it is difficult to say whether the Department [of Energy] maximised the sale proceeds" (NAO, 1987, p.15). In particular, it raised queries about the Government's expenditure on underwriting costs and shareholder incentives, and questioned whether the

Government had managed to strike the best bargain with the directors of British Gas, on behalf of British taxpayers .

Against this background of concern about the under-valuation of the privatised industries (which was regularly replayed in the media), it might be expected that the Government and its City advisers would seek to strike a discernably better bargain in the water and electricity privatisations. But if anything, evidence from these sales indicates that the reverse occurred (see below).

The question of what is the 'true value' of utility assets is a vexed one. The Labour Party has consistently argued that the utilities should be valued according to the replacement costs of their assets (e.g. in House of Commons debates on the 16th January 1991 and 2nd July 1991). On this basis, the water companies, for example, would have been valued at £34,503M [current cost] and £8,665M [historical cost] (NAO, 1992a, Table 6). The Government, supported by the National Audit Office, has dismissed this as a hypothetical and massively unrealistic valuation and argued that the "accounting value of assets is not..a reflection of the underlying value of the company to investors, particularly in an industry like water where capital assets are highly specialised. Investors assessment of the value of a company is based on the expected stream of future dividends.." (NAO, 1992a, p.25).

A simple measure conventionally used by economists to assess the extent to which the privatised industries have been valued correctly at sale, entails comparing the offer price with the effective market capitalisation of the industries (based on share price) at the end



of the first day of trading on the Stock Exchange. This will invariably produce a valuation much lower than that based on asset replacement at current cost, but it provides an indication of the how the market values the industries immediately they come up for sale. Figure 5.1 shows the effective market value of the energy and water utilities at the end of trading on the first day of sale.

	Water companies	RECs	Gens	BG	Total
Offer M/Cap.	£5239M	£5181.6M <sup>2</sup>	£3597.9M	£5603M	£19,621M
Premium Day 1	19%	21%	21%	10%	
Premium £ equivalent	995.41M	1,088.14M	755.56M	560.30M	3,399M
M/Cap end Day 1	£6,234M	£6,270M	£4,353M	£6,163M	£23,021M

**Figure 5.1: Effective Market Capitalisation of the Public Utilities**

It can be seen from this that the market value of all of the utilities appreciated considerably over the course of the first day's trading on the Stock Exchange and that the accumulated under-valuation of the energy and water utilities, according to this measure, was in the region of £3.4 billion.

The first day's trading indicates the market's immediate response to the privatisation sales, but a more accurate measure of the industries' valuation might be obtained over a longer time-frame, when the market has had an opportunity to settle down. The initial

response of the market may artificially inflate the value of the industry, or conversely may not capture the full value of the industry being sold. In both the water and ESI sales, the Department of the Environment and the Department of Energy respectively, used a three week "aftermarket" period to adjudge whether the objectives of the sales had been achieved (NAO, 1992a; 1992b). The movement in utility share prices over the first full three weeks of trading on the Stock Exchange is outlined in Figure 5.2.

Premium (fully paid)			
	end 1st day	after 1 week	after 3 weeks
British Gas (£1.35)	10%	11%	11%
Water companies (£2.40)	19%	21%	28%
RECs (£2.40)	21%	22%	20%
Generators (£1.75)	21%	21%	18%

Figure 5.2: Increase in Public Utility Share Prices over first three weeks <sup>3</sup>

Using a three week period then to estimate the market value of the utilities, reveals that the utilities were effectively worth a total of £23,389 million, which is around £3.8 billion (or 19%) more than the gross proceeds the Government obtained from their sale. By the end of August 1992, the total market capitalisation of these companies was £33.7 billion, some 72 per cent higher than the gross proceeds received in the sales <sup>4</sup>.

The Government justified the apparent under-valuation of the public utilities <sup>5</sup> on the grounds (i) that they were selling into an "untested market", (ii) that the utilities - particularly the water industry - represented an "investment risk" (NAO, 1992a, p.9), and (iii) that a small premium on the shares (around 10%) was necessary in order "to promote wider share ownership" and "to ensure a healthy aftermarket in the shares of each company" (House of Commons Committee of Public Accounts, 1992, p.vii).

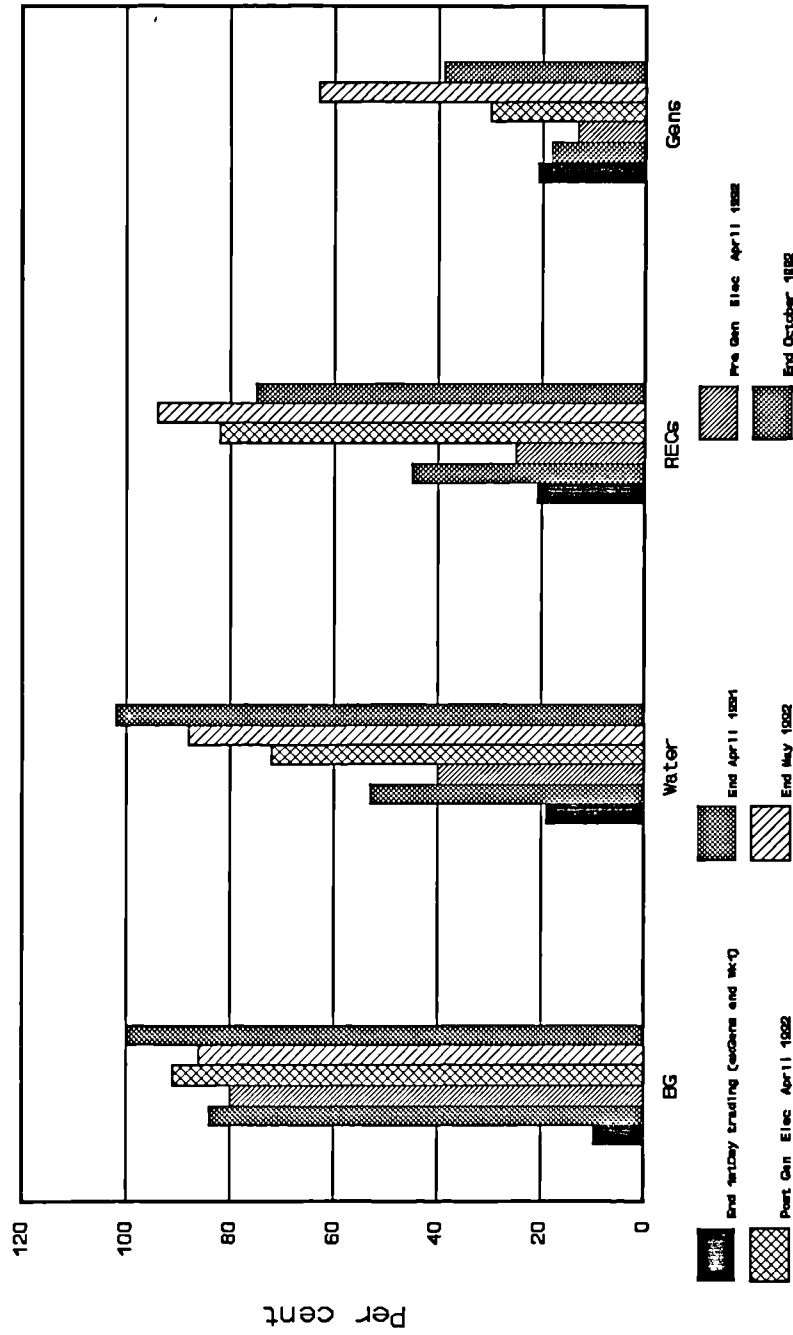
The untested market argument would hardly seem to hold much validity from the period after the flotation of British Telecom, where the 'market acceptability' of a modestly-priced utility was immediately apparent in the way that the issue was heavily over-subscribed <sup>6</sup>. The dimensions of the risk factor appear, in retrospect, to have been grossly over-rated by the Government and its advisers. This is underlined by the extremely high level of investor interest in the water industry at flotation and subsequently; to the point where water shares are described as having "been an outstanding investment to date" and "1992's top performing sector" (Investors Chronicle, 4/9/92, p.58). Also significantly, the Director General of Water Services, in his analyses of the capital structure of the water companies (1991; 1992o) has consistently characterised the water industry as "low risk". The third argument, concerning the need to ensure a 'modest premium' in order to encourage investors, reinforces the point made earlier about the inherent contradictions in the rationale and objectives of the Government's privatisation programme.

The direct beneficiaries of the discounted sale of the utility industries have been the individuals and institutions who invested in privatisation shares. Substantial profits were made by those investors who sold their shares within the first few weeks after the sale, although the actual premiums gained would have been rather higher than those cited in Figure 5.2 above, as these are based on the price of fully paid up shares <sup>7</sup>. For investors who have retained shares in the privatised utilities, the discounts built into the sales have provided the platform for a sustained growth in the value of these equities, as illustrated in Figure 5.3 overleaf <sup>8</sup>. On the other side of the equation, the loss of substantial sums of public revenue in the sales has been manifestly to the detriment of taxpayers in general.

The gross proceeds of the sales do not represent, of course, the actual amount gained in public revenue from these receipts, for costs such as underwriting and banking fees, advertising and marketing, and shareholder incentives have to be deducted. In addition, debt write-offs, taxation relief and 'incidental payments' to the privatised industries have to be taken into account. Once this is done the amount obtained from the sale (i.e. net proceeds) looks even less satisfactory than that quoted earlier. This is most noticeably the case with water privatisation, where the net proceeds of the sale change from £3,594.4 million (the official figure) to minus £1,578 million. Figures 5.4 and 5.5 on the pages that follow, set out the balance sheets of the sale of the water and regional electricity companies.

# PRIVATISED UTILITIES

Increase in value of Shares



Sources: The Guardian, Financial Times

Figure 5.3: Movement in the value of utility shares

Figure 5.4

## SALE OF THE WATER AUTHORITIES

	£Million
<u>DIRECT COSTS:</u>	
(1) Cash injections	1,572
(2) Shareholder incentives	85
(3) DoE costs	
Underwriting	33.2
Selling & broking comm.	6.7
Marketing	36.3
Advisers Fees	25.8
Bank costs	26.1
Overseas costs	15.4
Minus interest	(12.6)
Sub-total (a)	130.9
(4) Minus debt introduced	(72.9)
(5) Restructuring costs (b)	74
Sub-Total (c)	1,789
<u>INDIRECT COSTS:</u>	
* Debt write off	5,028
Sub-Total	6,028
<u>TOTAL COSTS:</u>	7,817
<u>PROCEEDS:</u>	
Gross Proceeds	5,239
Official Net sale proceeds	3,594.4
Actual Net sale proceeds	-1,578

The water companies were also given tax allowances valued at £7,700 million

Notes: (a) In addition, the Water Authorities spent £176 million on marketing, advisers and associated privatisation costs, (b) restructuring costs includes cost of creating National Rivers Authority and new regulatory arrangements, and expenditure connected with preparation of legislation, (c) DoE aggregate (1) (3) (4) and £15 million of (2) only in calculating costs.

Sources: National Audit Office (1992a); House of Commons Committee of Public Accounts (1992)



**Figure 5.5 SALE OF THE REGIONAL ELECTRICITY COMPANIES**

	£Million
<u>GROSS PROCEEDS:</u>	
Sale of shares	5,181.6
 <u>DIRECT COSTS:</u>	
Shareholder incentives	112
Department of Energy costs	
Underwriting	36.6
Selling/broking commission	10.5
Marketing	15.2
Advisers Fees	28.8
Banks fees	92.3
Overseas costs	18.5
Minus interest	(33.6)
Sub-total	168.3
 Total	 168.3
 <u>TOTAL COSTS:</u>	 280.3
 <u>PROCEEDS:</u>	
Net sale proceeds	4,901.3

In addition the RECs were injected with debt totalling £2.8 billion, repayable over eighteen years

Source: National Audit Office (1992b)

It would seem difficult to conclude, on the basis of an examination of the balance sheets of these privatisations, that the objective of maximising the returns to the public purse from the sale of the utilities was actually achieved. Yet surprisingly, that was more or less the conclusion drawn by the National Audit Office in its reviews of the water and ESI sales (1992a; 1992b); although the National Audit Office did criticise the Government for not making provision in the sale of the ESI for the "clawback" of excessive profits in the first year<sup>9</sup>.

The findings of the National Audit Office, however, have to be viewed in the light that (a) it has no remit to examine the broader policy context of the sales ("the Office cannot question matters of policy", Beauchamp, 1990, p.55), (b) its frame of reference in evaluating the sales is confined to the objectives set by the initiating department (many of which were in direct conflict with the public revenue imperative, i.e. "to promote wider share ownership", "to ensure a healthy aftermarket", "to maintain the momentum of the privatisation programme" [NAO, 1992a], and "to complete the sale of the electricity industry during the lifetime of the Parliament"), and (c) a number of its core findings bear more than a hint of qualification (for example on the sale of the RECs, "...the valuation of the companies' assets was reasonable **in the circumstances of this sale**, NAO, 1992b, p.2 author's emphasis).



The House of Commons Committee of Public Accounts (1992) possibly came closer to the fundamental public interest question of whether the taxpayer got value for money in the sales, when it stated in relation to water privatisation that:

*We note that the water companies' shares maintained a premium of some 20 per cent on a fully paid basis during the first six months of trading and performed above the general stock market trend. These factors indicate that the Department achieved their objective of a full take-up of shares with something to spare. p.xvi <sup>10</sup> (author's emphasis)*

The use of evaluative measures applying a broader 'public interest test' to the utility sales, would be likely to conclude in a manner similar to that of Vickers & Yarrow (1988) at an earlier stage in the privatisation programme:

*Whatever the underlying motives of policy makers may have been, it is hard to see how their methods of selling state assets can be judged other than a failure in terms of the general public interest and in view of the opportunities available. Their short-run success in political terms is another matter. p.193*

## 2. EXTENDING SHARE OWNERSHIP

*The extension of share ownership has been one of this Government's central aims - and privatisation makes a major contribution to its achievement. The ownership of shares gives individuals a direct stake in the success of British industry. Conservative Research Department (1991) p.97*

*I believe that there are significant advantages in transferring the water authorities out of public and into private ownership. By making the transfer there will be genuine public ownership of a kind that does not exist today.*

Ian Gow, Second Reading Debate on the Water Bill, HoC 8/12/88, Col. 511

As the previous chapter argued, the Government's "popular capitalism" agenda became increasingly important over the life of the utility privatisation programme. This has been evidenced subsequently in the fact that official ex post facto accounts of the privatisation process, such as those produced by the National Audit Office, have elevated widening share ownership above fiscal management and other objectives. The success of the share ownership campaign, which has been instituted at substantial direct and indirect costs to the Exchequer, constitutes therefore an important test of the efficacy of the privatisation programme. In conjunction with providing an answer the question, "has the Government extended the participation of individual investors in the stock market?", an analysis of the pattern of share ownership created by the public utility sales, adds another piece to the distributional jig-saw puzzle on the winners and losers in the privatisation programme.

At a superficial glance, the campaign appears to have been an outstanding achievement for the Government. The number of adults owning shares has increased from less than 5 per cent in 1979 (Grout, 1987) to around 22 per cent in 1992 (NOP, 1991), with much of this growth being attributable to the sale of privatised industries <sup>11</sup>. And the level of over-subscription in the share offers at each successive flotation attests to the success of the Government in stimulating public interest in the equity market <sup>12</sup>.

But on closer examination, the achievement of "popular capitalism" is something of a mirage. This is illustrated in the following facts and figures:

# the majority of people who owned shares in privatised companies held only one privatisation issue - 57% (NOP, 1992, Table 10A).

# substantial numbers of individual investors sold their privatisation stocks in the period immediately following the flotation of the privatised companies and continually thereafter - e.g. the number of shareholders in the water industry had halved within seven months of the sale (House of Commons Committee of Public Accounts, 1992). [see below]

# the bulk of shareholders have only a small tranche of equities - both by volume and value (NOP, 1992, Table 30A)

# the long-term decline in the level of individual ownership of the stock market has not been arrested by the share ownership campaign i.e. 54 per cent in 1963, 28 per cent in 1981, 21 per cent in 1989 (CSO, 1991c, Table 2).

Beyond general rhetorical injunctions to the British public "to go forth and buy", the Government has never been very explicit about what it is actually trying to achieve in the quest for universal share ownership (a fact which drew criticism from the National Audit Office in the RECs sale <sup>13</sup>). But, if the Government was seeking to use the privatisation sales as a device for (i) stimulating interest in the share market generally (i.e. people would move on to buy tranches of stocks in addition to their privatisation

holdings), (ii) prompting investor/customer engagement in the on-going management of the privatised companies and (iii) countering the domination of institutional players in the stock market (i.e. pension funds and insurance companies) - all of which would seem to be constituent elements of a share-owning democracy scenario - then, the figures above add up to anything but success. Significantly, the chairman of the London Stock Exchange recently concluded that "[w]ider share ownership is a delusion - what we have is a lot of investors owning a few shares, basically in privatisation stocks" (*The Observer*, 2/8/92).

An analysis of the pattern of individual shareholdings in the utility industries, over time, does little to support the late Ian Gow's claim that privatisation will lead to "genuine public ownership". Not all of the privatised utilities provide details on the shareholder composition in their Annual Reports, so it is difficult to assemble an aggregate picture. But amongst those that do, there is evidence of a clear trend away from individual small investor equity in the companies; which was relatively small even at the outset. Figure 5.6 (overleaf) provides some illustrative examples of this. The withdrawal of the small investor has been complemented, almost invariably, by an increased concentration of ownership amongst large investors. In reality, the small individual investor and the 'customer shareholder' <sup>14</sup> occupy very peripheral places in the ownership structure of the privatised utilities. And rather than changing the composition of equity holdings in Britain, the sale of the utility industries appears to have simply mirrored, as well as entrenched, the domination of the institutional sector in the stock market generally.

### SHARE OWNERSHIP IN THE UTILITY INDUSTRIES <sup>15</sup>

	Total No. of Shareholders	Equity held by individuals %	Equity held by small Shareholders %	Equity held by large Shareholders %
<b>British Gas: *</b>				
1987	3,111,872	35	27	59
1988	2,903,416	32	25	66
1989	2,695,450	30	22	68
1990	2,480,564	28	20	69
1991	2,178,855	25	18	73
<b>Thames Water: **</b>				
1990	391,896	26	23	54
1991	331,844	23	19	65
1992	306,165	20	17	71
<b>South West Water: ***</b>				
1990	57,249	19	16	75
1991	43,166	14	13	77
1992	39,876	13	11	73
<b>Norweb:</b>				
1991	286,340	N/R	19	75
1992	228,263	N/R	15	79
<b>Midlands Elect.</b>				
1991	353,809	26	20	31
1992	284,629	17	17	50

\* At privatisation, 4.55 million shareholders

\*\* At privatisation, 680,816 shareholders

\*\*\* At privatisation, 129,064 shareholders

N/R = Not reported

Sources: Company Annual Reports

Figure 5.6: Changes in the pattern of utility share ownership

The distribution of individual share ownership follows, not surprisingly, the major contours of inequality in British society:

*..shareholders were drawn disproportionately from men, from people in the middle age-groups, from those in the professional and managerial socio-economic groups, and from those with higher income levels.*

1988 General Household Survey (1990) p. 165

The 1987 and 1988 General Household Surveys on share ownership found *inter alia* that people with a gross weekly income of £50 or lower were almost six times less likely to own shares than people in the highest income group, and that the level of share ownership was twice as high in the South East England compared to the North of England.

Both surveys found that the proportion of people in manual socio-economic groups and with lower incomes holding shares, was marginally greater in the case of privatisation stocks than for shares generally. But this was hardly of a sufficient order to suggest that privatisation has acted as an egalitarian influence on the stock market in any substantive way.

The most recent survey carried out by NOP for the Treasury (January and February 1992) largely confirms the earlier GHS findings (although it did not collect income data, and hence is not comparable along this dimension). Along the key axes of class, gender, age and regionality, the NOP survey reveals a similar degree of inequality of participation in the equity market as that identified in the GHS. Interestingly, the results of the NOP study do not appear to support the earlier finding that privatisation issues engendered marginally greater involvement amongst manual socio-economic groups.

Social class AB was **five** and **three** times more likely to hold privatisation shares than social classes DE and C2 respectively, whereas they were **four** and **two and a half** times more likely to hold shares generally. One explanation for this could be that more people in the manual socio-economic group (compared to other groups) cashed in their shares between 1988 and early 1992, possibly as a result of the impact of the recession and rising unemployment. The pattern of share ownership according to social class, in the NOP survey is illustrated in the bar chart below.

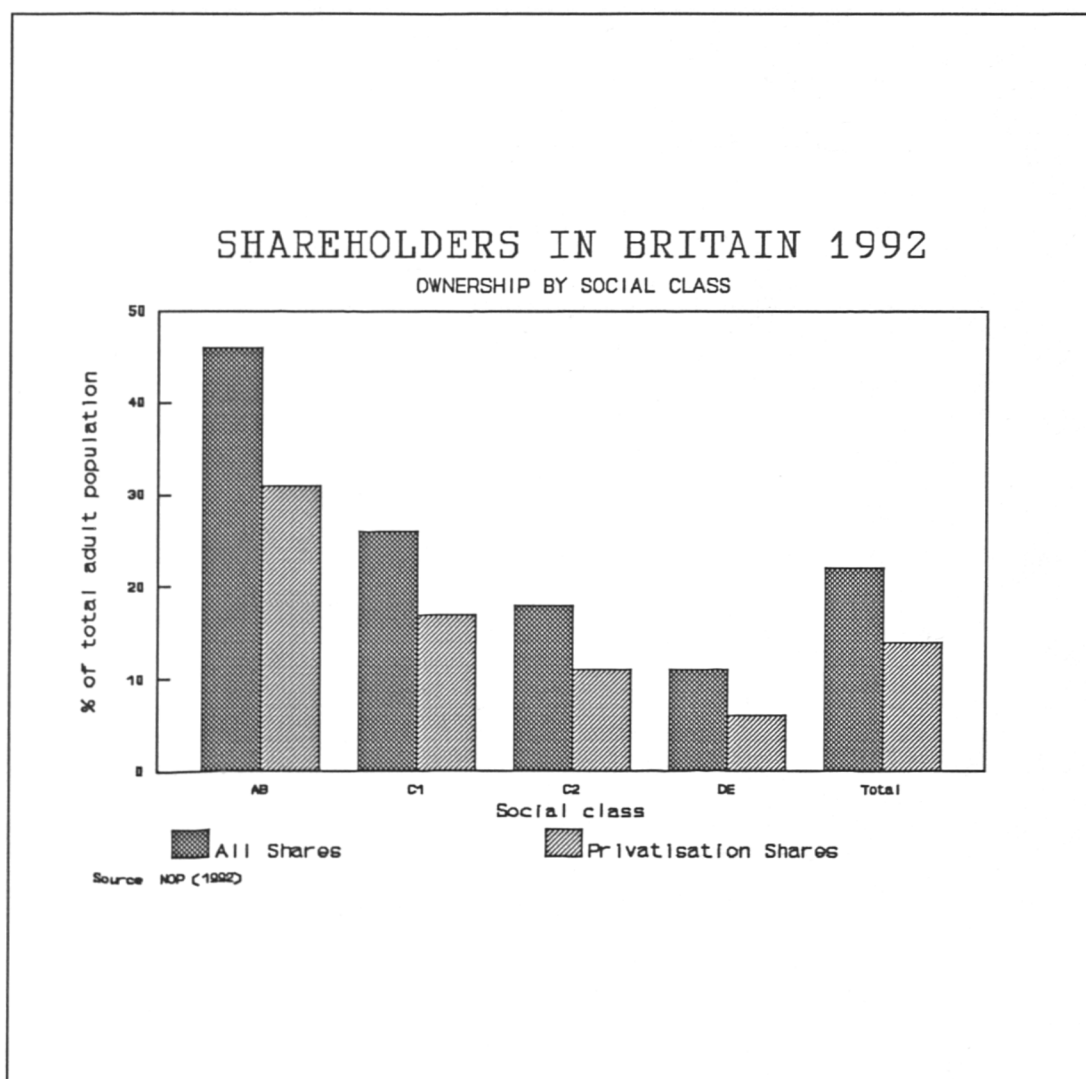


Figure 5.7: Share ownership by social class

Irrespective of the minor differences between the results of the three surveys on share ownership, it would seem obvious that the benefits of privatisation shareholding (and as Figure 5.3 in the earlier section indicated, these have been considerable) have not been equally shared amongst the population. Overall, the share ownership campaign has tended to simply re-trace, rather than re-draw, the extant dividing line of property ownership and property rights in British society.

In the previous section, it was seen that British taxpayers incurred a considerable financial loss through the sale of the utility industries. In this section it is apparent that the prospect for recovering some of this loss, at an individual level, through ownership of discounted privatisation shares has been disproportionately distributed across the population. So whatever else the privatisation programme has achieved, or might achieve in the future, it could hardly be said to have advanced the cause of social justice in Britain. In his recently published account of the Thatcher years, Lord Gilmour (1992) suggests that the Government could have adopted an alternative approach to "popular capitalism", which would have resulted in a far less regressive outcome:

*The best and fairest way of carrying out privatization would have been that suggested by Samuel Brittan..his scheme was that, instead of state assets being sold to investors, shares in them would be given to all adult citizens in equal numbers. p.101*

*..it would have helped to mitigate probably the worst feature of Thatcherism: the treatment of the poor. It would also have been far the most ethical method. After all, in theory, the nationalized industries belonged to the nation. Therefore privatization on the Brittan plan would merely have given to the people in one form what they already owned in another. By contrast privatization by sale deprived those not rich enough to subscribe of part of their property. If the left had ever perpetrated a similar confiscation on the rich, the right would have howled with righteous rage and pain. p.102*



### 3. ASPECTS OF THE ECONOMIC PERFORMANCE OF THE PRIVATISED UTILITY COMPANIES

The drive for improved efficiency lay at the heart of the Government's economic case for privatisation of the public utilities. But in the view of most commentators, change in ownership, in itself, is not a sufficient condition for achieving greater efficiency, and that in order for this to be realised, competitive forces need to be introduced into the operating environments of the utilities. Studies of the utilities privatised in the 'first wave' - i.e. British Telecom and British Gas - generally confirm the hypothesis that privatisation minus substantive competition results in few, if any, efficiency gains (Bishop & Kay, 1988; Vickers & Yarrow, 1988; Dunsire et al, 1991). Indeed this latter study, which examined the economic performance of a wide range of both privatised and (still) nationalised enterprises concluded, suggestively, that even the advent of competition does not guarantee improved performance:

*..neither investigation supports the simple assertion that change in ownership necessarily changes enterprise performance, even in its sophisticated form, where capital market change is assumed to be accompanied by increased competition and improved managerial incentives. Sometimes it does, sometimes it doesn't. Dunsire et al (1991) p.38*

The retention, at privatisation, of the geographical monopoly structure of the public utilities (with the exception of electricity generation, and electricity supply to large users), would suggest then that the signs were not terribly propitious for a significant lift in the efficiency performance of the industries. In fact this seems to be a conclusion that the Government itself formed, at least in the case of the water industry, for the "efficiency targets set by the Secretary of State [in the setting of the K factor] implied a reduction of around 3 per cent per year in the base level of operating costs. This target

was broadly in line with the performance aims set for the former water authorities" (OFWAT, 1992o, p.22).

It is still much too early in the case of the later utility privatisations to properly assess the efficiency outcomes that have occurred since the change of ownership. Very few analyses of the economic performance of the water and electricity supply industry, based on empirical research, have emerged thus far; and the few studies that have been published focus primarily on the performance of the industries immediately preceding, or around the time of, privatisation (e.g. United Research, 1990; Thompson et al, 1991).

In this section, three selected aspects of the economic performance of the three utilities will be briefly elaborated - i.e. profitability, executive salaries (relevant to the question of management incentives), and employment. These are all elements which contribute to the mosaic of economic performance, but just as importantly from the perspective of this study, they interact with the issue of the distributional consequences of the privatisation programme. They also form significant parts of the landscape of the privatised utilities which should be kept in mind in the analysis of the consumer-related effects of privatisation in the two chapters that follow.

(i) Profitability

In most studies into the comparative performance of public and private enterprises the levels of profit achieved by the industries is used as an indicator of economic performance and efficiency. However, it is debatable whether profitability - particularly for industries operating in monopoly or quasi-monopoly conditions - is a relevant measure of efficiency. The two sides of the debate are reflected in the following quotations:

*Given some degree of market power, it might be expected that private firms will tend to be more profitable, but this in itself has no direct bearing on the question of economic efficiency. Vickers & Yarrow (1988) p.39*

*If..the conventional interpretation is used, then the high profitability levels achieved by any firm or group of firms in the industry clearly would represent the marginal valuation of capital. Accordingly, one could argue that the low profit levels of public firms mean that capital is used less efficiently and that privatization has the potential to improve the use of society's capital resources.  
Hutchinson (1991) pp.105-6*

Irregardless of the issue of whether profitability should occupy a place amongst the indices of efficiency, it is clearly important to the direct stakeholders of utility industries - management, shareholders and consumers. Managers and shareholders benefit directly from rises in company profit and conversely (in theory at least) suffer the disbenefits of poor profit performance. Whereas for consumers the flow of benefits tend to run the other way with, for example, the achievement of a high level of profitability possibly suggesting that the utility provider is gaining "monopoly rents" through excessively high charges.

By any standard the profit performance of the public utilities since privatisation, as indicated in Figure 5.8, has been remarkable.

PUBLIC UTILITY PROFITS SINCE PRIVATISATION		
		% increase
British Gas	1985/86-1990/91	99
Water companies	1988/89-1991/92	137
RECs	1989/90-1991/92	47
Generators	1990/91-1991/92	24

Sources: Company Annual Reports

**Figure 5.8: Privatised utility company profits**

In all the utilities (with the exception of British Gas), because of the short time-frame between privatisation and the release of the most recent profit results, the ‘efficiency-related effects of privatisation’ would seem to be a highly implausible explanation for this vigorous profit growth. In any case, a major acceleration in profits has tended to occur during the early stages of privatisation. For example, water industry profits grew by over 90 per cent in the first full year of privatisation (1989/90 to 1990/91), and the RECs performed some 22 per cent above the projected profit level set out in the Prospectus at the time of privatisation. This would seem to add further weight to the view that these two industries were significantly under-priced at sale. Alternatively, it

may indicate that the efficiency strictures, set for the companies (the *K* and *X* factors) as part of the privatisation settlement, were particularly unchallenging.

In the case of the RECs, it has been suggested that the ability of these companies to exceed the Prospectus profit forecasts by some margin is attributable to "their success in conning the Department of Energy in the pre-privatisation negotiations (OFFER staff in interview with researcher, July 1992) <sup>16</sup>. The National Audit Office report on the sale of the RECs (NAO, 1992b) also implied that this was the case. In his explorations into the capital structure of the water industry, the Director General of Water Services has regularly reminded the water companies that the privatisation settlement has been very much in their favour (OFWAT, 1991i; 1992o; 1992z).

Figures based on average increases in profits in the water and electricity supply industries also disguise profits out-turns well in excess of the norm, for example, those achieved by companies such as Northumbrian Water, Welsh Water, South Wales Electricity and Manweb. Figures 5.9-5.11 illustrate the year-by-year performance of British Gas and the individual profit performance of the water and regional electricity companies over the period of privatisation.

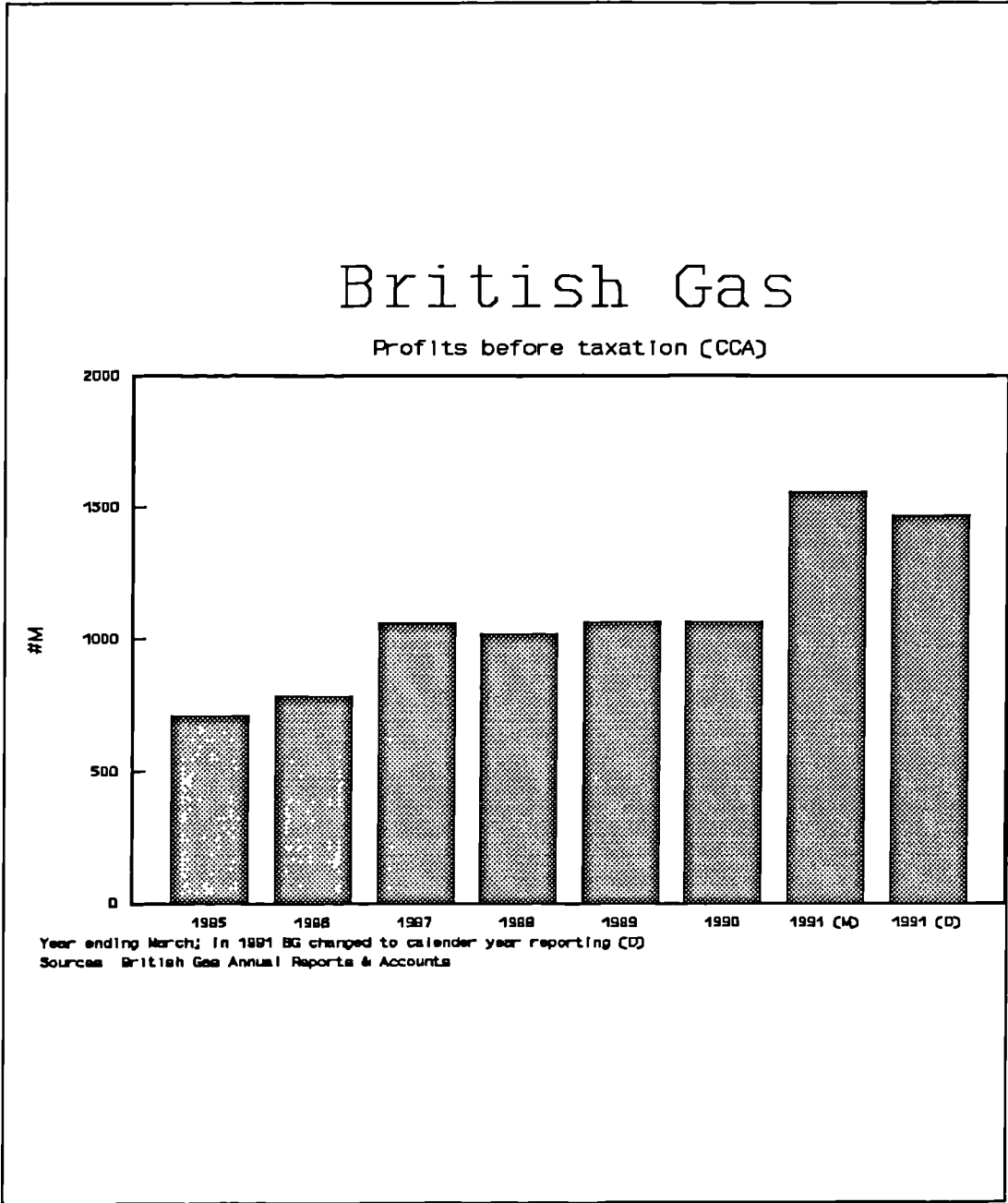


Figure 5.9: British Gas profits

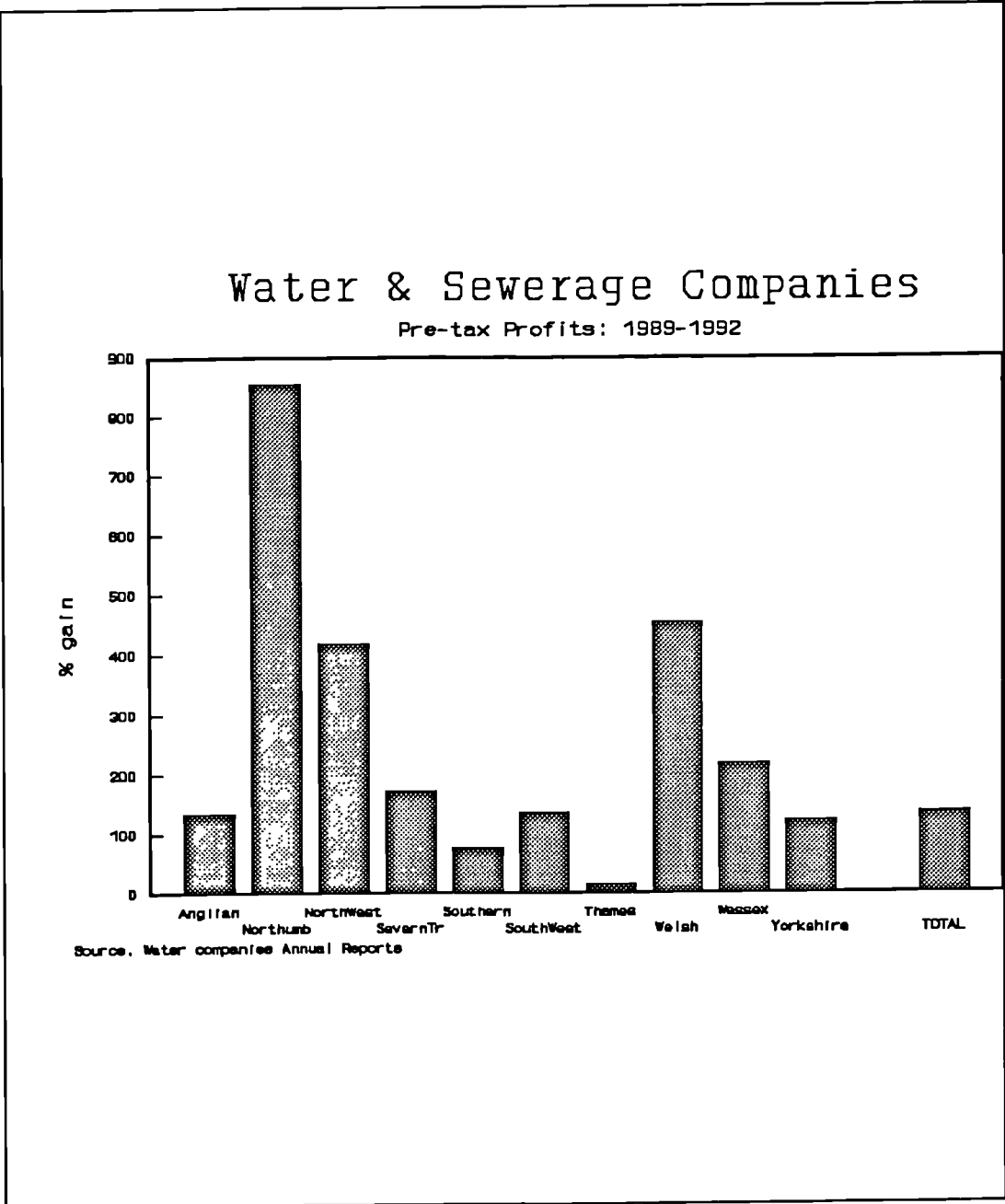


Figure 5.10: Water company profits

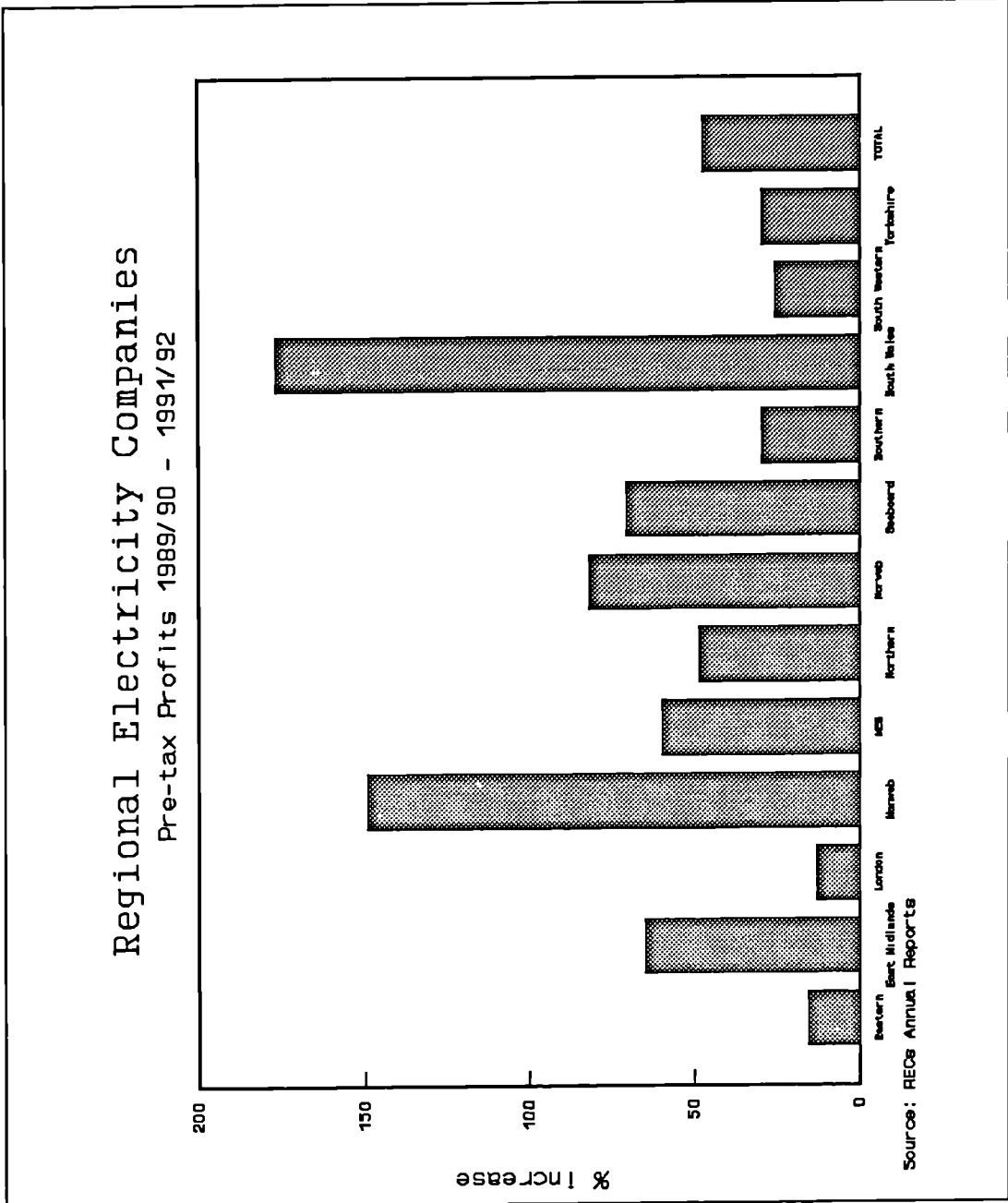


Figure 5.11: Regional electricity company profits



The privatised companies have responded to negative media and public reaction to these profit figures by arguing that sustained profit growth is necessary if the industries are to secure the level of capital investment required to accommodate future demand and to upgrade the existing infrastructure, and in order to be able to deal more effectively with environmental externalities (e.g. Carney, 1991). Because of the scale of the capital works programme, this argument has rather greater validity in the water industry than in the other utility sectors. But even in the water industry, just on 38 per cent of the water companies' profit, £450 million (on a current cost basis), was reinvested in the business in 1991/92. This did, however, represent a substantial increase from 1990/91, when only 25 per cent of profits was retained in the business (OFWAT, 1992z, p.10).

In addition to enlarging the pool of finance available for investment in capital and plant (and increasing the size of dividends paid to shareholders), profit growth also potentially adds to public revenue receipts, through larger payments of corporation taxation and the like. But artificially low rates of taxation can also have the effect of increasing company profitability. The taxation paid by the water and electricity companies in England and Wales is shown in Figure 5.12 overleaf. It can be seen in this Figure that the water industry has fared particularly well, in terms of a light taxation impost, relative to the electricity industry; which in turn partially explains its strong profit performance. The lower rate of taxation paid by the water companies is the result of the tax allowances agreed to by the Government at the time of privatisation <sup>17</sup>. The total amount of taxation paid by the ten water and sewerage companies in 1991/92 was £143 million. By comparison, the water industry generated some £636 million in 'public profit' in its last year under public ownership (1988/89).

<b>Privatised Utilities - Taxation</b>		
	£M	
	1990/91	1991/92
Water services companies:	128	143
Proportion of Pre-tax profit (%)	9.4	9.5
RECs:	332	409
Proportion of Pre-tax profit (%)	29	28
Generating companies:	241	266
Proportion of Pre-tax profit (%)	34	30
National Grid Co:	126	163
Proportion of Pre-tax profit (%)	33	33
<p>Note: Includes all forms of taxation, including overseas taxation. The latter is likely to represent only a very small proportion of the total taxation paid, for example, it represented just over 2% in the case of Severn Trent Water in 1991/92.</p>		
<p>Sources: Company Annual Reports</p>		

**Figure 5.12: Privatised utility taxation**

Overall, the highly profitable early history of the privatised utilities gives credence to the view that shareholders and management have been major beneficiaries of the privatisation programme. The extent to which domestic consumers have benefitted similarly - in terms of reduced tariffs and/or improved services - is the subject matter of Chapters 6 and 7.

(ii) Executive salaries

A very tangible measure of the rewards for management in the privatisation process is obtained by examining the movement in executive salaries over the period leading up to, and following, privatisation. Most reviews of the privatisation programme have considered this issue (e.g. Bishop & Kay, 1988; Chapman, 1990; Whitfield, 1992; plus copious numbers of media reports) and as the evidence is clear and the explanations fairly self-evident, there is little need to devote much space to it here.

A dramatic change in the level of salaries paid to top executives has invariably formed part of the immediate fall-out of privatisation. In the water industries in 1990, for instance, the highest paid director in the Southern, Welsh and Yorkshire water companies received salary increases in the order of 209%, 74% and 59% respectively (Company Annual Reports, 1991).

The chairmen of the regional electricity companies similarly made major salary gains in the year immediately following privatisation. This is illustrated in Figure 5.13.

It is important to note that these figures does not include other elements of the executive remuneration package, such as pension contributions and executive share options.

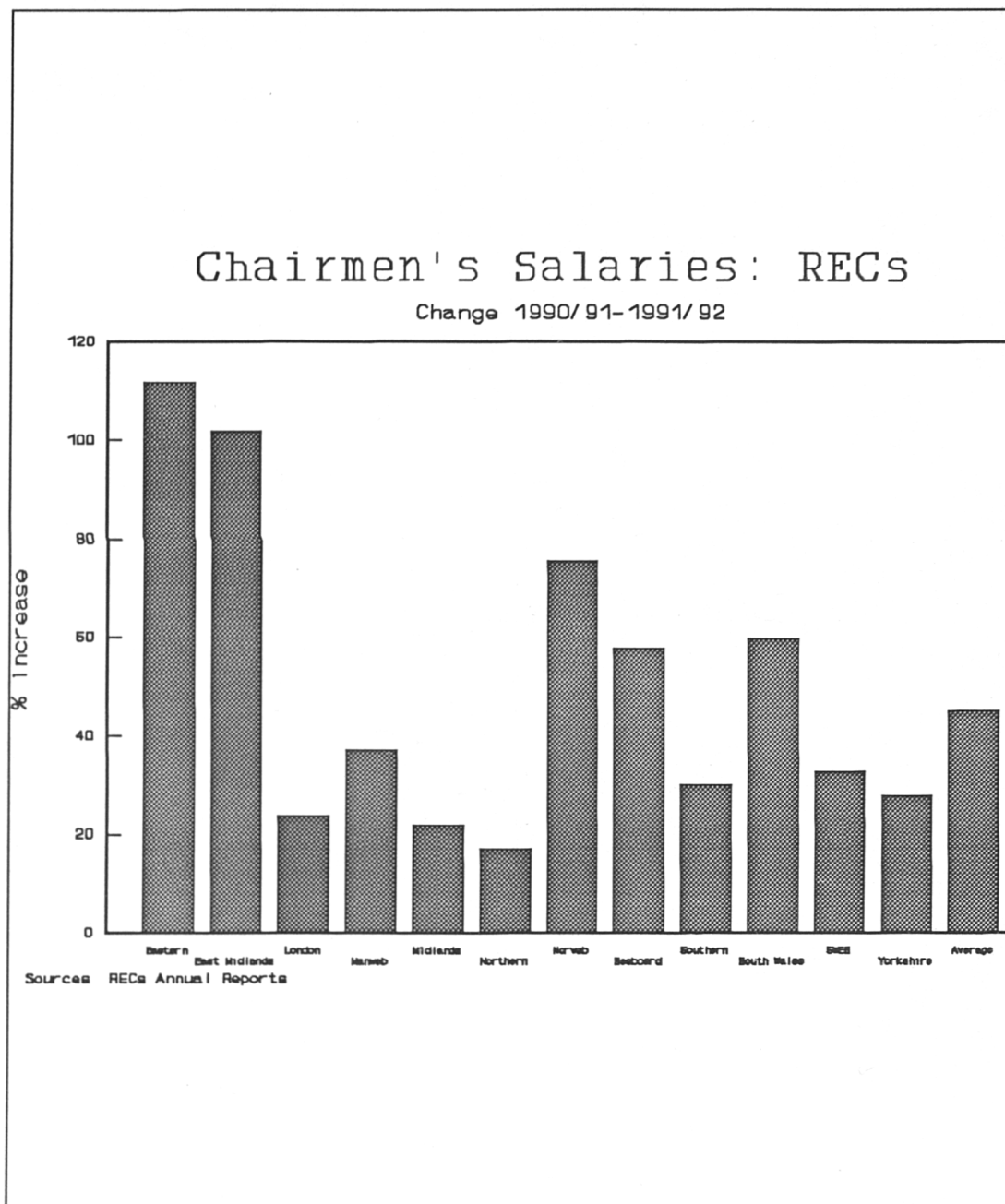


Figure 5.13: Increase in REC chairmen' salaries

Executive salary increases have usually been justified on the grounds that (i) senior managers in the nationalised industries were notoriously under-paid relative to their private sector counterparts and therefore changes were required in order to achieve some form of parity, (ii) the industries' would be constrained in their ability to attract talented management expertise unless high salaries were awarded and (iii) salaries needed to reflect the greater responsibilities of senior executives in the more commercially exposed and higher-risk environment of the privatised utilities. The latter argument in particular has been contested by commentators, and even *The Times* had occasion to fulminate on the subject:

*High private sector remuneration is only justified by a high level of personal risk-taking and a significant personal contribution to increased profitability by the executive concerned. It is the reward for enterprise and wealth creation. That is why it is so objectionable to see heads of privatised near-monopolies being rewarded as if they were buccaneering captains of industry, when many of the industries they run are not performing well, and their prices were being manipulated by the regulators to make sure they were profitable.*

The Times, Editorial 24/9/91

In the water industry there are indications that, after the initial remunerative haemorrhage, the level of executive salary increases has abated. The average increase in salary for the highest paid directors in the water companies in 1991 was 14 per cent, with the highest rise in South West Water of 39 per cent (Company Annual Reports, 1992). In the light of media and public hostility to the earlier round of salary rises, this relative degree of moderation may reflect the power of public opinion. The average increase in 1991 was still, of course, somewhat above the level of wage increases in the economy generally.

### (iii) Employment

Data on aggregate changes in employment in the privatised utilities is easy enough to gather, but how to interpret it is another matter. One person's "over-manning" is another's "service quality", just as one person's "productivity and efficiency gains" is another's "personal and social dislocation". And the extent to which job losses or increases can be directly attributed to privatisation per se, and not to other variables like general economic growth or decline, changes in demand and the advent of new technologies, is highly problematic. A further compounding factor is that in virtually all cases the nationalised public utilities experienced a sustained level of labour shedding over the decade leading into privatisation (Whitfield, 1992; Hogwood, 1992) <sup>18</sup>. The same is true also for the industries that presently remain in the public sector such as British Coal and British Rail (Bishop & Kay, 1988, Table 24).

Nor does the post-privatisation employment trend itself run entirely one way; on first glance at least. The picture portrayed in Figure 5.14 (overleaf) is one of an overall reduction in employment (-4.5%) in the public utility sector since privatisation.

But taken individually, the trend in the water industry runs counter to this, with a net increase in employment of 13 per cent since 1989, just as do a couple of the regional electricity companies. In fact the aggregate figure for the RECs masks variations across the companies, with the 'ends of the axis' being represented by East Midlands with a net increase of 10 per cent in its labour force and Manweb with a net decrease of 17 per cent. Even so, the predominate pattern is one of labour shedding, with ten out of the

twelve companies having reduced their workforce since privatisation (Company Annual Reports, 1992).

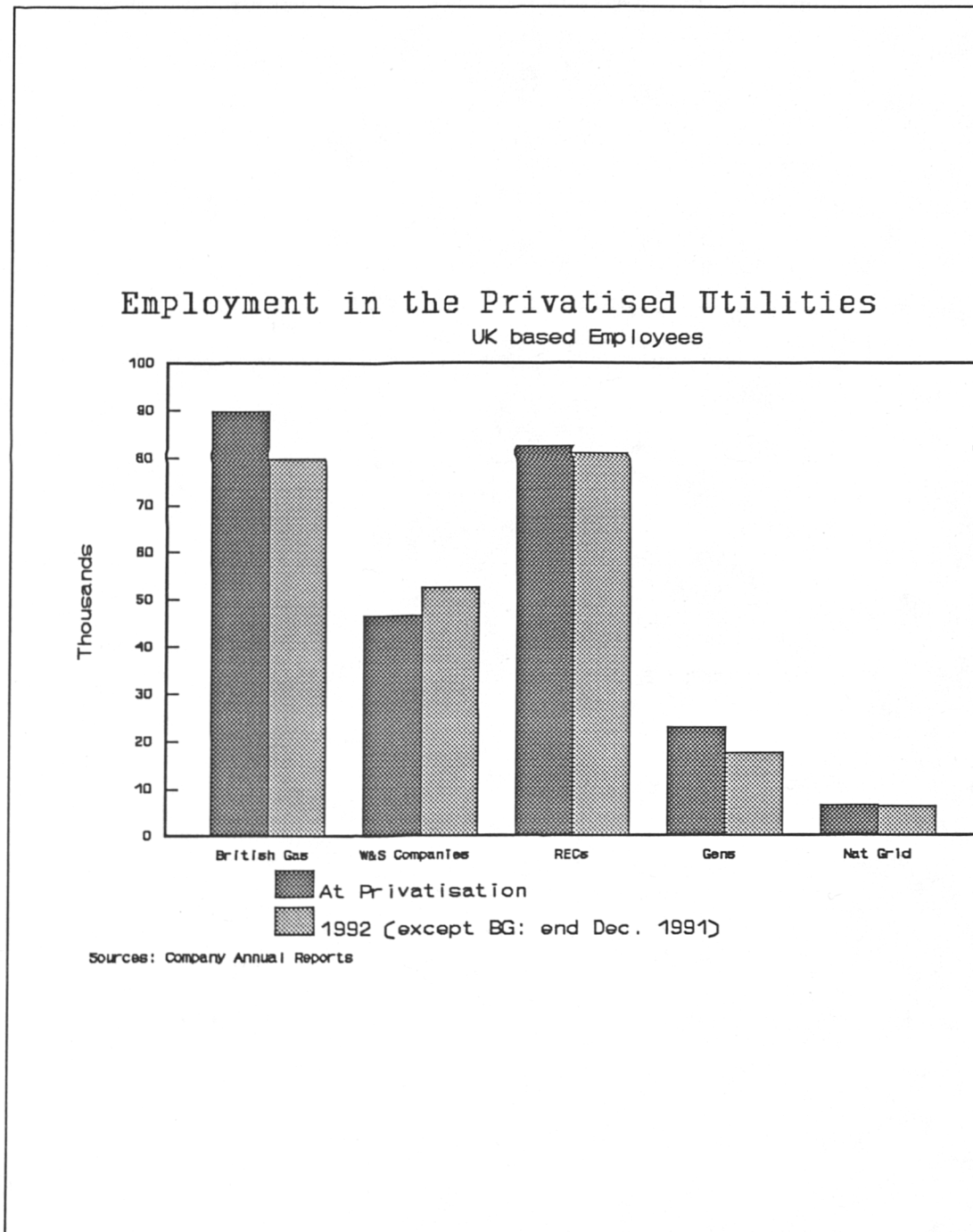


Figure 5.14: Changes in employment in the privatised utilities

Those utilities with the largest job losses since privatisation have been British Gas (-11 per cent) and the generating companies (-23 per cent) <sup>19</sup> and the unequivocal message given by management in both these sectors is that the reductions in personnel will continue apace over the next several years at least (see for example National Power, 1992 p.9; *The Guardian*, 18/11/92 and 20/11/92).

Most of the water and sewerage companies have embarked upon extensive diversification programmes since privatisation, most notably in areas like waste management, process engineering <sup>20</sup> and leisure management. These extensions to the "non-core" area of the water companies' business have been made largely through taking over and purchasing existing enterprises. The against the trend employment record of the privatised water industry can be explained, therefore, after a closer analysis of the distribution of employment across the "core" and "non-core" activities of the companies.

Again not all companies report this, so an aggregate picture is hard to obtain; but Figure 5.15 (overleaf) gives the data for three water companies, and it is unlikely that this pattern would be very much different in the other water companies that have diversified their operations. The table shows that over the period 1990-92, employment in the "core" water and sewerage activities of the three companies declined marginally overall (-0.2%), while employment in the "non-core" areas rose handsomely. Most of this employment "growth" is unlikely to represent new jobs, however, as the great majority of these jobs would have existed previously and would have been simply added to the water companies' establishment as a result of takeovers and mergers. Whitfield (1992) suggests this has happened elsewhere in the privatised industries:



*Many privatised companies have increased their workforce since privatisation, but this is almost entirely due to takeovers and mergers..The underlying trend in the core business is still downwards.*  
p.268

EMPLOYMENT CHANGE IN THE WATER INDUSTRY				
	1990		1992	
	W&S	Other	W&S	Other
Thames	7688	61	7562	1786
North West	7100	0	7035	1166
Wales	3397	314	3547	1149
Total	18185	375	18144	4101
Growth in W&S			-41	-0.2%
Growth in Other Activities			3726	993.6%

Sources: Company Annual Reports

**Figure 5.15: Employment change in the water industry**

In some instances, privatisation will have an employment-related impact well beyond the organisational boundaries of the utility industries themselves. This is probably nowhere more apparent than in the electricity industry, where the move away from using domestic coal as the primary fuel in electricity generation, will have a consequential and profound impact on the level of employment in the coal industry. It has been estimated by the Henley Centre, for example, that the decision to close thirty-one of the remaining pits in Britain (now temporarily deferred) would have the effect of making 31,000 mine workers - and possibly as many as 63,000 other workers - redundant (Henley Centre analysis, *The Guardian*, 21/10/92).

It would be a gross over-simplification to attribute the general decline in employment in the public utility sector to privatisation alone, however, labour-shedding has constituted a significant means of securing efficiency gains in many of the utility companies. Regardless of the economic justification for this, those workers in the public utilities, and in associated industries like coal, who have been made redundant over recent years could hardly be included amongst the beneficiaries of the privatisation programme.

## CONCLUSION

*Nearly all the industries were sold off for much less than they were worth..Thus the government was a negligent guardian of public assets, failing to look after the interests of the collective public. Yet individual members of the public profited mightily from the government's lax generosity. The cut-price sales provided a considerable boost to the private wealth of those who subscribed to them. Gilmour (1992) p.103*

This chapter has shown that a fair measure of disharmony exists between the outcomes of the privatisation programme and the objectives enunciated by the Government. In general, the Government failed to realise, in the sale of the industries, an appropriate return on the decades of accumulated public investment in the utility industries.

A significant part of the financial benefit accruing from utility privatisation has been appropriated by the shareholders of the privatised companies, in the form either of windfall gains on the value of shares or inflated dividends. This, in combination with the flawed implementation of the Government's wider share ownership programme, has meant that the majority of the British population have been net losers through the sale of the three industries. And importantly, through the exclusion, by and large, of poor households from the share ownership programme, the sale of the utilities has merely served to deepen the level of material inequality in British society.

It is still too early to draw firm conclusions about the financial performance of the newly privatised water and energy companies, but certainly their profit performance appears impressive. Arguably, however, the rapid rise in profitability following privatisation has had more to do with the generous terms of the privatisation settlement

negotiated between the industries and the Government, than to the efficiency initiatives of the companies themselves. The way in which these substantially increased profits have been distributed is a microcosm of the privatisation process generally; with the direction of benefits appearing heavily to favour certain groups (i.e. shareholders and company executives), at the expense of others (e.g. displaced workers and possibly, consumers).

As Dunleavy & O'Leary, 1987, Sherman, 1989, Vickers & Yarrow, 1988 and Pint, 1990, among others have argued, the privatisation sales could be viewed as a classic expression of the policy-making art of 'concentrating benefits and diffusing costs' <sup>21</sup>. To this extent, the Government's approach was extremely successful; for its patently regressive method of relinquishing public assets encountered little effective political resistance.

It is now time to consider whether the Government's promise of new consumer rights and prerogatives has had more substance than much of the rest of its explicit rationale for privatisation.

## ENDNOTES TO CHAPTER 5

1. Revenue foregone as a result of discounting shares (£1,814 million), cost of bonuses, vouchers and free shares (£389 million) and flotation costs (£274 million).

2. The Government will additionally retrieve £2.8 billion from the RECs in staged debt repayments over 18 years. This is excluded here because it does not form part of the market capitalisation of the RECs at sale. A similar approach is adopted in the National Audit Office's (1992b) report:

*The Department set the fully paid value of shares at nearly £5.2 billion..Following the start of dealings, the market valued the shares at £6.3 billion. The Department's advisers attribute this to upward movements in the stock market between the time the offer had to be priced, when market conditions were uncertain, and the start of dealings.*  
p.3

The same argument applies to the £2.5 billion British Gas debenture repayable in instalments to the Consolidated Fund.

3. The equivalent change in the FTSE 100 (as a measure of the general movement of the stock market) was:

- \* BG: +3.6% from beginning of trading (8/12/86) to end third week (29/12/86)
- \* Water companies: +4.8% from beginning of trading (13/12/89) to end third week (4/1/90)
- \* RECs: -1.7% from beginning of trading (11/2/90) to end third week (2/1/91)

4. Water companies: £9667B; RECs: £8517B; Generating companies: £5111B; British Gas: £10406B [Source: *Financial Times*, 29/8/92].

5. Roberts et al (1991) conclude differently in relation to the sale of the RECs:

*The most fundamental criticism of the REC privatisation is not that the companies were sold too cheap, but that they were sold too well.* p.82

However, it is difficult to see how this argument can be maintained in the face of the evidence on market capitalisation.

6. The first issue of British Telecom shares in 1984 was five times over-subscribed (see Vickers & Yarrow, 1988, Table 7.1).

7. The amounts cited in Table 5.2 are based on the premiums applicable to fully paid up shares. Initially, investors were required to only make a part-payment on the shares and hence these premiums do not express the real level of profit made by investors who sold their shares over this period. The Figure overleaf shows the premiums obtainable on part-paid shares.

Premium (part-paid):			
	end 1st day	after 1 week	after 3 weeks
British Gas (£0.50)	27%	29%	31%
Water companies (£1.00)	46%	50%	68%
RECs (£1.00)	51%	53%	48%
Generators (£1.00)	37%	38%	31%

8.

PUBLIC UTILITY SHARES RELATIVE TO FTSE 100			
	Change in share price between sale & end August 1992 %	Change in FTSE 100 between sale & end August 1992 %	Net Gain %
Water companies	88	-2	89
RECs	66	7	59
Generators	43	-3	46
British Gas	79	42	37

9. "In view, however, of the limited track record of the companies and the correspondingly cautious basis on which forecasts for the first year were made, the National Audit Office and their advisers, Hambros, believe that it would have been appropriate for the Department to have explored in detail with their advisers whether higher net proceeds might have been achievable by making provision for clawback of a proportion of at least some part of any profits exceeding the forecast or that first year." NAO (1992b) p.2

10. Robert Sheldon, the chairman of the Committee of Public Accounts was rather more explicit in his criticism of the sale to the press:

*There is no question that the companies were sold far too cheap. The speed of the privatisation conveyor belt meant they ended up being flogged like overripe oranges on a Saturday night. Financial Times, 23/7/92*

11. 14% of all adults held privatisation shares, NOP (1992) Table 1A.

12. The shares offered to the public in the flotation of the water companies were 5.7 times over-subscribed (House of Commons Committee of Public Accounts, 1992, p.vi). 12.75 million applications were made for shares in the RECs "...two and a half times the number of applicants made in connection with any previous privatisation." NAO (1992b) p.20

13. "...it would, in the opinion of the National Audit Office, have nevertheless been appropriate for the Department to have set broad target ranges for numbers of applicants and new shareholders, and taken these also into account in pursuing their objective of widening and deepening share ownership." NAO, 1992b, p.4

14. For example in Yorkshire Water, the number of customers holding shares at the end of March 1992 was 53,000, which represents less than 3 per cent of the unmetered premises in the Yorkshire Water region.

15. These figures are generally not comparable, nor are they meant to be. The definition of small and large shareholders varies according to how the shareholdings are reported in the company Annual Reports:

\* small shareholders are variously defined as:

less than 1001 shares - British Gas, South West Water  
less than 1000 shares - Midlands Elect.  
less than 501 shares - Thames Water, Norweb

\* large shareholders are variously defined as:

100,001+ - British Gas, Thames Water  
100,000+ - Midlands Elect., South West Water  
50,001+ - Norweb

16. In June 1992 in a press release, the Director General of Electricity Supply stated:

*Companies have certainly made large profits - larger than was expected when the Government set the price controls. I can well understand customers' concerns about this. OFFER (1992t)*

17. "Total expenditure qualifying for capital allowances was agreed between the water companies, Inland Revenue, the Treasury and the Department at £7.7 billion..These arrangements meant that, given the scale of the capital expenditure programme, the new water and sewerage companies would not pay mainstream Corporation Tax, as distinct from Advance Corporation Tax on dividends for, on average, seven years, although they

would continue to have unrelieved Advance Corporation Tax on dividends for more than 10 years." NAO (1992a) pp.20-1

18. Employment in the RECs was basically stable over the immediate pre-privatisation period. Between 1988 and 1990 employment grew an average of 0.3%, although in seven out of the twelve RECs the level of employment declined (REC Prospectus). The longer term trend, however, has been unambiguous: in 1982, 89,880 people were employed in the Area Boards and by 1987, this had fallen to 81,958 (Electricity Council, 1990, Table 54 - Part II).

19. The employment figures for the generating companies are for the first full year of privatisation i.e. 1st April 1991 to 31st March 1992.

20. Process engineering involves the manufacture and installation "of the filters, reactors and other hardware that go into sewerage treatment plants" Investors Chronicle, 4/9/92, p.60

21. *When new rules can be drawn up through political acts, new rents can be created, and interest groups will form to seek them..Those with more knowledge and influence will usually benefit, but a large number of more diffuse and unorganised citizens will lose.* Sherman (1989) p.286

*An important feature of the process is that the gainers know that they have gained, but the losers are less aware that they have lost.* Vickers & Yarrow (1988) p.180

*The more organized and active groups receive benefits and are able to defend their own interests, while costs are imposed on diffuse, unorganized groups.* Pint (1990) p.296

See Table 3.3 "Political implications of policy programmes and politicians' reactions" in Dunleavy & O'Leary (1987) p.111



## CHAPTER 6: THE CONSUMER INTEREST: THE IMPACT OF PRIVATISATION AND REGULATION ON DOMESTIC CONSUMERS

*We believe that privatisation offers a good opportunity to improve the contract between the water industry and its customers. National Consumer Council (1989b) p.2*

*Whatever one thinks about private ownership of supply companies, the legal arrangements for the supply of gas and electricity are being developed to the advantage of consumers (SHAC/WRUG, 1989)*

### INTRODUCTION

Any attempt to address the question of how domestic consumers have fared under the privatised utility industry framework in Britain must necessarily be preceded by a major caveat. Because the privatisation of two of these industries (water and electricity) is a relatively recent phenomenon, it would be injudicious to be too definitive about the impact of ownership change. Clearly many of the ground rules - particularly in respect to the role of the regulatory bodies - are still evolving.

The influence of the regulatory regime on the operation of the industries is still being tested, not least of all by the regulators themselves. Developing practice experience may strengthen the ability of the regulatory bodies to act as catalysts for consumer-oriented reform of the industries; conversely, under the 'regulatory capture' thesis, the regulators' effectiveness may recede over time, in line with their growing connections and familiarity with the utility industries. At an industry level, the structural, policy and practice changes effected by the new companies in the wake of privatisation (a form of 'Hawthorne effect') may weaken in impact over time (Dunleavy, 1991). Alternatively, it may take several years to achieve the kind of 'customer conscious' culture change that

is seen to characterise the private sector (United Research, 1990; Lockwood, 1991; James Capel Research, 1992).

Given the highly-charged political environment in which these ownership changes have been affected, it is manifestly in the interests of both the Government and the privatised industries to project a strong image of 'customer care' during the formative phase of the restructuring process. This would serve to allay public anxiety about the possible impact of the private control and provision of utility services, as well as win belated popular support for the privatisation programme.

Equally, the interests of opponents of the Government's privatisation programme lie in applying the most negative gloss possible to the behaviour of the privatised industries and to the actions of the regulatory agencies. This oppositional instinct to 'damn outright' has been in evidence in House of Commons debates on privatisation, such as those conducted on the water industry and the electricity and gas industries in June and July 1991 respectively.

As a consequence, it will be a number of years before an evaluation of privatisation along any dimension - be it in regard to efficiency, or competition, or consumer outcomes - will be able to be completed with confidence. The evaluative task is rendered all the more difficult through the absence of comparable 'before' and 'after' data in a number of areas, and by the fact that it is impossible, obviously, to predict what might have happened had the utility industries remained in public ownership.

However, in acknowledging this it is possible, even at this reasonably early stage, to identify a number of patterns and impacts, related to privatisation and the advent of independent regulation, in the key domestic consumer domains of (i) prices, (ii) debt and disconnection, and (iii) standards of service and consumer representation. The three parts of Chapters 6 and 7 examine the evidence on outcomes, to date, in these areas.

## PART 1: PRICES AND TARIFF SYSTEMS

*..a system of economic regulation will be designed to ensure that the benefits of greater efficiency are systematically passed on to customers in the form of lower prices and better service than would otherwise have occurred. Secretary of State for the Environment et al (1986), p.1*

*Greater competition will create downward pressures on costs and prices, and ensure that the customer, not the producer or distributor, comes first. Secretary of State for Energy (1988), p.16*

Price - along with service quality - is the domain of public utility practice of most immediate importance and relevance to consumers. The issue of price is important in any instance of producer-consumer interaction, but this is particularly so in areas of natural monopoly, where there is an ability to charge monopoly prices (either directly through raising tariffs or indirectly through attenuating service quality) independent of consumer demand and conventional market forces. Not surprisingly, there appears to be a direct correlation between the importance attached by domestic consumers to the question of utility prices and socio-economic status (see, for example, DoE, 1991a; MORI, 1992; and Part 3 in Chapter 7). The structure and level of energy and water tariffs has a critical bearing on the extent to which these services can be accessed by, and are affordable to, low income households in Britain.

In the public marketing of the utility privatisation programme, the Government regularly drew attention to the way that domestic consumers would benefit through lower prices for utility services (as reflected in the quotations from the White Papers above). In this section, the pricing outcomes for domestic consumers in the three utility areas will be reviewed. As each of the utilities has had a somewhat different recent history in respect to pricing, they will be considered individually in order of privatisation.

## 1. GAS

### (i) Tariffs over the first five years of privatisation

The regulation of prices for domestic gas consumers, as with the other utilities, is built upon the RPI-X formula first developed by Professor Stephen Littlechild for British Telecom. Over the first five years of its privatised existence, British Gas was allowed to raise its prices for tariff consumers, i.e. consumers purchasing less than 25,000 therms (in 1991, the average annual consumption for domestic consumers was 651 therms, British Gas, 1992c, p.35), by the retail price index minus 2%, under the formula regulated by the Office of Gas Supply (OFGAS). Notably, the standing charge was exempt from this constraint and could be raised by the level of the retail price index each year.

In the view of a number of commentators, the initial price cap set for British Gas represented a rather modest efficiency target for a national monopoly provider:

*Taken as a whole, the pricing constraints imposed on British Gas can hardly be described as stringent. The implicit target of a 2 percent per annum reduction in nongas costs should not prove to be onerous. Some demand growth over the five-year period was predicted in the prospectus for the share issue and, given the existence of scale economies, this should lead to reductions in real unit costs even in the event that internal efficiency is not improved. Moreover, the nationalized BGC was set a target of reducing its real net trading costs per therm by 12 percent between financial years 1982-1983 and 1986-1987 and managed to meet this target within the first three years of the four-year period. Vickers & Yarrow (1988) p. 265*

The formula was seen to be particularly generous in light of the provision enabling British Gas to automatically pass-through to tariff consumers any increases in the purchase price it paid for gas from off-shore suppliers.

Figure 6.1 illustrates the year-on-year movement in prices for gas tariff customers between 1986 and 1992.

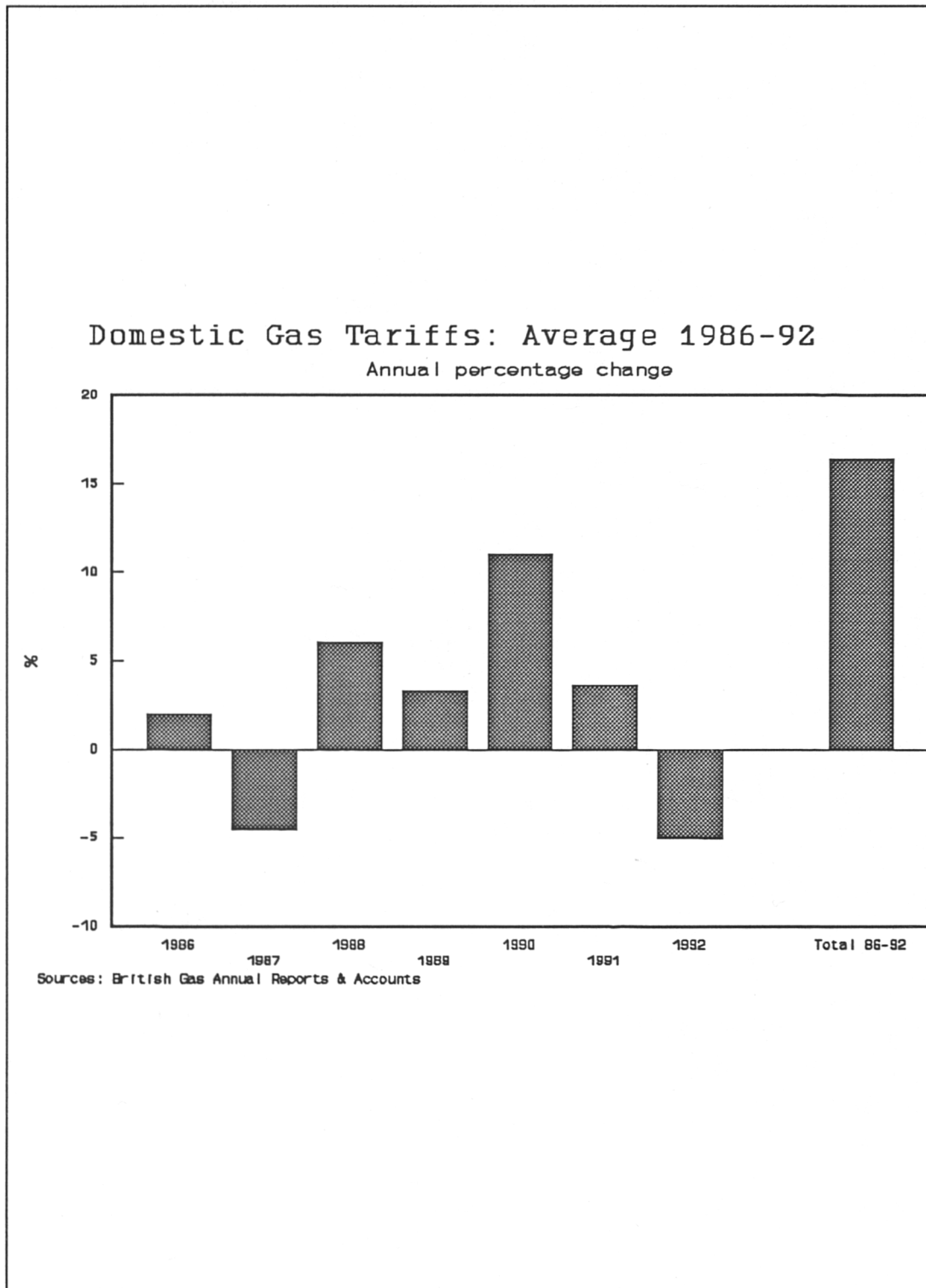


Figure 6.1: Changes in domestic gas tariffs 1986-92

Between 1987 (the first full year of privatisation) and 1991, British Gas prices for domestic consumers rose by 19.5 per cent. As the cost of living increased between these years by 31.6 per cent (Department of Trade and Industry, 1992, Table 54), domestic gas tariffs effectively decreased in real terms by just over 12 per cent. At the same time, British Gas moved progressively towards the development of uniform standing charges across the country, involving above average increases in standing charges for consumers in the North of England and the Midlands between 1987 and 1991 (25 per cent and 24 per cent respectively, compared to 13 per cent for the rest of Britain); although these were still below the actual level of inflation for the period.

The reduction in gas tariffs over the first five year period has been attributed as much to "the fall in gas purchase costs that had occurred as a result of the fall in world oil prices" (Vickers & Yarrow, 1988, p.279) as to any efficiency savings effected by British Gas. Commenting on the 4.5 per cent reduction in tariffs in 1987, for example, Sir Denis Rooke, Chairman of British Gas stated:

*Last year we felt the full benefit of the 1986 oil price falls which, in line with the price formula under our authorisation to act as a public gas supplier, produced a reduction in the price of gas to tariff customers.*  
British Gas (1988) Chairman's Statement

Indeed it might be argued that British Gas had even greater scope for reducing tariffs (on the basis of cheaper gas purchasing costs) than those actually achieved over the 1987-90 period. Between 1987 and 1991 the average price of natural gas (inclusive of the gas levy) purchased by British Gas increased by five per cent, from 17.85 pence per therm to 18.79 pence per therm (Department of Trade and Industry, 1992, Table 63). Once inflation is taken into account, the average price of natural gas was 27 per cent cheaper in 1991 compared to 1987 (i.e. 5% minus 32%).

Translating this fall in gas costs to the tariff market (gas costs represent around 40 per cent of British Gas' costs in supplying this sector, OFGAS, 1991d, p.6) reveals that the 'full equivalent price' in 1991 of £100 worth of gas (at 1987 prices) was £108.32, whereas the actual price charged by British Gas was £112.10 [see table below]. In other words, tariff prices between 1987 and 1991 increased by over 3 per cent more than would have been necessary had the full saving on gas purchase costs been passed through to tariff consumers.

£100 worth of gas, of which	£40 represents gas purchase costs (G) £60 represents operating costs (O) £100 total costs (T)
Gas purchase costs = -27%	
Operating costs = RPI +32%	
Full discount of gas purchase cost savings 1987-91 (i.e. what it actually cost British Gas):	
Gas purchase costs [G * -27%]	£29.20
Operating costs [O * 32%]	£79.20
Total (T)	£108.40
Actual tariff	£112.10
Difference	£ 3.70 (3.3%)

**Figure 6.2: The reduction in gas purchase costs and domestic tariffs**

The validity of the assertion that the efficiency target set for British Gas at the time of privatisation was not particularly onerous, was effectively acknowledged by the Director General of OFGAS in his review of the gas tariff formula:

*..the judgement of OFGAS and its consultants was that British Gas achieved this [efficiency gains under the old formula] without showing*



*any signs of being an organisation under serious cost pressures. Nor, on examination, did OFGAS find any reason to believe that these cost savings were one off in nature or a simple squeezing out of pre-privatisation "fat". OFGAS (1991d) p.12.*

This, in conjunction with the consistently high levels of profit generated by British Gas between 1986 and 1991 (as shown in the previous Chapter), gives credence to the view that, while domestic consumers have benefitted from decreases in tariffs during the first quinquennium of privatisation, the fall in tariffs could well have been greater had British Gas been subjected to a more testing price cap. In relative terms, tariff consumers have not experienced anything like the price gains that have been made by large users in the contract market, who have been subjected to a marginally more competitive gas supply environment. This is illustrated in Figure 6.3 for the period 1988 to 1991.

<u>Gas Prices</u>	
<u>Changes in Major Sectors</u>	
<u>(per cent)</u>	
	1988-91
Domestic	+24
Industrial:	
Small [Less than 50,000 therms]	+14
Medium [50,000-300,000 therms]	-4
Large [Greater than 300,000 therms]	-4
RPI	+27

Sources: Derived from DTI (1992c) Table 61, Table 54

**Figure 6.3: Changes in gas tariffs for all sectors 1988-91**

(ii) The review of the gas tariff formula

During 1990-91, the Office of Gas Supply carried out a major review of the formula regulating British Gas' charges to tariff customers. Although the process of consultation used in the review has drawn some criticism from consumer and community sector organisations <sup>1</sup>, it is generally acknowledged that the package of measures announced by OFGAS in April 1991, should result in more substantive gains for domestic gas consumers over the second five years of privatisation (from April 1992) compared to those achieved during the first quinquennium. There is, however, the prospect that the settlement agreed between OFGAS and British Gas during the review could be subject to re-negotiation, following the recent referral of British Gas to the Monopolies and Mergers Commission (see below).

Under the revised tariff formula, the regulator has set a more demanding efficiency target for British Gas. The new price cap ( $X$ ) on charges to tariff customers has been raised from the original minus 2 per cent to minus 5 per cent (i.e. the Retail Price Index minus 5%) <sup>2</sup>. This should result, according to the Director General, in gas prices being "15% or more lower than they would otherwise have been at the end of five years" (OFGAS, 1991h). The re-setting of the level of  $X$  has been complimented with the introduction of three other changes in the regulatory regime which will impact directly on domestic consumers: a change in the way that gas purchasing costs can be passed through to consumers, provision for the pass-through of energy efficiency costs, and the modification of British Gas' Authorisation incorporating standards of performance (Condition 13A). The first two of these will be discussed below, the third is considered in the next chapter.

In the first of these measures, the regulator has removed British Gas' ability to pass-through fully increases in gas purchase costs to tariff consumers. The free hand of British Gas in dealing with gas purchase costs under the previous formula was identified as a significant issue requiring action, by a number of organisations including the Gas Consumers Council, during the tariff review consultation:

*Of particular concern is the pass-through of costs of new gas as this automatic cover reduces the incentive for BG to negotiate the cheapest price for new contracts. There may even be an opportunity for British Gas to pay over the odds for gas to keep out competitors as the higher price can be passed on automatically to tariff customers.*

Gas Consumers Council (1990) p.3

From April 1992, the allowable pass-through of wholesale gas costs has been indexed (using a "gas price index") and is subject to a one per cent reduction each year ('RPI-Z'). This provides a hitherto absent efficiency incentive for British Gas:

*The advantages of a gas cost price cap are essentially the same as those of the RPI price cap - that is, the arrangement gives British Gas a clear incentive to improve its purchasing efficiency because lower costs will lead to higher profits.*

OFGAS (1991d) p.7

This will become increasingly important as the cheaper sources of gas supply from the Southern Basin gas fields in the North Sea 'dry up' and as existing long-term contracts between British Gas and gas producers are renewed.

Measures to stimulate energy efficiency serve two, not necessarily complementary, policy agendas. Firstly, they meet a set of environmental imperatives aimed at protecting the global environment, through reducing energy consumption. Secondly, they occupy an important place in the strategy to address fuel poverty, for when targeted effectively energy efficiency programmes raise the end-use quality of energy services to low income households; although this may not necessarily result in a net reduction in energy consumption (Boardman, 1991a; Owen, 1990; NEA, 1991).

As a corporate sponsor, British Gas has a history of involvement in community-based energy efficiency and energy conservation programmes; exemplified by its financial support for the major energy efficiency charity, Neighbourhood Energy Action. However, up until the 1991 review of the gas tariff formula there was neither the regulatory framework, nor the economic incentive for energy efficiency to be treated as a core operational activity of British Gas. Indeed the thrust of economic regulation worked in the reverse direction, with the structure of economic rewards weighted in favour of inefficient, and at times the profligate, use of gas (OFGAS, 1991e).

Under the revised tariff formula, British Gas will in future be able to designate areas of energy efficiency expenditure and, with the approval of the Director General OFGAS, pass-through these energy efficiency costs to tariff consumers:

*It enables expenditure on energy efficiency measures to be passed through to consumers in the same way as gas purchasing costs. This allows British Gas to view expanded gas sales and greater energy efficiency as equally competing commercial alternatives. OFGAS (1992i) p.4*

The administration of 'E factor' funds and projects will be the responsibility, following the announcement by the Government in May 1992, of the *Energy Saving Trust*. In the first year of operation, British Gas will contribute £6 million for three pilot projects, one of which is explicitly directed at low income households<sup>3</sup>. In addition to British Gas, the regional electricity companies in England and Wales and the two Scottish electricity companies, have 'signed up' as participants in the Trust, although they have not as yet committed any funding towards its operation.

The 'E factor' initiative has been warmly welcomed by both the energy conservation and fuel poverty lobbies (e.g. Association for the Conservation of Energy in submission to the House of Commons Energy Select Committee, 1992b and the National Right to Fuel

Campaign, 1991), and the Office of Electricity Regulation has been urged to introduce a similar device in the electricity industry (Boardman & Houghton, 1991). Yet, as an effective measure aimed at reducing either carbon dioxide emissions or fuel poverty (or a combination of both) the 'E factor' and its *Energy Trust* corollary are likely to constitute an inadequate policy response.

The 'E factor' methodology, with its emphasis on market incentives rather than regulatory controls, falls well short of the 'least-cost planning' approach to energy investment and resource management (Brown, 1990; Berry; 1992) employed in many parts of North America. But even as a mechanism for stimulating market-led decisions in favour of energy efficiency, its structure of incentives is flawed; for although explicitly identified expenditure on energy efficiency is compensated through the price formula, any loss of income associated with reduced energy demand is not. As revenue foregone through lost sales of energy will form the major potential cost of energy efficiency programmes for gas and electricity companies, the inability to pass these losses on through the pricing formula is likely to act as a significant deterrent to expansive and imaginative energy efficiency activity on the part of companies concerned<sup>4</sup>. The 'E factor' in other words, only tinkers at the margins of the incentive structure of the price formula, and it does little to modify the dominating tenor of the reward and profit structure of the privatised energy industries, which is fundamentally predicated on a capacity to sell more energy rather than less.

From a fuel poverty perspective, the use of the 'E factor' to generate large sums of money for projects directed specifically at low income households, is constrained by the requirement that both the regulators and the utility companies avoid being seen to give 'undue discrimination' and 'undue preference' to particular classes of consumers

(Sharpe, 1992). While the creation of an independent trust to administer 'E factor' funds may obviate some of these problems, trust funds (which are effectively being provided by all consumers) will need to be distributed in an 'even-handed' way, in order to avoid the charge that the generality of consumers are being taxed to fund services for the benefit of one sub-set of consumers only.

The levying of an 'E factor' surcharge on the tariffs of low income households (along with domestic consumers generally) to finance measures to promote energy efficiency in affluent households, raises important equity considerations. The 'E factor' has the potential to become a form of disguised carbon tax - one directed only at domestic consumers (i.e. it excludes the franchise sector of the energy market not subject to price regulation) and without any off-setting compensation for low income households via the income security system.

The extent to which the 'E factor' will form no more than "a marginal consideration in the marketing strategy of BG or the first step on the road to regulation for energy services" (Roberts, 1992, p.13), and the nature of its impact on low income households is unclear at this point, as the development of the concept is still at a very formative stage.

What is clearer, however, is that the package of measures developed by the regulator in the gas tariff review, constitute in aggregate a far superior settlement for the domestic consumer than that achieved at privatisation. And the achievement of the Director General of Gas Supply is rendered all the more noteworthy by the knowledge that the revised tariff formula was introduced in the face of considerable opposition from British Gas; particularly following the announcement of the Office of Fair Trading's (OFT)

proposals for the separation of the distribution and supply businesses of the company in October 1991 (see OFGAS 1991 Annual Report; Powe, 1992; OXERA, 1992, for accounts of the difficult progress of the tariff review negotiations).

The positive outcomes for domestic consumers have been obtained only after assertive - some would say belligerent - action on the part of the regulator. An example of this was the attempt by British Gas in March 1992 to meet the new price formula conditions by freezing, rather than reducing, tariff charges and it was only after OFGAS threatened enforcement action (OFGAS, 1992c) that the company agreed to reduce its tariff by 1.7p or 3 per cent (from 1st July 1992). Reflecting on these events, the Director of the Gas Consumers Council concluded that:

*A reduction of this size can only mean that British Gas either got its sums wrong or decided to hoodwink its customers. Either way, British Gas has boosted the regulator's reputation and has dented its own credibility.*

GCCb, 1992

At the time of writing, the story of the torturous negotiations and attempted re-negotiations of the new tariff formula continues to unfold. British Gas' understandable hesitancy (from the point of view of protecting shareholders' interests) to concede too much, appeared to turn to recalcitrance as the implications of the OFGAS tariff and OFT competition review began to sink in. The company expressed concern, in particular, about the simultaneous loss of dominance of the contract gas market (demanded by the OFT) and the reduced profitability of the increasingly important tariff sector of its business (through the RPI minus 5% revision to the formula) <sup>5</sup>. It argued that the ground rules had changed substantially between the drafting of the conditions of the tariff review and their implementation; that is, in April 1991 it was an integrated entity, whereas by April 1992 (when the new formula came into effect) it was facing (a) the

imminent separation of its transmission division, (b) a reduction in its share of the contract gas market to 40 per cent (by 1996) and (c) the loss of its supply monopoly to users above 2,500 therms per year under the *Competition and Service (Utilities) Act 1992*. Because of this, it proposed that OFGAS re-consider the terms of the tariff review agreement.

### (iii) The MMC Reference

The impasse between British Gas and the regulatory bodies resulted, at the end of July 1992, in the Director General of Gas Supply using his powers under the *Competition and Service (Utilities) Act* to refer British Gas to the Monopolies and Mergers Commission. Initially the scope of the reference covered only the question of determining an appropriate set of financial arrangements for the operation of the gas transmission network. But the terms of the MMC inquiry were subsequently widened to encompass a full review of the gas market, following the issuing of parallel references by the President of the Board of Trade and the Director General of Gas Supply (Department of Trade and Industry, 1992a, 1992b; OFGAS, 1992g, 1992h).

The reference by the President of the Board of Trade was made at the behest of British Gas itself - but apparently, only after failing to get the Department of Trade and Industry to intervene to prevent the OFGAS reference on the transmission network going forward to the MMC (OFGAS policy officer, PUA meeting, 22/9/92). In the view of the Director General of Gas Supply, the action of British Gas to widen the scope of the enquiry, represents a strategic move aimed at putting the results of the tariff formula review "back into the melting pot in the hope that an outcome would emerge which was



more favourable than the one the company had already signed up to" (PUAF Newsletter, October 1992, p.5).

Partly in order to meet the terms of the new formula, but also, possibly with a view to strengthening its position leading into the MMC investigation, British Gas announced in August 1992 a further reduction in tariff prices by 2 per cent from the 1st October. The two 1992 pricing changes represent an effective reduction in gas tariffs, over a full year, of 3.25 per cent <sup>6</sup>.

Whether the pricing and standards of service reforms obtained through the tariff review will be sustained over the longer term is now effectively in the hands of the MMC. Certainly it is possible that some of the elements of the package could be revised, in light of the quite different gas market that may emerge after the release of the results of the MMC review sometime in the Spring 1993. It is quite likely that the MMC will recommend major changes to the competitive framework of the gas industry. In the opinion of some observers, it is by no means self-evident that domestic consumers will be amongst those sectors who stand to gain most from a more competitive gas market. The Gas Consumers Council, in particular, has cautioned that the break-up of British Gas and the introduction of competition in the tariff sector could result in higher tariffs, regional pricing and declining service quality for domestic consumers (GCCa, 1992; Powe, 1992; PUAF, September 1992; see also NEA, 1992d).

## 2. WATER

### (i) Domestic water tariffs since privatisation

Amongst the three utility areas under study, the water industry has probably attracted the greatest amount of public and media attention since privatisation. The sharp increase in water charges since 1989 has been a significant stimulus to this increasing interest in the activities of the water companies. In contrast to the energy utilities, above inflation price increases were explicitly structured into the economic framework of the privatised water industry at the outset. In setting the  $K$  factor in the price formula, the Government made provision for water and sewerage charges to increase by some 4-5 per cent each year in real terms until the end of the century. Price increases of this order were required, it was argued, to underwrite the costs of the £26 billion (1989 prices) ten-year capital investment programme of the water industry.

Figures 6.4 and 6.5 (on the next two pages) show the movement of water charges over recent years. It can be seen in the table (Figure 6.4) that average household bills for water and sewerage have risen at a consistent rate above the Retail Price Index, despite the fact that the Director General of Water Services negotiated a voluntary abatement by all but one of the water companies <sup>7</sup> of a sixth of their  $K$  factor increase in 1992/93. This action on the part of the Director General followed widely-expressed concern about the level of profits generated by the industry in 1990-91:

*..in a situation where bills are rising rapidly, customers will not expect companies to make unnecessarily high profits and in particular to pay out excessive dividends..It is up to management to decide on dividends, but if companies were to use the present position to pay out dividends above those anticipated when the  $K$  factors were set they would need to be ready to answer pointed questions from customers and from the regulator.. (OFWAT, 1991e)*

Average Household Water & Sewerage Bills				
			<u>Unmeasured</u>	
	£	Annual increase %	RPI increase %	Increase above RPI %
1989/90	118.80			
1990/91	134.27	13.02	7.7	5.32
1991/92	154.57	15.12	9.7	5.42
1992/93	169.56	9.70	4.3	5.40

The average water & sewerage bill for the 3% of households on metered supply in 1992/93 was £205 i.e. 21% higher than for unmeasured households

Source: Derived from CRI (1992); OFWAT (1992a)

**Figure 6.4: Average household water bills 1989-92**

Substantial political capital was made out of the Director General's successful negotiation of the *K* abatement. But the actual affect of this on the profits of the water companies would have been minimal, as it was more than offset by the real terms decline in construction costs - "15 per cent below the level assumed in 1989" (OFWAT, 1992z, p.4). As construction costs represent a major component of the companies' capital expenditure, the fall in these costs would have provided substantial savings. The impact of the fall in construction costs on company profits was illustrated in the Director General's determination on South West Water's application for an interim adjustment to their price cap (this is discussed in some detail in endnote <sup>8</sup>).

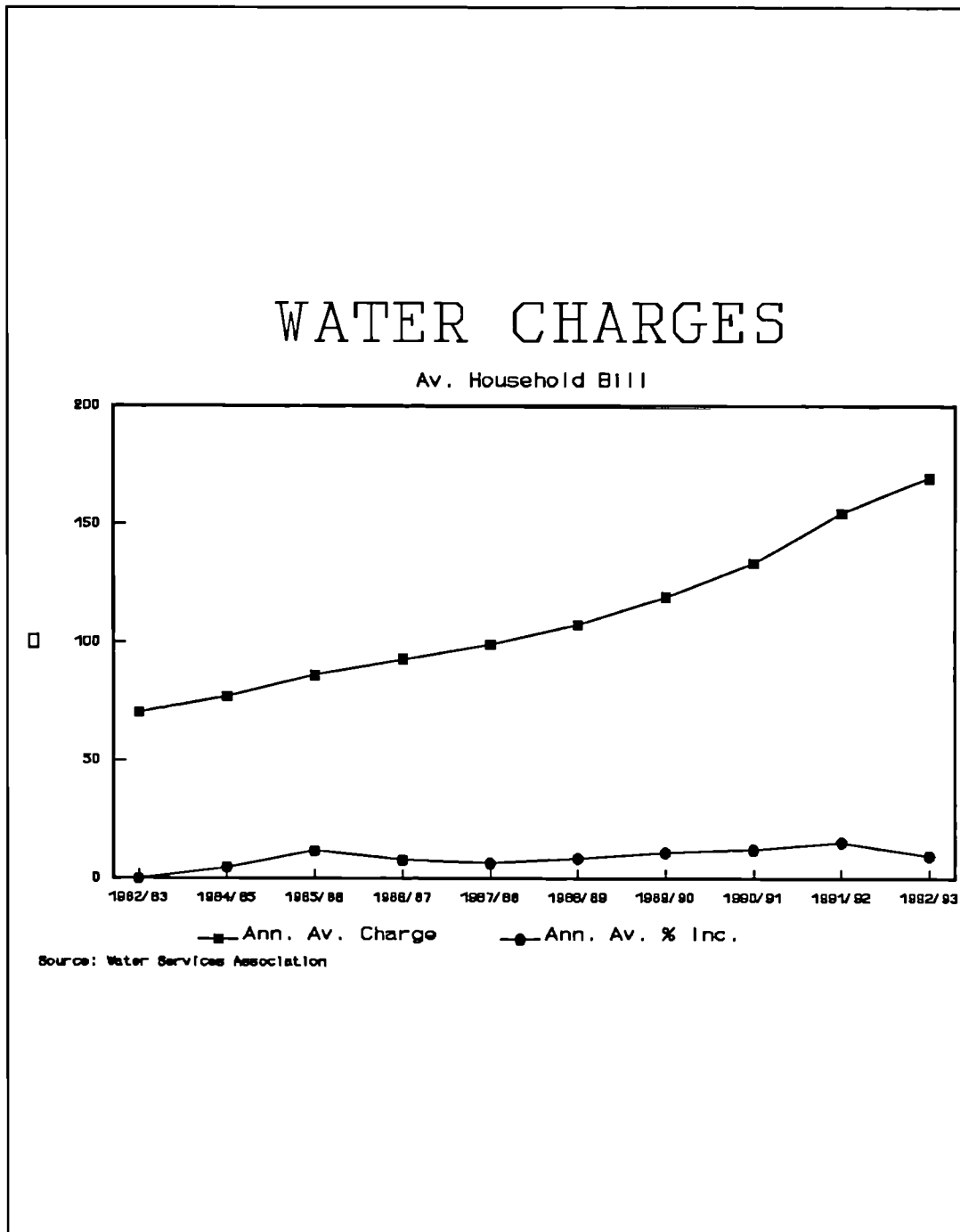


Figure 6.5: Domestic water tariffs 1982-92

Figure 6.5 gives a longitudinal picture of water charges and shows that the increases in recent years are part of a longer term trend that has been in evidence since the water industry entered its 'commercialised' course in the early 1980s. The figures before and after privatisation are not strictly comparable because (i) current charges exclude the 'environmental service charge', which since 1989 has been funded out of general taxation revenue to partly finance the National River Authority (see Macrory, 1989, p.13) and (ii) previously, additional capacity/infrastructure costs were spread across all consumers (with a component for this in each consumer's bill), whereas it is now paid directly by new consumers through Infrastructure Charges<sup>9</sup>. The exclusion of these elements would make the shift in the curve after 1988/89 somewhat sharper.

(ii) The explanations for rising water charges

The increases in water charges, since privatisation at least, have been invariably attributed by the Government, industry sources and OFWAT, to the costs associated with upgrading the infrastructure and environmental standards of the water services industry. This official rationale for the sustained water price increases experienced over the past four years (and into the future) was reiterated by the Under-Secretary for State for the Environment in a House of Commons debate on the water industry in June 1991:

*Privatisation has not of itself caused an increase in water charges. Privatisation has involved identifying all the requirements to ensure that the water industry meets agreed domestic and European Community standards, and costing those requirements and agreeing a capital programme to put them right.*

HoC (18/6/91) col. 157

Undeniably the cost of the capital programme has been the primary contributor to the rise in water charges, but there have been other forces at work as well. The higher rate of return required by the private water companies (compared to their publicly owned predecessors) and other factors associated with privatisation has had an influence on the current level of charges in England and Wales. Certainly this appears to be the view of water consumers themselves. In the OFWAT-commissioned MORI survey carried out between November 1991 and January 1992, the predominant explanation for future price increases related directly or indirectly to privatisation.

<i>What do you think will be the main reasons for the water bills going up by more than the rate of inflation?</i>	
	%
Because of privatisation	28
To pay shareholders/make money and profits	20
Increased directors'/managers' salaries	9
Total 'privatisation effect'	57

Source: MORI (1992) p.81

**Figure 6.6: Consumers' views on the 'privatisation effect' and water bills**

Although the Director General of Water Services has been at pains to point out that this survey finding reflects the fact that "customers have a poor understanding of the reasons for the real increases in bills" (OFWAT Annual Report, 1992), his own analyses of the capital structure of the water industry tends to belie the view that the 'privatisation effect' has been insignificant. In his two major excursions into this area - the *Cost of Capital* (OFWAT, 1991) and *The Cost of Quality* (OFWAT, 1992o) consultation papers - the Director General has emphasised that the return on capital obtained by the water companies need not necessarily be as high as that set at the time of privatisation:

*The Secretaries of State worked on the basis of a 7% real pre-tax return for the water and sewerage companies. For most of the water only*

*companies an 8% figure was used. For the smallest companies the rate was 8.5%. p.v*

*Taken together..these returns on debt and equity would suggest a weighted average cost of capital of perhaps 5% to 6% in the longer term for a water and sewerage company. The rates could be a little higher for the small independent water only companies. p.27 (both OFWAT, 1991)*

A reduction in the rate of return on capital is justified, in the Director General's view, because the water industry is a low risk area of commercial activity and it has a highly stable revenue-raising capacity (OFWAT, 1991). A future rate of return at the level envisaged by the Director General (above) would be similar to that applied by OFGAS in its review of British Gas' tariffs. Predictably, the water industry has vigorously contested the assumptions underlying the Director General's calculation of an appropriate rate of return and has countered that a "level of at least 9.5 per cent is justified given the risks to which the water companies are exposed" (*Water Bulletin*, 6/12/91).

In his more recent *Cost of Quality* paper, published as part of the consultative process leading into the 1994 Periodic Review of the price formula, the Director General identified three future water charging scenarios based on different assumptions about the standards of environmental quality expected of the water industry. In the paper, the Director General concentrates primarily on the impact that environmental improvements will have on household bills in the future; representing the latest stage in his long-standing campaign to make the cost of environmental policy, as it affects the water industry, more transparent and to give customers "...the material on which they can make informed judgements about the quality of the service they want and the price they are prepared to pay" (OFWAT, 1992o) <sup>10</sup>.

However, the paper also contains data on the financial structure of the water industry of more immediate relevance to the issues being considered here. If a sterner efficiency target (from 3% to 5%) and a lower rate of return (weighted average of 6%) were set for the industry, this would have a significant moderating effect on average household bills in the future. This is outlined in Figure 6.7.

THE IMPACT OF FINANCIAL CHANGES ON FUTURE WATER CHARGES		
PROJECTED INCREASE IN AVERAGE HOUSEHOLD BILL [REAL TERMS]		
ENVIRONMENTAL TARGET:	1992/93 - 1999-2000	
<i>PROGRESS MAINTAINED - LOWER</i>		£215 (+27%)
<i>PROGRESS MAINTAINED - UPPER</i>		£230 (+36%)
<i>PURE AND GREEN</i>		£255 (+51%)
[AVERAGE HOUSEHOLD BILL IN 1992-93: £169]		
PROJECTED INCREASE IN AVERAGE HOUSEHOLD BILL <u>MINUS</u> EXISTING EFFICIENCY TARGET		
ENVIRONMENTAL TARGET:	1992/93 - 1999-2000	
<i>PROGRESS MAINTAINED - LOWER</i>		£202 (+20%)
<i>PROGRESS MAINTAINED - UPPER</i>		£217 (+28%)
<i>PURE AND GREEN</i>		£242 (+43%)
-----		
HIGHER EFFICIENCY TARGET AND LOWER RATE OF RETURN MEASURES: IMPACT UPON PROJECTED WATER CHARGES		
	% SAVING ON BILL	REVISED
<i>PROGRESS MAINTAINED - LOWER</i>	8.8	£183
<i>PROGRESS MAINTAINED - UPPER</i>	8.3	£198
<i>PURE AND GREEN</i>	7.5	£223
PERCENTAGE INCREASE IN AVERAGE BILL UNDER HIGHER EFFICIENCY TARGET AND LOWER RATE OF RETURN [REAL TERMS]		
	1992/93 - 1999-2000	
<i>PROGRESS MAINTAINED - LOWER</i>		8
<i>PROGRESS MAINTAINED - UPPER</i>		17
<i>PURE AND GREEN</i>		32
Calculated from data in OFWAT (1992) <i>The Cost of Quality</i> , Figures 5, 8 & 9		

Figure 6.7: The impact of future financial changes on water charges



Under this set of financial adjustments, household bills would continue to increase, but at a substantially reduced rate relative to alternative economic regulation scenarios. The calculations contained in Figure 6.7 also have another implication. For they suggest that because of the "generous" terms of the privatisation settlement (*Investors Chronicle*, 4/9/92; National Utility Services, September 1992), consumers have been paying more for their water than has been strictly required under the capital programme. Consumers in England and Wales appear to have been paying, in effect, a 'privatisation premium' in their water bills over the last four years.

In releasing the review of capital investment and financial performance of the water companies at the beginning of October 1992, the Director General of Water Supply declared his intention to make a "formal reduction" of 2 per cent in the level of  $K$  for the majority of water companies in 1993-94. This will have the effect in many cases, but by no means all (see Endnote 11), of moderating the rise in water tariffs in 1993-94 by a broadly similar amount <sup>11</sup> (OFWAT, 1992z). This action - essentially involving an incremental revision of the economic and financial assumptions made at the time of privatisation, to the advantage of consumers - presages, possibly, the sort of changes that could be introduced, following the completion of the Periodic Review of the price cap in 1994.

(iii) Variations in domestic water tariffs

An examination of average annual household bills across the country provides only part of the picture of tariff change since privatisation. Two of the most significant changes, from the perspective of domestic consumers, have been (i) the moves towards full cost apportionment, or what OFWAT describes as 'de-averaging' and (ii) the relationship between standing and variable charges.

Ever since the demise of the *Water Charges Equalisation Act 1977* differential water and sewerage charges have been levied across different parts of England and Wales. The case for differential tariffs, based on the variable costs of supplying different localities, is argued on the grounds of efficiency and 'economic fairness'. Full cost recovery in line with the marginal costs imposed on the water and sewerage systems is ostensibly fairer, as people pay the actual cost of supplying water services to their homes, and it removes cross-subsidisation and promotes allocative efficiency. Similar arguments underpin the economic case for universal water metering. The Office of Water Services has actively encouraged the water and sewerage companies to move towards 'de-averaged' charging systems, such as differential tariffs based on geographical location (zonal charges), seasonal tariffs and tariffs for different classes of consumers (OFWAT, 1990c; OFWAT charges control staff in interview with researcher, July 1992). Severn Trent and Thames Water have introduced zonal tariffs and South West Water is considering introducing seasonal tariffs.

The gradual move towards more differentiated tariff systems across the country is reflected, at an aggregate level, in Figure 6.8. As can be seen from the chart, variations in the level of average household bills have increased over recent years.

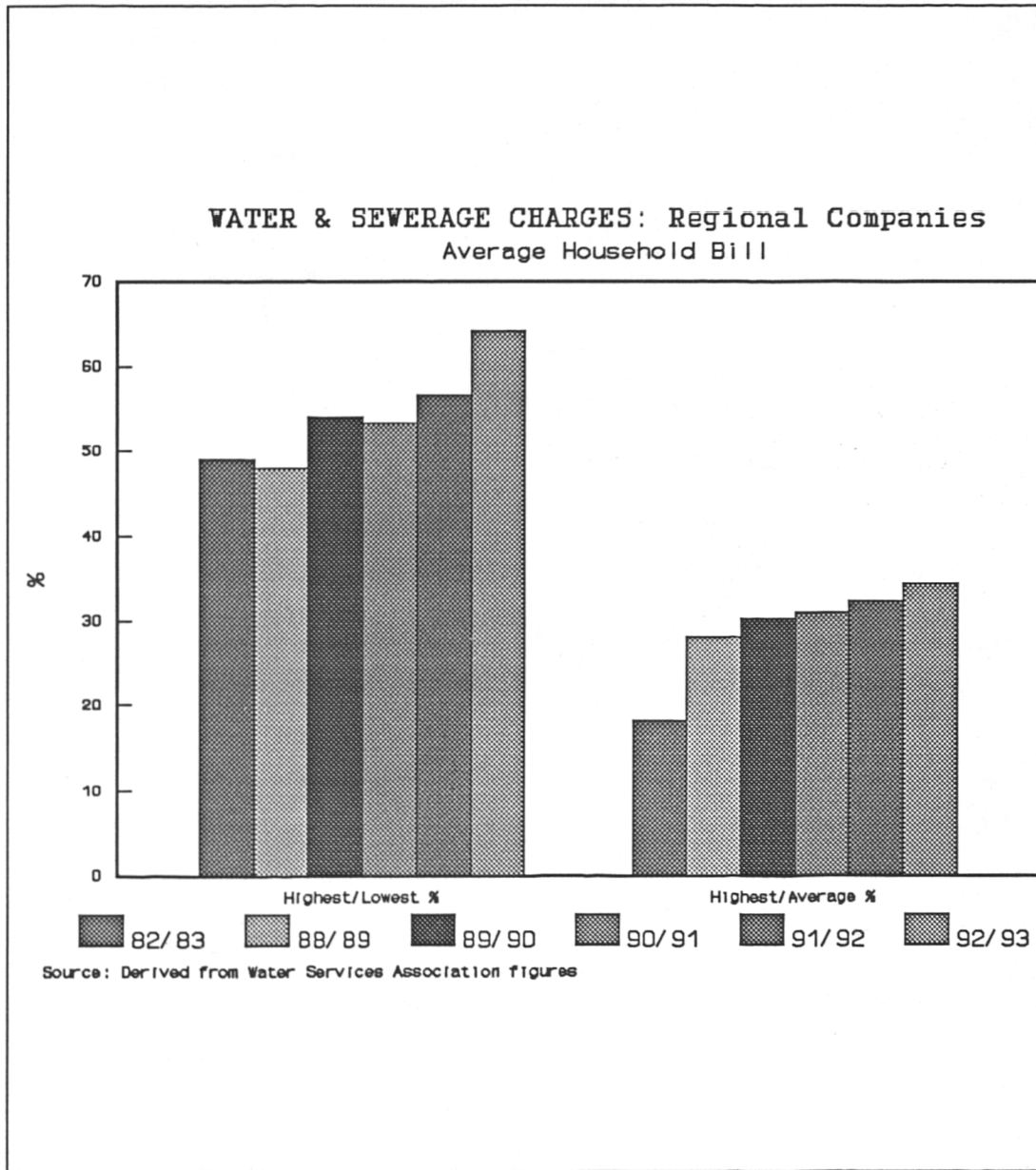


Figure 6.8: Variations in domestic water charges

Whatever the merit of the economic argument, the extension of cost apportionment tariff systems will result in higher price increases for some sectors of the domestic and non-domestic consumer population. And they further corrode the nexus between water charges and 'capacity to pay'.

The standing, or fixed charge, element has always been proportionally much higher in the water industry than is the case in the energy industries. Because they provide a secure and predictable income stream, high standing charges are manifestly attractive to the water companies. However, they discriminate in a regressive manner against low consumption households, and under the still prevailing rate-based system of charging, against consumers living in low rateable value properties. They also confound the driving economic principle of cost apportionment according to use of the system.

For these reasons, the Director General of Water Services has prompted the companies to review their tariff structures so that standing charges cover only billing and associated costs and he has argued that "broadly similar standing charges [should be levied] across all companies" (OFWAT, 1991u). In particular, the Director General has been anxious to see the disparity between measured (i.e. metered) and unmeasured standing charges removed, as higher standing charges for measured supplies acts as a disincentive to customers taking up the metering option (OFWAT, 1992j). Figures 6.9 and 6.10 (overleaf) list the standing charges for the ten water and sewerage companies and indicate the percentage change in standing charges between 1990/91 <sup>12</sup> and 1992/93.

**Figure 6.9 Domestic Standing Charges (Water & Sewerage) - Unmeasured**

	1992/93 (£)	Increase 90/91-92/93 %
Anglian	57.93	20
Dwr Cymru	134.16	27
North West	25.00	18
Northumbrian	64.00	60
Severn Trent	-	-
South West	55.00	22
Southern	41.50	26
Thames	35.00	17
Wessex	38.00	46
Yorkshire	42.00	40
Average	54.70	30

Sources: Water Services Association (1992); CRI (1992)

**Figure 6.10 Domestic Standing Charges (Water & Sewerage) - Measured**

	1992/93 (£)	Increase 90/91-92/93 %
Anglian	69.93	-16
Dwr Cymru	96.00	-19
North West	99.00	9
Northumbrian	96.00	26
Severn Trent	28.32	25
South West	91.40	16
Southern	74.00	28
Thames	50.00	19
Wessex	70.30	23
Yorkshire	54.00	-23
Average	72.90	5

Sources: Water Services Association (1992); CRI (1992)

The Figures indicate marked variations in the levying of standing charges across the companies and show that practice is still a long way short of the uniformity desired by the Director General. Importantly, unmeasured standing charges - which apply to all but three per cent of domestic consumers - have risen ahead of the rate of water price increases generally, i.e. 30 per cent compared to overall price rises of 26 per cent over the period. The average standing charge for metered households remains substantially higher than that for unmetered households, although these have increased at a rate well below prices overall.

(iv) Water metering

Under section 145 of the *Water Industry Act 1991* water companies have been prohibited from using rateable value-based charges after the 31st March 2000. This legal constraint (arising from the introduction of the ill-fated community charge), in conjunction with the new commercial orientation of the privatised water companies, has given rise to a search for charging alternatives. The most frequently cited substitute mechanisms are metering, flat rate charge or 'licence' (effectively a 100% standing charge) and a 'new generation' property-related charge.

Metering is the option most favoured on economic pricing grounds (OECD, 1987; Patterson, 1987; Gadbury, 1991; Rees, 1992), but the ability to adopt consumption-based charging systems is constrained, in the short- and medium-term, by the absence of metering technology in most domestic properties. Only 3 per cent of households in England and Wales were metered in May 1992 (OFWAT Information Note No.13). The proportion of metered domestic households in England and Wales will rise very gradually over time - independent of future regulatory or other policy actions - as water and sewerage companies are generally installing meters in new domestic properties. It has risen from 1 per cent of households to its current level since privatisation.

The impact that the introduction of universal metering would have on household water and sewerage bills is obviously impossible to determine precisely at this stage; although clearly there would be a substantial one-off direct or indirect increase in charges arising from the cost of installing meters in domestic premises (estimated on average to be around £200 per household <sup>13</sup>). And households currently metered are already, on average, paying 21 per cent more than unmetered consumers, although the higher

standing charge accounts for much of this. The overall distributional impact of universal metering in all likelihood would be uneven, with smaller households in high rateable value properties experiencing a net decrease in their water bills, and with the reverse applying to larger households in low rateable value properties.

The final results of the metering trials conducted in twelve areas throughout England will not be available until 1993. Preliminary results of the metering trials indicated that "about 65% of households in the small trial areas are paying less than or the same as their previous RV bill..[with] about 20% of households paying more than 20% over their previous RV bill" (National Metering Trials Co-ordinating Group, 1990, p.iv). Data from the metering trials will not be a reliable guide to the impact of volumetric charging on domestic consumers generally though, as the composition of the households in the twelve trial areas is not representative of the population as a whole (see below), and the tariff structure used in the trials has not reflected the full costs of metering:

*It should be remembered that the trial tariffs didn't attempt to recover the full costs of the meter installation (or allow for any savings). In a full scale meter installation the tariffs might look somewhat different.*  
National Metering Trials Group (1992) pp. 2-3

It is most unlikely that a nation-wide metering installation programme - akin to the programme to connect households to natural gas in the 1960s - would be embarked upon because of the huge capital costs involved (estimated at around £4 billion <sup>14</sup>). However, domestic metering of a more incremental kind has attracted a number of powerful sponsors in recent years - not the least of whom are the Department of the Environment (DoE/Welsh Office, 1992) and the Director General of Water Services - and it will almost certainly become increasingly prominent as a method of water charging.

The Office of Water Services initiated a major national debate on water metering in November 1990, which at the time of writing still has some way to run. The consultation process on *Paying for Water* had a number of strands, of which only three will be considered at length here, i.e. consumer attitudes to metering, the position of the water companies on the metering issue, and the views of the community sector.

OFWAT used two approaches to gathering the views of consumers on metering: through opinion polling and through the use of its ten customer services committees. In combination, the outcomes of this information search provided less than conclusive evidence that metering is the charging method preferred by the majority of consumers.

In the OPCS Omnibus survey 46 per cent of consumers supported metering, compared to 25% rates, 21% banding, and 9% licence fee (OFWAT, 1991f) <sup>15</sup>. A result which showed, as OFWAT itself pointed out, that "at least as many people favoured one of the other choices" (OFWAT, 1991u p.16). The fragility of consumer support for the metering option was emphasised in the survey finding that 59 per cent of those expressing a preference for metering, changed their view when it was suggested that metering could be accompanied by an additional charge of up to £30 on top of the current average bill. Indeed the reliability and interpretation of the survey results generally is clouded by OFWAT's warning that the survey results "need to be treated with caution. It would appear that many respondents had not thought through the issues before the interview; and modified their views as the interview progressed" (OFWAT, 1991u, p.15).



A second OFWAT survey, which involved inviting customers to return a postal questionnaire included with domestic (unmeasured) water bills in February & March 1991, is an even more suspect guide to consumer preferences for different charging methods <sup>16</sup>. Although 64 per cent of the nearly 290,000 people responding to the survey supported metering (OFWAT, 1991u), the self-selected nature of the exercise makes any interpretation of the results perilous. Yet, as in the OPCS survey, there was little support for metering at anything other than the most minimal of additional cost; and only 15 per cent of respondents favouring metering indicated that they would be willing to pay up to £29 for metering costs (OFWAT, 1991u).

A third survey, not formally conducted as part of the *Paying for Water* consultation, and directed primarily at gathering consumer views on more general water services matters, indicated that whether or not metering is the charging system most favoured by consumers in abstract, few had actually seriously considered having a meter installed:

*All customers who were aware of the meter option [40% of the sample] were asked the likelihood of their installing one in the next year or two. Very few (7%) seem likely, 20% say they are not very likely to and 69% say they are not at all likely to install a meter (75% of those in the DE social grade say they are not at all likely to install, compared with 59% of those in the AB social grade). MORI (1992) p.67*

Submissions to OFWAT in the *Paying for Water* consultation by each of the ten regional Customer Service Committees (based on local public consultations) also failed to offer clear support for one charging method over another. Although five CSCs favoured metering, four of the other five CSCs supported a form of property banding, with the remaining CSC expressing no overall preference (OFWAT, 1991f; OFWAT, 1991u). The CSCs in favour of metering were Anglian, Wessex, Wales, Southern & Thames, while the CSCs in support of property banding were Central, North West,

Yorkshire & South West. Northumbria CSC indicated that it was firmly opposed to both metering and flat-rate charges.

Within the water industry itself, there appear to be only a small number of water services companies who favour metering as the sole device for levying water charges. In submissions to OFWAT, most companies expressed a preference for charges based on the new council tax, along with selected metering. Only two companies - Dwr Cymru and Northumbrian - supported the use of flat rate charges (*The Guardian*, 29/4/91), and interestingly, these two companies currently levy the highest standing charges for unmeasured supply.

The industry's general reluctance to introduce widespread metering arises from a number of concerns including, the capital costs involved, the possibility that metering will result in widely fluctuating and depressed revenues through reduced demand (e.g. in a wet summer), and consumer hostility. But measures by the water companies to move away from the commitment to meter new properties have drawn a sharp response from the regulator. This was exemplified in June 1991 when, following advocacy by the Yorkshire Customer Service Committee and Sheffield City Council, the board of directors of Yorkshire Water decided to amend the company's policy on the compulsorily metering of new housing estates, in favour of offering consumers a choice about charging methods. Following intervention by the Director General of Water Services, however, the company quickly rescinded this decision.

The regressive impact of volumetric charging on low-income households has been - and will continue to be - at the nub of community and consumer sector concerns about metering. Metering could particularly affect large families and households containing a

disabled member or members, but its impact is likely to be more generalised than this. Potentially, all households presently living in low rateable properties would face steep increases in their water and sewerage bills if they became metered. Because of these equity implications, metering has been opposed by most of the major consumer and welfare organisations, such as the National Consumer Council, the National Association of Citizens Advice Bureaux, Age Concern and the Child Poverty Action Group <sup>17</sup>.

The opposition of community services and consumer groups to metering is in contrast to the position adopted by some sections of the environmental movement, with organisations, like CPRE declaring strong support for water metering on conservation grounds. Friends of the Earth, however, has recently indicated that it does not support a national programme of domestic water metering (*Water Bulletin*, 13/11/92, p.3). The Department of the Environment/Welsh Office discussion paper *Using Water Wisely*, released in the summer of 1992, advocated water metering on environmental grounds.

In the view of two commentators, at least, "...the introduction of environmental issues into the metering debate is a red herring. Domestic household metering as a method of charging for water is unlikely to tackle this environmental problem effectively but metering will have impacts on poverty and equity which carry major implications for social policy" (Childs & Huby, 1992, p.2). As Chapter 2 illustrated, empirical evidence on the relationship between pricing and water consumption is ambiguous and often difficult to interpret (see OECD, 1987; MMBW, 1991 for a review of studies in different countries). But the overall trend of the data seems to suggest that "water demand is highly price inelastic" (Mann, 1989, p.166) and that very substantial price increases are required before consumption is reduced to any significant extent (MMBW, 1991; Martin

& Wilder, 1992). This is particularly the case with water used inside the home, as opposed to more 'discretionary' outside use.

In its submission to the OFWAT consultation, the National Consumer Council favoured the use of flat rate charges, despite its explicitly regressive impact, because

*[the] ease of administration makes the licence fee far more likely to be integrated into the social security system than any other. That being so, then whatever regressive effects it may have in theory would be heavily offset by the fact of its being rebated for those on low incomes.*

NCC (1991) p.18

Neither the NCC's position on water charging, nor its remarkable expression of faith in the capacity of the social security system, and more particularly the Government, to respond to changes in water tariffs, drew much support from other consumer and community sector organisations.

Addressing the environmental agenda, the NCC proposed that "leakage repair" would prove more cost effective as a conservation measure than water metering. It is estimated that somewhere between 20 per cent to 25 per cent of water in England and Wales is lost through leakage; although paradoxically in the absence of metering the accuracy of this estimation (and the locus of the leakage) is rather uncertain (DoE/Welsh Office, 1992).

The National Association of Citizens Advice Bureaux concluded that while it was opposed to water metering, it was also unable clearly to support either of the alternatives to metering being proposed by the Director General. In addition, it argued somewhat cryptically that the Director-General's powers "need to be strengthened in order to ensure a stable base on which to place public policy for help with water charges for

those on low incomes or high levels of water dependency" (Covering letter to submission *Paying for Water*, 1991).

The fears expressed by community sector groups about the impact of metering on low income households appear to have been corroborated in the DoE/OFWAT-commissioned study on *The Social Impact of Water Metering* published in three volumes, some six months behind schedule in September 1992 <sup>18</sup>. Despite the fact that the study was conducted in the socio-demographically unrepresentative metering trial areas <sup>19</sup>, it clearly revealed that a small, but by no means insignificant, proportion of households experienced acute deprivation and/or financial hardship as a result of the advent of metering.

At first glance the study showed, as expected, that there were winners and losers under metering, and that there is a strong correlation between higher bills and household size. However, it was obvious from the in-depth interviewing phase of the study (Second Report) that some of the 'winners' under metering were only so because they had sharply reduced their water consumption, in some cases at a considerable cost to quality of life. Also, it was found "that with the exception of retirement pension recipients (many of whom are one-person households), those receiving social security benefits, were more likely to report that they were paying much more." (OFWAT, 1992t, First Report p.4-18)

Overall, the correlation between "financial hardship" as defined in the study (i.e. problems paying water bill, large increases in charges relative to rateable value equivalent, difficulty paying water bill and difficulty meeting household expenses) and income was found to be less direct than the association between "financial hardship" and

family size and medical conditions. This could well be attributed the significant under-representation of low income households in the sample group (see Endnote 19). But in the other category of "social hardship" as defined in the study (i.e. reductions in personal hygiene-related water use, worry about using water, perceived reduction in hygiene levels), low income households were markedly over-represented. This suggests that often low income consumers made heroic (if possibly misguided) efforts to reduce their bill by reducing their water consumption; at times involving a severe curtailment in their use of water with potentially serious personal hygiene and public health consequences.

In essence, the study underlines a fundamental problem with volumetric charging. In that for all its apparent commercial logic and the arresting appeal of its use of 'the simple fairness test' (i.e. you pay for what you use), and for all its laudable environmental aims, it will be poor households who disproportionately bear the costs; if not in extra charges then in reduced quality of life. More affluent consumers have an inherent capacity to absorb the additional costs of metering, either by paying more in water charges, buying water efficient appliances, or by reducing discretionary use (particularly outside the home). Most low income households do not have a similar capacity. Interestingly, most of the equity implications of the data contained in the Second Report, were either downplayed or ignored by the authors in their Summary report and recommendations.

### 3. ELECTRICITY

*We are still unable to answer the question we posed in 1988 - 'whether or not the privatised electricity supply industry is likely in aggregate to have lower costs, and hence be able to offer its consumers lower prices, than would be the case if the industry remained in public ownership'.*  
HoC Energy Committee (1992a) para 167

#### (i) Electricity tariffs since privatisation

Changes in the movement of electricity prices since privatisation are inordinately difficult to track. This is partly the result of the complex structure of price controls in the ESI, which the Director General of Electricity Supply himself has described as "not easy to understand, nor is it straightforward to check whether or not a licensee is complying with them.." (OFFER, Annual Report, 1992). But it is also because, in contrast to his counterpart in the water industry <sup>20</sup>, the electricity regulator (until recently at least <sup>21</sup>) has shown little inclination to make the pricing systems transparent. Nor has he been prepared to publish, on a regular basis, comparative data on electricity tariffs across the country. The journey towards answers about electricity prices is rather less direct than in the case of water, and far more circuitous than it should need to be <sup>22</sup>.

For much of the 1980s, electricity prices for domestic consumers declined in real terms, largely as a result of the fall in coal purchase costs. In the period immediately preceding privatisation, domestic electricity prices rose in excess of the rate of inflation. The Government-initiated increase in prices leading into privatisation had two purposes. The first related directly to the sale of the industry, with the Government seeking to enhance the commercial attractiveness of the ESI to potential investors:

*..there was a rise in the price of electricity at the time when electricity was privatised because we had to strike the right balance between the interests of the consumer, the interests of the taxpayer and the interests of the shareholders and we set the prices at the time of vesting to give a return on the assets employed of 5 per cent..*

John Wakeham, Secretary of State for Energy, HoC Energy Committee (1992c) para 336

The second purpose was to ‘factor in’ a degree of pricing surplus so that electricity tariffs could be maintained at a politically acceptable level in the years immediately following privatisation. This was explained by Dr Dieter Helm, in evidence to the Select Committee on Energy, in the following way:

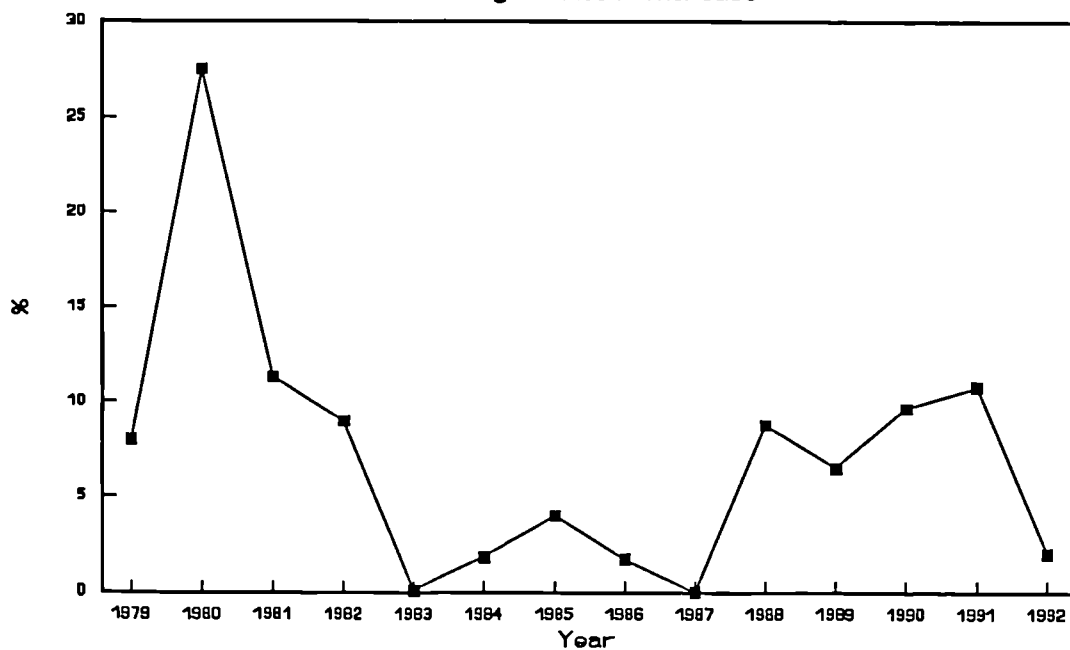
*..the Government raised the price level in advance of privatisation, in a series of steps, in order to fossilise-in a price level which then would not rise by more than inflation.*

The subsidiary price cap (Licence Condition 3C) was introduced with the explicit purpose of keeping electricity prices for domestic and small business users to the level of inflation for the first three years of privatisation. The three year life of the price cap was based on the duration of the contracts drawn up between the generating companies and British Coal (and the ‘back to back’ contracts between the generating companies and the RECs) in April 1990. But it is possibly not coincidental that this three year period was also sufficient to cover the time up to and beyond the next General Election. Figure 6.11 (overleaf) illustrates the movement of electricity prices between 1979 and 1992.



# ELECTRICITY PRICES - DOMESTIC

Average Annual Increase



Standard domestic tariff  
Sources: ECC (1988), OFFER (1992)

Figure 6.11: Domestic electricity prices 1979-92

Despite the intent of the subsidiary price cap, electricity prices for domestic and small business consumers rose by an average of 10.5 per cent in 1991/92, which was well above the prevailing rate of inflation. The excessive price rise in April 1991 was an artefact of the methodology used for calculating the rate of inflation, whereby regional electricity companies based their price increases on a forecast level of inflation for the year to October. Thus through a combination of (i) under-estimating inflation in the preceding year<sup>23</sup> (with provision being made in the licence for the 'catching up' of lost revenue through low inflation forecasts) and (ii) over-estimating inflation for the forthcoming year, tariffs rose by some 6.8 per cent above inflation in 1991.

The above inflation rise in tariffs in 1991 made something of a nonsense of the subsidiary price cap and caused acute embarrassment both to the Government and the regulator. In October 1991, the Director General wrote to the majority of the regional electricity companies "pointing out that the rate of inflation was turning out to be significantly lower than the rates which they had assumed in setting prices for 1991/92..[and] that, on the basis of the information that they had previously provided, it seemed likely that they might breach one of their price controls (the 3C subsidiary price cap)" (OFFER, 1992d). The Director General was asking, in effect, for some of the excess to be returned to electricity consumers. In the event, eight RECs exceeded the subsidiary price cap and while four of the companies agreed to return the full amount in reduced charges in 1992/93, the other four demurred; although they did ultimately agree to return a proportion of excess revenue raised (see Figure 6.12 overleaf). The inability of the regulator to enforce a repayment in full from all of the companies reflects, in part, the obscure wording of the supply licence, with phrases like "use its best endeavours" and "circumstances that are unavoidable" (Department of Energy, 1990a, pp.49-52). And it was on this basis that the four companies maintained

that they had no legal or moral obligation to respond to the Director General's request. In addition to the licence wording problem though, it might be argued that the Director General displayed less robust and assertive negotiating skills than might have been required in the circumstances in order to protect the interests of consumers <sup>24</sup>.

The 1991/92 Miscalculation of charges			
The eight companies who exceeded the Condition 3C subsidiary price cap in 1991/92 were:			
	Amount exceeded cap	Amount "returned" (through limiting charges)	
	£m		
Eastern	15	3	(20%)
London	4	4	(100%)
Manweb	2	2	(100%)
Northern	5	4	(80%)
Norweb	9	5	(56%)
Seeboard	6	6	(100%)
Southern	12	5	(42%)
Yorkshire	6	6	(100%)
<b>TOTAL</b>	<b>59</b>	<b>35</b>	<b>(59%)</b>

This variable pattern of money "returned" was not accidental and clearly reflected a difference of opinion:

"Four companies (London Electricity, Manweb, SEEBOARD and Yorkshire Electricity) have said that, by charging less next year and having a smaller increase in tariffs, they will return to their tariff customers any excess made this year. They will make an accounting change which has the effect of reducing the maximum amounts the control permits them to charge next year.

The other four companies (Eastern Electricity, Northern Electric, NORWEB and Southern Electric) have argued that their charges already meet their licence condition. This is because the 3C price condition requires best endeavour to meet the price cap, but the cap does not apply if certain of the licensee's costs have risen so as to have a material and adverse effect on the profits of its supply business (as distinct from the profits of its business as a whole).

These companies have nonetheless agreed to share some [author's emphasis] of the benefits of lower inflation with tariff customers by holding next year's charges below the permitted maximum. The amounts concerned are comparable to those of the other four companies concerned." p.3 [This may have been the case in absolute money terms, but not in proportion to the excess revenue generated through excessively high tariffs]

Source: Electricity Price Controls paper (1992)

Figure 6.12: The 1991/92 miscalculation of electricity charges

The effect of the 'claw back', in conjunction with a reduced level of inflation, resulted in domestic electricity tariffs rising on average by 2 per cent (in absolute terms) in 1992/93. Over the period from April 1989, average domestic electricity tariffs have increased by 28 per cent, while inflation has risen by 24 per cent. This above inflation increase in domestic tariffs is rendered all the more perplexing when it is considered that in 1991, the price of coal was 27 per cent cheaper in real terms than it was in 1988<sup>25</sup> (Department of Trade and Industry, 1992c, Table 63). As the cost of coal represents around 22 per cent of the cost of a unit of electricity to domestic consumers (National Power, 1992, pp.6 & 16), it might be expected that the unit cost to domestic consumers would have fallen by around 8 per cent (in real terms) on the basis of coal costs alone. Whereas, in fact, domestic tariffs rose in real terms by 7.8 per cent over the period 1988 to 1991. This indicates that either the generating companies have not passed on coal purchase savings to the RECs and retained the savings as additional profit, or that the latter have not passed on electricity savings to domestic consumers, with similar profit gains (or indeed a combination of both).

Another explanation for the inverse relationship between coal prices and domestic consumer tariffs might lie in the way that the generation and supply companies have differentially distributed the benefits of savings in purchasing costs between classes of consumers. It could be hypothesised that the supply companies (which includes the generating companies, for they supply a significant proportion of electricity direct to industrial customers) are more likely to direct these benefits to the 'over 1 MW' sector where competition prevails, than to the 'captive' franchise sector of the market. The validity of this hypothesis seems to be borne out in Figure 6.13 overleaf.

Electricity Prices	
Changes in Major Sectors (per cent)	
	1989-91
Domestic	+26
Industrial:	
Small	+23
Medium	+1
Moderately large	-6
Extra large	+13
RPI	+18

Sources: Derived from DTI (1992c) Table 61, Table 54; EEC (1989), OFFER (1992)

**Figure 6.13: Changes in electricity prices 1989-91: major sectors**

The recent rise in electricity tariffs for major industrial electricity users (e.g. ICI), primarily as a result of the termination of a number of Government subsidy schemes<sup>26</sup>, has prompted the Major Energy Users Council to call for the abolition of the 'fossil fuel levy' (*Financial Times*, 29/7/92). As discussed in Chapter 1, the 'fossil fuel levy' was introduced at the time of privatisation to financially support the nuclear power sector. Currently, the levy adds 11 per cent to all electricity bills. The deleterious impact of this surcharge on electricity bills is likely to be felt just as keenly by low income households, as it is by industrial and commercial users of electricity in Britain.

As in the case of the water industry, there is evidence that variations in domestic tariffs across the country have widened since privatisation. This is particularly evident in standard rate tariffs, as shown in Figure 6.14.

<b>Variations in Domestic Tariffs</b>			
<u>Standard Rate</u>	pence per therm		
	Lowest tariff	Highest tariff	Difference %
December 1989	Birmingham (MEB) 6.358	Liverpool (Manweb) 7.276	14
December 1991	Birmingham (MEB) 7.536	Cardiff (Sth Wales) 8.96	19
<u>Economy 7</u>			
December 1989	Nottingham (E Mid) 4.428	Plymouth (SWEB) 4.85	10
December 1991	Nottingham (E Mid) 5.282	Plymouth (SWEB) 5.927	12
Notes: Based on 5,000 kWh per annum - the average electricity consumption for all households in the 1986 English House Conditions Survey was 4,435 kWh per annum (DoE, 1991b); Tariffs include unit rate and standing charge			
Source: Derived from Department of Trade and Industry, 1992c, Table 57			

**Figure 6.14: Variations in domestic electricity tariffs**

(ii) Domestic tariffs post the subsidiary price cap

From the account above, it can be seen that the subsidiary price cap has not brought great advantages to domestic consumers. But even the minimal protection of the subsidiary cap will not exist after April 1993, when the price control reverts to the conventional  $RPI-X+Y$  formulation (Licence Condition 3B). This will enable the RECs to increase tariffs above the level of inflation as most have plus X factors (average +1.3 per cent) for distribution charges, and more importantly, to pass-through the full cost of purchasing electricity. The general supply price control (3B), though, is due for revision by April 1994 and a number of its existing elements are likely to change (see below).

Theoretically, in a market where purchase costs are falling (e.g. arising from the decline in coal prices) domestic consumers stand to benefit from lower tariffs. However, it is by no means certain that electricity purchasing costs will continue to fall; firstly, because of the increased use of what is likely to be more expensive forms of electricity generation (i.e. nuclear, coal-fired power plant fitted with expensive flue gas desulphurisation equipment and arguably, gas-fired <sup>27</sup> power plants) and secondly, because full cost-pass-through [Y] provides no incentive for the RECs to purchase economically. Nor does it encourage the companies to adopt energy efficiency-oriented models of electricity supply. As Helm & Powell (1992, p.103) conclude the "...introduction of a Y element assigns considerable risk away from the regional electricity companies towards their customers." It was for these reasons that the now-defunct House of Commons Select Committee on Energy in its examination of the *Consequences of Electricity Privatisation* recommended that the subsidiary price cap be retained until full competition is introduced into the ESI:

*Controls on supply revenue from franchise customers ought however to continue beyond 1993, since these customers are dealing with a monopoly supplier for an essential service, and in our view such controls should remain in existence after each reduction of the franchise until the Director General is satisfied that there is fair and effective competition in supply to customers who have ceased to be part of the franchise. This could mean price controls of some sort continuing beyond 1998. [author's emphasis]*

HoC Energy Committee (1992a) para 86

The Office of Electricity Regulation is currently in the process of reviewing the supply price control formula, and according to the Director General all of the factors alluded to above are being considered in the review (OFFER, 1992y). The decision taken by the Director General on the *Y* cost-pass-through element of the formula, in particular, will have a major bearing on future electricity prices, as the costs covered by *Y*<sup>28</sup> represent around 95 per cent of the cost of supplying electricity to consumers.

(iii) Competition and metering in the domestic sector

The Director General of Electricity Supply has set tremendous store on the advent of competition in the ESI. And the efficacy of competition, as a mechanism for creating the sovereign domestic consumer, was a dominant theme in his consultation paper on *Metering* published in January 1992. In this paper (OFFER, 1992b, pp. 28-37), Professor Littlechild sketched a post-1998 world of advanced metering technology, opening up an ever-expanding horizon of consumer choice and lower prices; which has been described colourfully by the *Investors Chronicle* as:

*Offer's literally millennial vision is of a Britain where, by the year 2000, even domestic consumers can shop around RECs for current, measuring their juice use with portable radio meters". 19/6/92*



New metering technology potentially offers a number of significant advantages to domestic consumers - not the least of which could be the elimination of the specific-purpose and arguably stigmatising, prepayment meter <sup>29</sup>, along with an ability to externally monitor self-disconnection. However, the Director General's paper glossed over two critical questions related to the introduction of a technology-led competitive regime in electricity supply. Namely, (i) who would pay for the installation of advanced metering technology in domestic households? and (ii) would the RECs be particularly interested in competing for business in the domestic sector anyway?

Even if OFFER's optimistic estimate of £50 to £60 per meter were to hold true (the most advanced meters currently available cost between £110 and £130), this additional cost would still present a formidable entry barrier to many low income households, particularly if consumers were expected to pay the cost 'up-front'. The technology itself is likely to be complex and could be difficult for certain groups to use e.g. the elderly, people with disabilities and people from non English-speaking backgrounds. The Consumers' Association (1992e) raised this issue in their response to the metering consultation paper:

*Not all domestic consumers are able to use highly technical appliances. It is important, therefore, that the trial test the ease of use among different groups of consumers, for example, the elderly and disabled, to ensure the needs of all consumers are taken into consideration. p.2*

A danger clearly exists, under the advanced metering scenario, that two classes of domestic consumers will be created, i.e. those with the means and ability to make use of the technology and hence take the competition (and tariff) gains on the one hand, and those without who will be locked into monopoly supply and possibly higher electricity tariffs, on the other.

But it is possible that these concerns will remain only academic ones, for the vision of restless competition amongst the RECs and second-tier suppliers for domestic consumer business may turn out to be fanciful. The supply of domestic electricity is the least profitable part of the RECs commercial activity, and in the financial year ending 31st March 1992, six of the twelve RECs in England and Wales actually incurred losses in their supply businesses (OFFER, 1992y, Figure 1). For this reason a number of commentators (including the Select Committee on Energy, 1992a, paras 80-84) have expressed the view that the prospect of a domestic electricity 'free market' in 1998 is hardly likely to cause enormous excitement amongst the supply companies:

*While technical advances in metering may, in fact, enable this [competition post 1998], it is unlikely that suppliers will pursue the very small electricity user in the same way that Mercury is now extending its domestic telephony market share. The price to the consumer of a unit of electricity is roughly the same as a unit telephone call, but, proportionately, the marginal costs of supply are much greater for the electricity company..Medium sized commercial consumers may eventually gain the benefits of choice, but these are unlikely to be extended to domestic consumers, who will remain customers of the monopolistic RECs. Roberts et al (1991) p.92*

Equally, it may transpire that domestic consumers themselves find little merit or cost-benefit in constantly monitoring their fuel costs and 'shopping around' for their electricity supply.

The issue of competition and choice is considered in a broader conceptual context in Chapter 8.

## CONCLUSION

*No benefits of any kind can be seen for [water] consumers who are forced to pay monopoly supplier prices escalating above inflation.*

National Utility Services (1992) p.1

During the first period of privatisation, each of the three utility industries experienced a fall in a number of their core underlying costs, i.e. gas and coal purchasing costs in the fuel utilities and construction costs in the water industry. This, in combination with the putative efficiency gains from privatisation, should have resulted in lower domestic utility tariffs over this period than was actually the case. The fact that domestic consumers did not benefit as directly as they might have suggests that either the original privatisation settlement was structurally flawed, or that it was not designed with the interests of domestic consumers in mind. Either way, it could be asserted with justification that, over the first period of privatisation, domestic consumers in Britain have been paying a 'privatisation premium' in their utility bills.

The tariff review process affords the regulatory bodies an opportunity to re-define the terms of the privatisation settlement, and to allocate the financial benefits accruing from reduced costs and structural efficiencies more equitably amongst the industries and their sub-sets of consumers. The gas regulator took a significant step in this direction in his review of the tariff formula in 1991, although the resilience of price/service package is likely to be fully tested in the current MMC inquiry into the gas industry. The water and electricity regulators are both in the early stages of reviewing the price formulae in their industries. It remains to be seen whether they will be similarly successful in re-negotiating the financial settlement to the advantage of domestic consumers. Of course, price forms only one dimension of the utility services 'package', and it is to the other key aspects of the relationship between domestic consumers and the utility industries that our attention will now turn.

## ENDNOTES TO CHAPTER 6

1. The Consumers' Association was particularly strident in its criticisms of the later stages of the review process: "Ofgas has not, in our view, been open about its negotiations with British Gas on the proposed changes to the formula at any stage. With only the agreed changes to comment on, we cannot assess whether compromises were reached in discussions between Ofgas and British Gas, and if so, whether such compromises were in the best interests of consumers..We consider it unacceptable that the review of the price formula was undertaken in a manner that makes it impossible for Ofgas to take account of the comments made during the consultation period".

Consumers' Association (1991a) pp.1-2

2. Stated fully the new formula is **RPI-5+GPI-1+E**; with GPI-1 representing the cap on the pass through of gas purchase costs, and E being the energy efficiency factor (OFGAS, 1991g).

3. The three pilot projects are: (i) owner-occupier condensing boiler scheme, (ii) residential CHP scheme for housing associations and local authorities, and (iii) the owner-occupier affordable heat scheme. The latter "will provide funds to enable gas fires, wall-heaters and water-heaters to be made available to "fuel poverty" households, to provide efficient, affordable heat input." OFGAS (1992i) p.14 In November 1992, the Government appointed Lord Moore [John Moore - who has been quoted at length in Chapter 4] as chairman of the Energy Trust.

4. Commenting on US least cost planning regulation, Berry (1992, p.781) states the: "the conventional wisdom..to least cost planning is that utilities must be able to profit as much from conservation and demand management as from building power plants before they will actively seek to lower their Kwh sales". Amongst the "five pillars of financial wisdom" cited by Berry for providing financial incentives for electricity utilities to undertake conservation seriously is "Recovery of lost net revenues attributable to decreases in Kw and Kwh sold due to demand management" (op cit).

5. The domestic tariff market has become an increasingly significant segment of British Gas' revenue earning capacity in the years following privatisation.

Revenue from gas sold (£M):

	1986	1991
Domestic	4285	5777
Total revenue		
from gas sold	6999	8300
%	61.2	69.6

[Source: British Gas (1992) *Financial and Operating Statistics for the year ended 31 December 1991*, London]

6. 3% (1st July): applicable over 3 quarters = 2.25%; 2% (1st October): applicable over 2 quarters = 1.00%. Total = 3.25%

7. South West Water's *K* factor was increased from 6.5% to 11.5% following an application for an Interim Adjustment arising from its increased environmental obligations (OFWAT, 1991x)

8. Director General's Determination on South West application for interim adjustment in December 1991 (OFWAT, 1991x): "The fourth change which I have taken into account is the movement of the economic factors such as labour and energy costs, since 1989 when price limits were originally fixed. These cover actual changes which have taken place, compared with the assumptions which were made in 1989, and revised assumptions for the period up to 1994-95. The changes **reduce** the allowable amount by £25m over the five years from 1990-91 to 1994-95." [author's emphasis]. In fact the summary table attached to the determination indicates changes in "economic assumptions" as follows:

1990/91: -£9m	
1991/92: -£12m	
1992/93: -£6m	[all in 1991/92 real terms]

For comparison, South West's profit before tax in 1990/91 was £85m (thus cost reduction 'windfall' represented around 10% of profit in that year) & £90m in 1991/92 (hence 1991/92 'windfall' represented 13.3% of profit in that year). This suggests, in effect, that all the companies have benefited by an equivalent fall in these costs - over this period, with a concomitant gain in profits! And these are **not related to efficiency**, which is the rationale used for retaining unanticipated profits e.g "if a firm succeeds in increasing its efficiency beyond what was predicted it will be able to retain the extra profits until its price limits are revised at a periodic review." OFWAT Information Note No.5: Comparing Company Performance. Was this 'windfall' sufficient justification for the Director General to make an Interim Adjustment to *K* (downwards) for all companies? He is legally empowered to do so "if the impact of economic assumptions is different from that assumed in the initial determination", but it needs to "exceed, in total, 10% of turnover" (both Information Note No. 8: The *K* Factor - What it is and How it can be changed). And South West's 1990/91 turnover = £139 (i.e. change in economic assumptions for that year 6.5%). The companies made voluntary reductions to *K* in this charging year of 16% in real terms. But does this fully cover the savings made [using South West as a guide around 13% of profits in 1991/92] plus the 'inflation factor' (as in electricity companies). RPI is based on twelve months to November 1991 for charges beginning April 1992, and therefore the inflation figure used would have been somewhat higher than the actual (as also would have been the case the year before). Even if all this adds up, the companies still got to keep the 1990/91 'windfall', despite the fact that it was not efficiency-related.

9. Infrastructure charges were introduced at the time of privatisation and involve the levying of a charge on new properties, to purportedly take account of the consequential impact of development on the demand for enhancements to the existing water services infrastructure. The charges were set by the Secretary of State at privatisation and are contained in the Instrument of Appointment (licence). The charge is levied in addition to normal connection charges. The application of infrastructure charges has been criticised because *inter alia*:

- \* there are massive variations in the level of charges between areas e.g. £233 in York compared with £1216 in the rest of Yorkshire (CRI, 1992, Table B.7)
- \* the flat-rate nature of the charge applied to all new properties takes no account of the differences in demand actually created e.g. a one-bedroom flat attracts the same charge as a five-bedroom house
- \* they act as a disincentive to developers embarking on new housing and other development projects (see House-Builders Federation, 1992)
- \* they result in horizontal and inter-generational inequities: "[they] represent a cross-subsidy from new customers to customers generally" (OFWAT Annual Report 1991, p.37)

The Director General of Water Services has indicated that he wishes to reduce the levels of infrastructure charges in the review of the price cap (ibid).

10. See HoC Library Research Division (1991) pp.25-27 which provides an account of the 'dispute' between Ian Byatt and Lord Crickhowell (chairman NRA) in late 1990 on the cost of environmental improvements.

11. "Broadly similar" because the companies have the ability to 'carry over' the *K* amount voluntarily abated in 1992/93 (or indeed in earlier years) to water charges in the following year. Yorkshire Water has, for example, 0.8% to 'carry over'; but its 'carry over' amount is overshadowed by North East (3.4%), Dwr Cymru (1.7%) and Southern (1.4%). If these amounts are carried over in full by the companies concerned, they will clearly neutralise the effect in 1993/94 of the Director General's decision.

12. 1990/91 is used as the baseline year as it was over this period that the Director General started to exert pressure on the water companies about standing charges.

13. But "...there is a hard core [of properties] of 5 to 10 per cent where the costs would be much higher, perhaps up to £1,000 per property." National Metering Trials Group (1992) p.2

14. David Gadbury, chairman of the National Metering Trials Group, *The Observer*, 14/6/92.

15. 54% of respondents favoured metering if the alternatives were only banding and a licence fee. It is also worth noting that there was "a very clear preference for meters amongst the more professional groups and less support for meters in the less professional groups". OFWAT (1991f).

16. The survey has been criticised by independent market researchers for among other things, loading the questionnaire in favour of metering, and skewing the sample by failing to provide reply paid envelopes (*Water Bulletin*, 12/7/91).

17. The Consumers Association, in contrast to most other consumer/community sector organisations, has given its support to the concept of domestic metering.

18. It was reported at the October meeting of the Yorkshire Customer Service Committee meeting that this delay was partly caused by the Department of the

Environment, which sought to hold up the publication of the study until after the discussion paper *Using Water Wisely* had been released.

19. 32% of households were in the AB (professional & managerial) group compared to 17% for Britain generally; only 6% were in receipt of income support - a third of the national figure; 35% of households had a gross annual income over £20,000 compared to 22% in Britain. Home ownership: 83% buying or owning compared to 74% in Britain; 9% local authority housing compared to 24% nationally (Social Impact of Metering Summary report, p.3) See Tables 3C, 3H, 3J Social Impact of Metering First Report. And the bill paying analysis in the "hardship" sample study was further biased by the absence of South Normanton data: "This meant that households with data available had a more affluent profile than the potential hardship sample as a whole." Second Report p.6-1

20. The water industry peak bodies - the Water Services Association and the Water Companies Association - also provide substantially superior information on prices compared to the body representing the electricity companies, the Electricity Association.

21. *The Supply Price Control Review Consultation Paper* (OFFER, 1992y) released in early October 1992 places some of this data in the public domain for the first time.

22. This has the important consequence, as the NCC pointed out in its evidence to the Select Committee on Energy, of excluding electricity consumers from this fundamentally important arena of industry decision-making.

23. "The 1991/92 jump [in average earnings] is a legacy of the privatisation process. When the companies set tariffs in March 1990 for the 1990/91 period, they had to estimate the change in the RPI to October 1991. The Government, keen to keep price rises in line with the contemporary inflation rate of 6%, "encouraged" the RECs to use an estimate of 5%. In the event, inflation was 10.9% and the companies made good the shortfall in 1991/92." James Capel Research (1992) p.12

24. The Director General also appears to have made a rod for his own back when he said in relation to the subsidiary price cap in his formal statement on *The Regulatory System and the Duties of the DGES* in October 1990, that "[i]f the outcome proves to be different from these assumptions, then (provided that a REC has suffered an increase in its allowed costs per unit supplied, which results from unavoidable circumstances and which would materially increase and adversely affect the profits of its supply business) a REC would no longer be bound by the subsidiary price cap for that year." (para 5)

25. Coal prices per tonne: 1988 £47.11, 1991 £43.47 i.e. a fall in price of 8%; plus inflation = 27% cheaper in real terms. At privatisation, the Government negotiated a contract between the generating companies and British Coal based on RPI minus 5%. This contract is currently being re-negotiated and will almost certainly result in even lower coal prices: *It is believed that, in parallel negotiations with the 12 regional electricity distribution businesses, the generators are confident that the coal deal will enable them to offer a package that should reduce energy costs from the present price of 3.15p per unit to less than 2.8p a unit. The Observer, 12/7/92*

26. "The most intensive users of electricity previously benefited from the Qualifying Industrial Consumers Scheme (QUICS), which protected the largest users from the full CEGB Bulk Supply Tariff, and subsequently the Large Industrial Consumers Scheme (LICS), which provided transitional support in the first year after privatisation. In effect, their electricity consumption was cross-subsidised by smaller customers." HoC Energy Committee (1992a) para 19

27. The figures on the relative cost of gas and coal-fired electricity generation are something of a 'moveable feast' and are very difficult to pin down precisely. The Director General of Electricity Supply is due to report on this issue - which is of fundamental importance to the future of the domestic coal industry - in December 1992. In its evidence to the Select Committee on Energy (1992a, Table 4, para 51), PowerGen estimated that the cost of gas-fired electricity generation was between 2.64 (p/kWh) and 2.89 (p/kWh), whereas the cost of coal-fired generation [existing large inland coal-fired using British coal] was 2.20 (p/kWh), and for coal-fired power with flue gas desulphurisation 2.73 (p/kWh). The figures for coal are based on the running costs of existing coal-fired stations and the economics of power generation is likely to change - in favour of gas - when existing coal-fired plants need to be replaced. However, even this will depend on the future movement in gas prices:

*There is also a serious question about whether the gas price charged for new capacity is likely to hold in the long term..Higher gas prices would call into question both the investment in gas plant and the coal redundancies. Christopher Huhne, The Independent on Sunday 18/10/92*

In an address to the November meeting of the Public Utilities Access Forum, the Director of the Gas Consumers Council (Ian Powe) provided the following estimates of the relative costs of generating electricity:

- \* Existing coal-fired plant with flue gas desulphurisation: 2.7p-4.1p per kWh
- \* New coal-fired plant with flue gas desulphurisation: 3.6p-4.2p per kWh
- \* New gas-fired plant (existing 15 year contracts): 2.3p-2.7p per kWh

He also pointed out, however, that gas prices are likely to rise in the future as greater use is made of more distant North Sea fields and exports from other countries.

28. In addition to electricity purchase costs, which is the largest item (around 60%), *Y* also covers distribution charges (around 25%); fossil fuel levy (around 10%); payments for the use of the National Grid (4%); and payment for the administration of the Pool. (OFFER, 1992y, pp.8-9 and Figure 2, p.10).

29. "It would also be possible to use the same kind of meter for both credit and prepayment customers. This would provide cost savings in that a change in payment method would not necessitate a change on meter. It would also avoid invidious identification of a customer's payment method by type of meter." OFFER (1992b) p.34



## CHAPTER 7: THE CONSUMER INTEREST: THE IMPACT OF PRIVATISATION AND REGULATION ON DOMESTIC CONSUMERS (CONTINUED)

### PART 2: DEBT AND DISCONNECTION

Changes in the level and structure of energy and water charges will have a disproportionate impact on low income households simply because, as Chapter 2 showed, expenditure on utility services occupies a more prominent position in the budgets of these households than it does within the population generally. Increases in utility tariffs therefore, would be likely, *a priori*, to lead to greater levels of indebtedness and payment default, resulting ultimately in a growth in the number of disconnections. Conversely, the impact of reductions in tariffs would be manifested in a moderation in debt and disconnection.

But to draw this direct causal link is to over-simplify, for movements in tariffs are only one part of the complex web of intersecting variables at play in utility debt and disconnection. Other factors at work include (i) the policy and practice of the utility companies regarding payment arrangements and options, debt retrieval and the like, (ii) the advent and use of technologies which enable the simultaneous maintenance of supply and recovery of debt and (iii) the degree to which social security benefits are up-rated in line with increases in utility charges. All of these factors need to be taken into account in examining the question of utility debt and disconnection <sup>1</sup>.

(i) The context of debt and disconnection

The correlation between fuel debt and low income has been well established (see for example, Boardman, 1991a, 1991b; Berthoud and Kempson, 1992; City of Liverpool, 1991). It has been estimated that in 1991, some 7 million households in Britain experienced fuel poverty, and there is both empirical (Boardman, 1991b) and case-related evidence (NACAB, 1991b;) that the number of households living in fuel poverty has increased over the recent years.

If a rough indicative measure of the number of households experiencing difficulty paying fuel bills can be constructed on the basis of the number of households with prepayment meters, on fuel direct, or that have been disconnected, it can be seen below that over three million households in Britain fell into this category in the first half of 1992. It should be noted that there is an element of 'double counting' in these figures as, for example, some households will use prepayment meters as a method of paying both their electricity and gas bills.

**Households experiencing difficulties paying fuel bills**

Prepayment meters (June 1992)	2,918,124
Fuel direct (May 1992)	291,285
Disconnections (Year ending June 1992)	50,440
Total	3,259,849

[Sources: GCC, 1992; OFFER, 1992; Benefits Agency, 1992]

By comparison with energy, there has been a dearth of empirical work in Britain on the interaction between water consumption and poverty; with the OFWAT-commissioned study on the social impact of water metering constituting one of the first (if limited) excursions into this field. There are, however, strong indications that water charges now occupy a much more significant, and problematic, place in the budgets of low income households than has been the case hitherto (for example, Social Security Advisory Committee, 1990<sup>2</sup>, 1992; NACAB, 1992a; Huby & Dix, 1992). Tangible measures of the increased manifestation of water debt (often described as 'water poverty') can be found in the way in which water companies are making greater use of the courts and their disconnection powers to retrieve outstanding debt (see below), and in the escalation in the number of direct payments for water being made through the social security system for income support recipients in debt. From the May quarter 1990 to the May quarter 1992, the number of direct payments for water increased from 32,499 to 126,979, a rise of over 290 per cent. This is shown graphically in Figure 7.1 on the next page.

The rise in water-related debt, as reflected in Figure 7.1, might be seen to mirror the substantial increases in water charges over the past three years; but there have been other influences as well. Foremost among these have been (i) the 1988 social security change in the payment of water bills - previously the water rates of income support recipients were paid in full, now recipients have to pay directly out of their weekly benefit and (ii) the abandonment by many local authorities and housing associations of the system of collecting water charges with the rent. The practice of tenants paying their water bills with their rent has the advantage of protecting them from disconnection, but it does result, in some instances in eviction or threatened eviction because of non-payment of water charges (NACAB, 1992a).

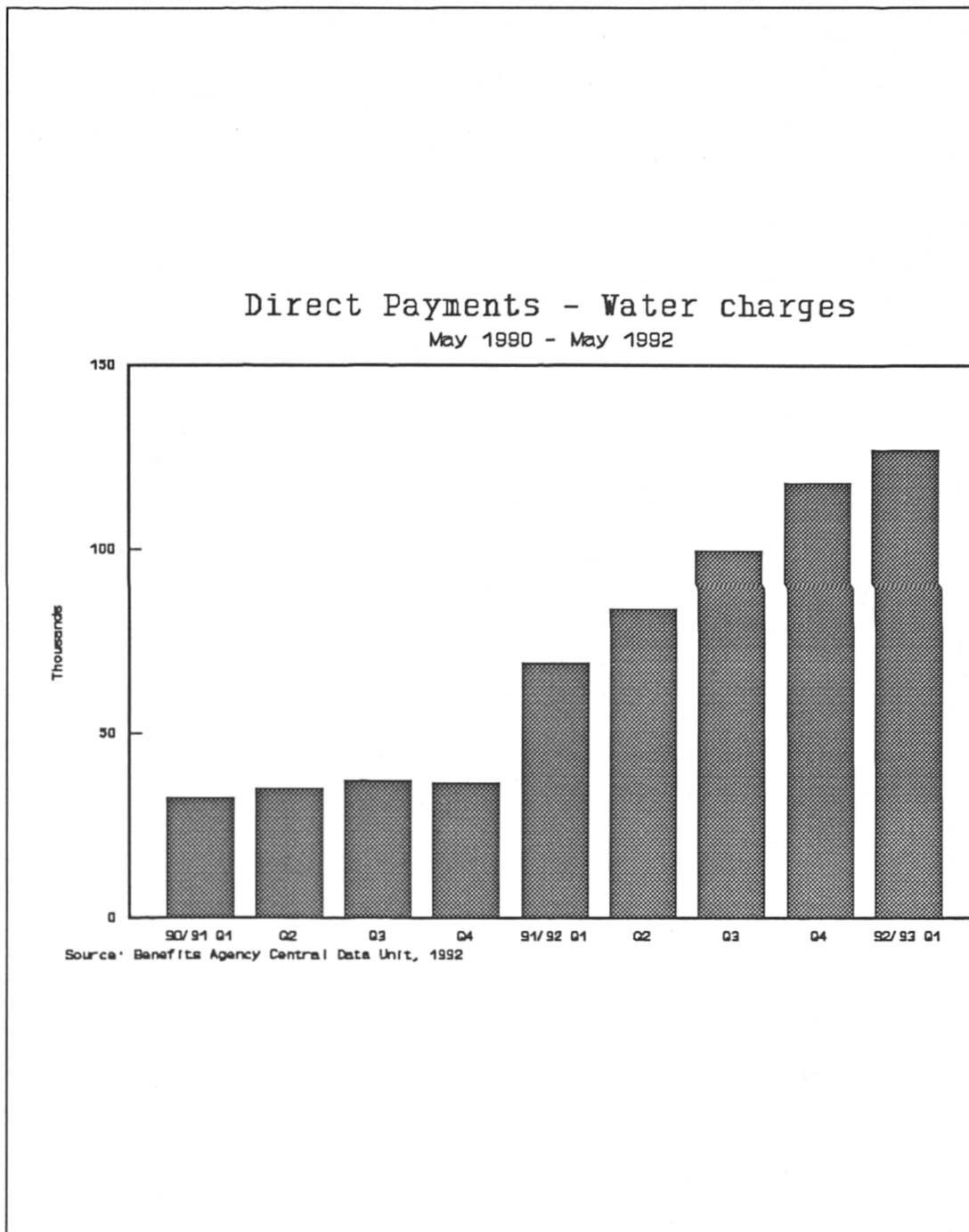


Figure 7.1: Direct payments - water

As with fuel there appears to be a strong correlation between water debt and socio-economic status. In the 1992 OFWAT survey on *The Customer Viewpoint*, 3 per cent of the customer sample (i.e. 123 respondents) had received a court summons for the non-payment of water bills in the past. Sixty-six per cent of these respondents had a gross household income of less than £10,000 (compared to 44% of the entire sample) and 58 per cent identified themselves as being in social class DE (compared to 33% of the full sample). The nexus between low income and water debt is underlined in the casework of citizens advice bureaux throughout the country (NACAB, 1992 and NACAB *Social Policy Bulletins*), in OFWAT's examination of the problem of debt and disconnection (OFWAT, 1992g) and in the results of recent research into water debt commissioned by Welsh Water (Welsh Water, 1992<sup>3</sup>).

The social security system has been slow to respond to the problems being experienced by low income households as a result of rising water charges and the other changes alluded to above. The Social Security Advisory Committee (SSAC) had been arguing since 1990 that the Government make provision for water tariff increases in the annual uprating of benefits. In the wake of the 1988 social security changes, water along with housing costs was excluded from the system of increasing benefits in line with inflation (the "Rossi" Index). In October 1991, the Secretary of State for Social Security announced that water charges would in the future, be included in the "Rossi" index for uprating benefits. This did not, however, address the water payment deficit experienced by beneficiaries over the previous three years, as the SSAC pointed out in its Annual Report:

*It should be noted, though, that there remains a shortfall in the income of those receiving income related benefits as no recompense was made for the period from 1988 to 1991, although water charges increased dramatically in that time. SSAC (1992, p.18)*

Nor does the notional element belatedly included in benefits to cover water charges appear to correspond with the actual water bills of many low income households. Fitch (City of Bradford, 1992) estimates that the water element paid to social security beneficiaries is currently £2.25 per week, whereas the average household water bill in England and Wales is £3.25 per week. In some parts of the country, consumers are paying bills well in excess of this average figure, with for example, consumers in the South West Water area paying on average £4.38 per week (Water Services Association, 1992). In Autumn 1992, both the water industry and the OFWAT Customer Service Committees called on the Government to increase the water element in social security benefits (Welsh Water, 1992; Water Bulletin, 13/11/92; OFWAT, 1992ai).

(ii) Disconnections for debt in the privatised energy and water industries

Prior to privatisation, fears were held by community sector and consumer organisations that the advent of explicitly commercial regimes in the utility industries would lead to a more stringent approach to the handling of consumer debt. And that this, in conjunction with anticipated price increases, would be likely to result in the industries' making greater use of their disconnection powers as a means of dealing with payment default. In actuality, the management of consumer debt by the privatised utilities, to date, has been rather more variable, and in the case of the gas and electricity industries at least, more favourable, than this 'worst case' scenario might suggest.

Over the initial period following the privatisation of British Gas, and during the lead up to the sale of the water industry, a more assertive approach to payment default by domestic consumers was indeed in evidence. Domestic gas disconnections rose from 35,626 in 1985 to 60,778 in 1987, an increase of 70% in the first two years of the industry's privatisation. This increase was the result, in the view of British Gas, of worsening socio-economic conditions generally. But this argument was substantially refuted by the research of the Gas Consumers Council (1988) and, as reflected in the subsequent insertion of a new condition on debt and disconnection in the Licence of British Gas in early 1989, ultimately discounted by the regulator himself.

Disconnections (domestic and non-domestic) carried out by regional water authorities rose by 25% between 1986/87 and 1988/89 <sup>4</sup>. This understated though, a longer-term trend in water disconnections which coincided with the industry's 'commercialisation' in 1982, where disconnections rose from 1,171 in 1981 to 9,187 in 1987/88, almost an eight-fold increase (AMA, 1989).

The electricity industry was the exception to this pattern of increased recourse to disconnection at or around the time of privatisation, as the number of domestic disconnections had been in gradual and continuous decline since 1986 and remained that way over the period of privatisation. The greater availability of token prepayment meter technology in the ESI compared to the gas industry may explain the downward trend in disconnections over this period (until recently, equivalent technology did not exist in the water industry - see below). Support for this thesis can be found in the fact that the prepayment meter became the critical element in the reversal of the disconnection trend in gas.

Responding to general community sector alarm and a request by the Gas Consumers Council to take action about the escalation in gas disconnections, the Director-General of Gas Supply introduced in a modification to British Gas' operating licence (known as Condition 12A) in April 1989. Condition 12A largely precluded the company from disconnecting a domestic customer experiencing difficulty paying their gas bill until a prepayment meter had been offered as an alternative payment arrangement (OFGAS, 1989b). The effect of this was to move the customer from paying for gas on credit, to paying for it in advance, with the meter calibrated to recover past debt. As a result of this change to the way that British Gas was allowed to pursue debt-recovery, domestic disconnections dropped from a peak of 61,796 (or 4 disconnections for every 1,000 domestic customers) in the year ending 31st March 1988, to 19,266 in the year ending 31st March 1990 (just over 1 for every 1,000 customers).

The dramatic success of the OFGAS-enforced licence modification encouraged the Government to add a similar provision, with almost exactly the same wording, to the draft licences of the regional electricity companies during the passage of the *Electricity*



*Bill*. This subsequently became Condition 19 of the supply licence (Code of Practice on methods for dealing with tariff customers in default). Figure 7.2 shows the domestic disconnection trends in the two industries over the past decade.

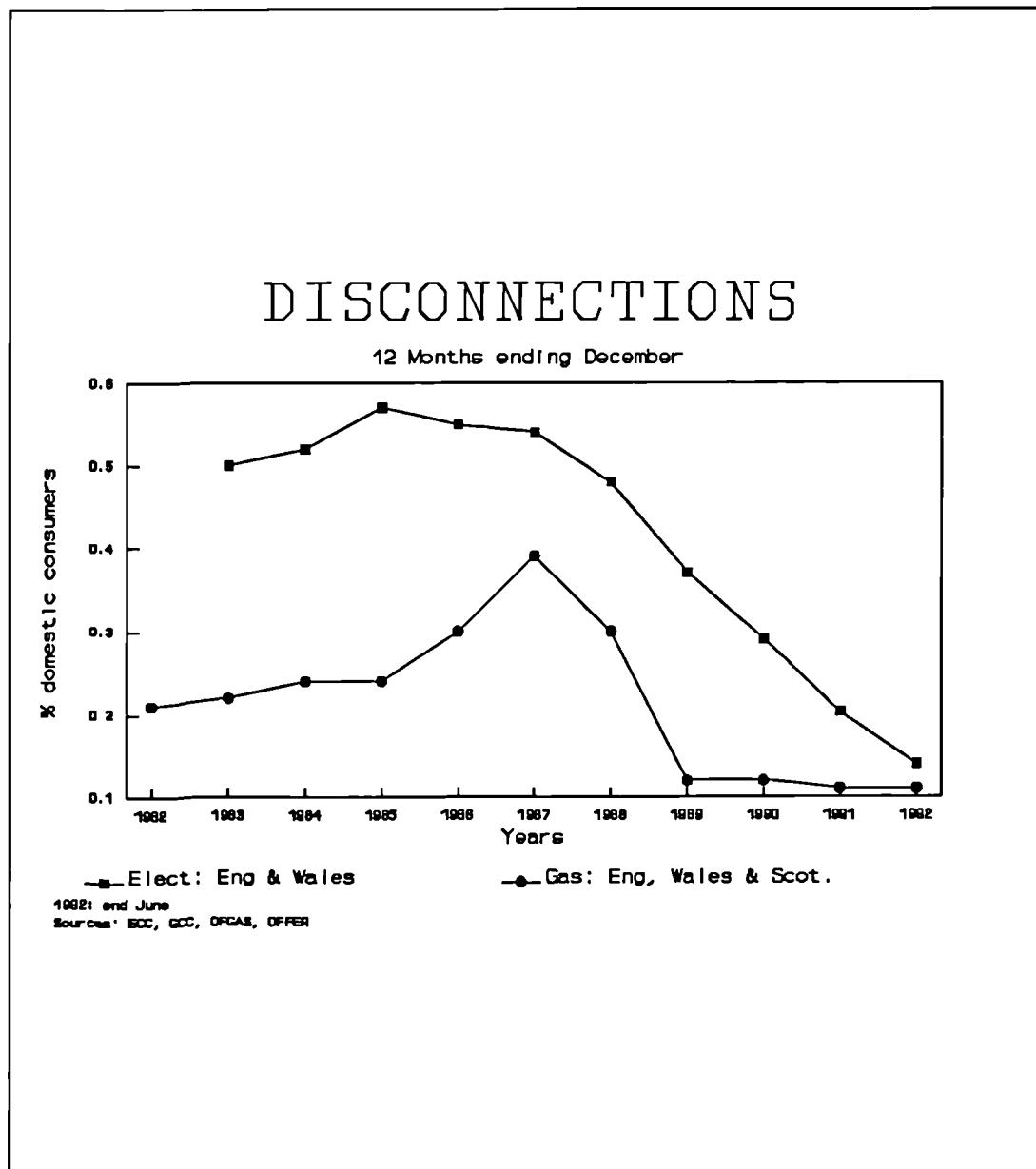


Figure 7.2: Gas and electricity domestic disconnections

The part played by prepayment meters in reducing the level of gas disconnections for debt is visually apparent in Figure 7.3.

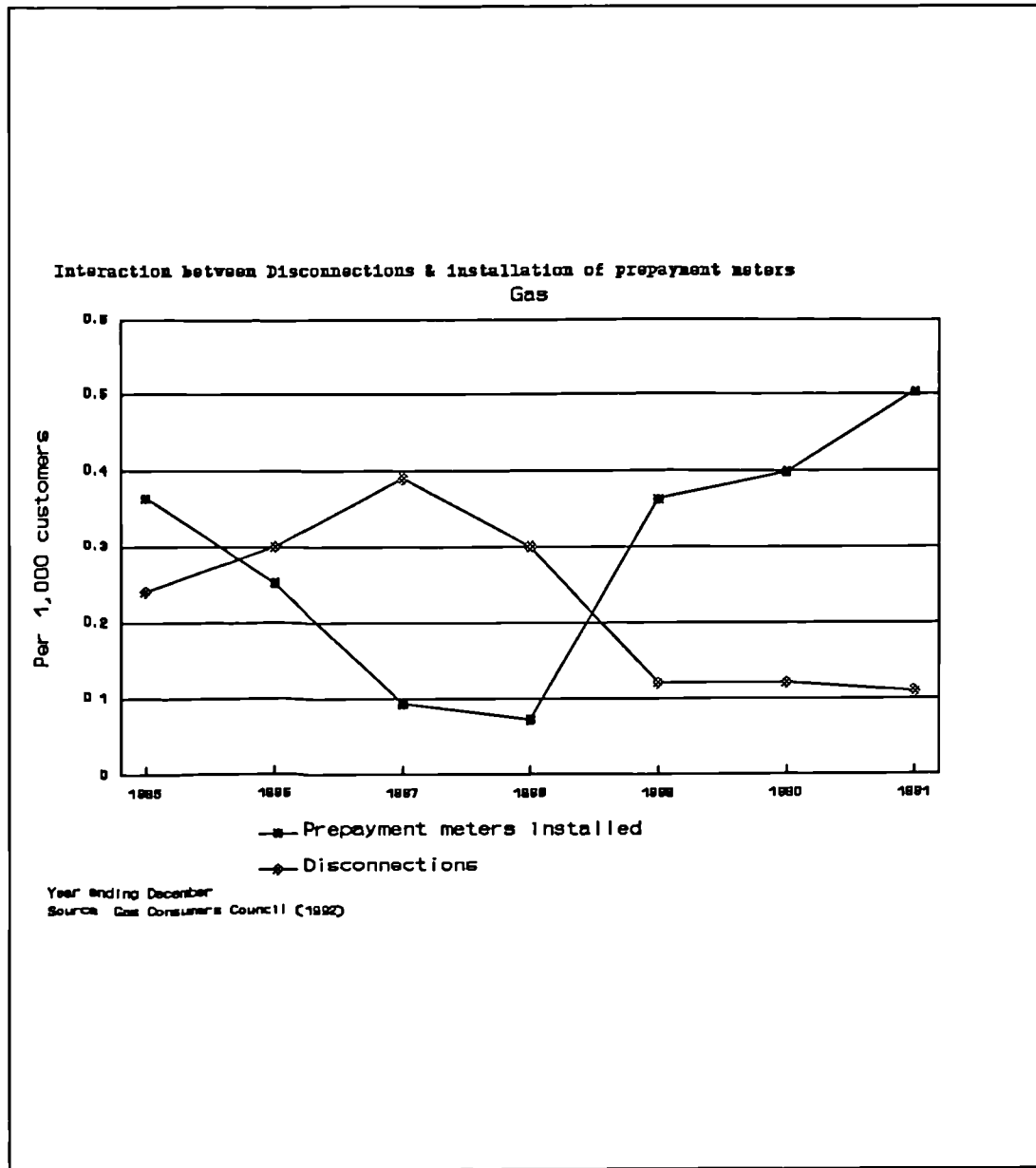


Figure 7.3: Prepayment meters and gas disconnections

In the electricity industry, it would be unlikely to be coincidental that the number of disconnections in England and Wales fell by 43 per cent between July 1991 and June 1992, while at the same time, the number of domestic customers paying for their electricity via token meters rose by 41 per cent. Another illustration of the strong correlation between prepayment meters and disconnection is found in the fact that in the

June quarter 1992, the RECs with above average falls in the rate of disconnection were also those with above average rates of prepayment meter installation during the quarter (64%). Whereas in those RECs with a below average decline in disconnections, the level of prepayment meter installation for the quarter was also below the average (39%).

The Condition 12A and Condition 19 licence changes, and their impact in reducing disconnections, have been universally welcomed by consumer and community services agencies in Britain. Yet despite the broad intent of these codes of practice, which is to effectively eliminate withdrawal of supply because of inability to pay, a total of 50,440 households were disconnected by either electricity or gas companies in the year ending June 1992. In the case of gas, the decline in the rate of disconnection has hovered around the same level (just over 1 per 1,000 domestic customers) since March 1990. Theoretically, if Conditions 12A and 19 were being implemented to their optimum, the number of domestic disconnections should be very low indeed; involving only those consumers who have vacated properties without notifying the utility companies and those who for one reason or another refuse to pay their bills when they have a capacity to do so. This, of course, is based on the view (which has been supported by empirical research from Berthoud, 1983 onwards) that the proportion of 'won't pay' as opposed to 'can't pay' consumers is extremely small.

The factors that underlie the continuing residual of domestic disconnections have yet to be effectively identified, despite the efforts of the regulators (and OFGAS in particular) to find plausible explanations. An inability to make contact with the defaulting consumer has been identified by the industries and the regulators<sup>5</sup> as the source of the problem. According to British Gas, "over 95% of customers disconnected have made "no contact" with the company" (OFGAS note on Gas Debt and Disconnection to PUA, 29/4/92).

The "no contact" issue has been a long-standing one in the utility industries and Berthoud identified it as a major barrier to the resolution of debt problems in his seminal study of the operation of the voluntary codes of practice in 1983 (see Annexe 1, Part 3). While consumer advocates agree, as the companies argue, that without contact it is impossible to offer the customer either a pre-payment meter or to come to some arrangement over the payment of debt, there is less consensus over whether "no contact" is the cause of the problem or merely a symptom, and over where the onus of responsibility for making contact lies (i.e. with the consumer or the utility):

*There is a risk in dwelling upon no contact as a problem. It is arguable that the focus of concern should be on involuntary disconnection for debt, and that no contact is an explanation for such disconnection. The explanation is one that is offered by suppliers, and the notion of no contact comprises a multitude of administrative and legal considerations. Perhaps observers should remain agnostic about the status of no contact as a problem, especially as suppliers are the main source of data about the issue, and information about it is collected and released in accordance with their requirements and interests. PUAf (1990a)*

The National Right to Fuel Campaign (1989) and the Gas Consumers Council (1991), amongst others, have questioned whether the utility companies make sufficient efforts to contact consumers in default, and have sought clearer regulatory directions to the companies regarding the steps that need to be taken to establish customer contact.

The number of reconnections within a short period has been seen as a possible indicator of failure on the part of the companies to pursue contact as actively as they might, and certainly it raises questions about the validity of disconnection in the first place.

Amongst the sample of gas disconnection cases regularly monitored by the Gas Consumers Council, the proportion of domestic consumers reconnected within 28 days has been consistently in the region of 37-40 per cent, which "must represent a considerable waste of time and resources for British Gas and a cost to all consumers,

in the long run.." (GCC, 1991d). In 1992, British Gas commissioned the Policy Studies Institute to carry out a qualitative research project on "no contact" and the results of this research are due to be released towards the end of the year.

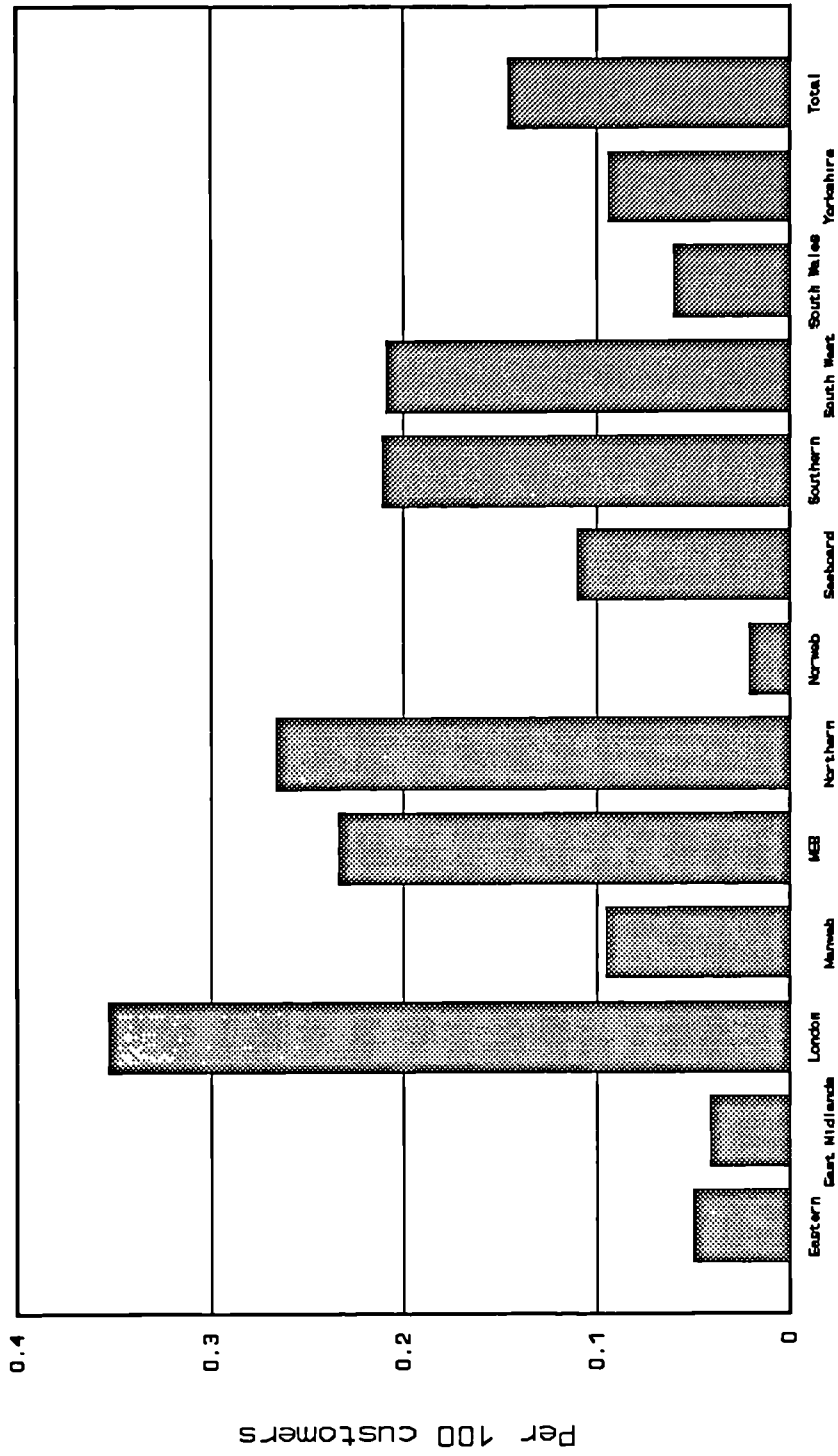
In the June quarter of 1991, 35 per cent of domestic customers disconnected by the electricity companies in Britain were reconnected within one month (OFFER, Customer Accounting Statistics, 1992). But an even more disconcerting figure can be found in the fact that two and a half thousand households remained disconnected over the twelve months up to June.

Despite the across-the-board downward trend in disconnections, individual company performance varies greatly as Figure 7.4 (overleaf) shows. The ability of a REC like Norweb to implement what amounts virtually to a "no disconnections" policy (in 1991/92 only 218 customers were disconnected) is heavily predicated on the prepayment meter 'solution'. Norweb has adopted a vigorous policy on the installation of prepayment meters for customers in default, which apparently has involved installing them without the agreement of, or even in some cases, without the presence of, the customer concerned.

Until recently, British Gas' capacity to reduce disconnections much below the March 1990 level had been constrained by an absence of appropriate coinless prepayment meter technology. This, however, is likely to change in the future with the mass production and installation of the new Quantum meter. Developed by Landis & Gyr, the Quantum prepayment meter is a card-operated system with a number of the hi-tech features envisaged by Professor Littlechild in his metering consultation paper (see *Gas World International*, April 1992 and BG video *The Quantum System*). The meter is currently

# ESI Disconnections

1992



Year ending June  
Source: OFFER (1992)

Figure 7.4: Electricity disconnections

being tested throughout the country and British Gas plan to install around 20,000 Quantum meters per month from 1993 onwards. The charge the consumer will have to pay for the installation of the Quantum meter has yet to be determined by British Gas.

Regulatory action and community sector advocacy notwithstanding, the prepayment meter has manifestly been the key to the progress made in reducing the number of gas and electricity disconnections. Without the advent of coinless prepayment meter technology, it is doubtful that the dual objectives of reducing the level of domestic energy disconnections and enhancing the commercial capacity and freedom of the utility industries could have been reconciled.

As well as giving customers in default the facility to remain on supply, prepayment meters have clear advantages for the utility companies. They provide a continuous revenue stream in advance of the consumption of energy, which contrasts with the way that revenue is raised from the bulk of consumers<sup>6</sup>, and they give the utilities a secured way of retrieving debt with minimal costs:

*[prepayment meters] improve the cash flow of the supply business compared with quarterly payment methods, since payment is received..prior to consumption of the electricity..Consequently, the more customers that choose these payment methods [prepayment meters and direct debit], the better the cash flow of the supply business, and the lower the necessary return of the supply business (OFFER, 1992y, p.37).<sup>7</sup>*

From the consumers point of view, however, prepayment meters are not without their costs. These are manifested in the additional charges borne by consumers paying for their electricity or gas through prepayment meters. First, generally in the form of higher standing charges (and sometimes higher unit charges); prepayment meter customers of Yorkshire Electricity and Northern Electricity, for example, on economy 7 tariffs pay an additional 44 per cent and 46 per cent respectively on their standing charge. Second,

in the financial and 'opportunity costs' incurred by consumers having to travel to purchase supplies of tokens/cards to operate the meters <sup>8</sup>.

At another level, a major and rather more insidious cost has been identified. The increasing use of prepayment meters has been paralleled by rising concern about the possibility of self-disconnection amongst households unable to afford to buy the requisite tokens to operate pre-payment meters (e.g. Community Energy Research et al, 1990; Birmingham Settlement et al, 1992). By its very nature the level of self-disconnection within the community will remain largely hidden and undetected; although two qualitative studies - one in Leicester and the other in Birmingham and Bristol - have provided evidence that users of gas and electricity prepayment meters tend to ration their use of energy (Law et al, 1990; Birmingham Settlement et al. See also Huby & Dix, 1992 <sup>9</sup>). Self-disconnection, in the sense of cutting back on essential energy use, can occur whether people have prepayment meters or not, but in the more recent Birmingham and Bristol study, it was found that self-disconnection "appears to be particularly prevalent among households with prepayment meters - especially when the calibration is set high to recover a debt" (Birmingham Settlement et al, p.94).

The two studies present somewhat different accounts of the reaction of consumers to prepayment meters. The Leicester study concluded that they assist with the more immediate problem of managing energy costs:

*They..[enable] consumers to be aware of the real costs of their fuel needs and to better budget for these. They are on the whole liked by those consumers who were using them.* Law et al (1990) p.33

The Birmingham and Bristol study found that while prepayment meters helped low income households manage their fuel bills, this was often only because they "forcibly alter[ed] the priority of repayment of debts" (p.17) and that attitudes "to prepayment



meters ranged widely from strong support to militant antagonism..[the] most common perspective on prepayment meters was that they were a means to an end - typically debt repayment" (Birmingham Settlement et al, 1992, p.92).

From a social policy perspective, prepayment meters have more of the attributes of a 'quick fix' than a considered and effective approach to improving the access of low income households to essential utility services. Most fundamentally, they do little, in themselves, to address the underlying causes of fuel poverty. And they have the propensity to simply 'privatise' the disconnection process, through the consumer rather than the company acting as the mechanism for disconnection when fuel can no longer be afforded. Prepayment meters also serve to reinforce the social division of utility service access through creating a second (and potentially stigmatised) class of gas and electricity customer.

Until recently prepayment meter technology has not been available to the water industry. However, this is likely to change in the future as trials on "budget metering" <sup>10</sup> are currently being conducted by a number of water companies; the largest of which is the OFWAT-supervised trial of the Schlumberger budget meter by Severn Trent Water involving 3,000 households <sup>11</sup>. The Director General of Water Services has expressed a strong interest in the development of 'pay as you go' systems "because budget meters may, in principle, have a valuable role to play in avoiding disconnection" (OFWAT Annual Report, 1992, p.40).

Beyond the current technological constraints which, for the present, limits the extended application of prepayment metering systems in the water services industry, major reservations have been expressed about the use of this approach to debt management in

the water industry, given the possible public health consequences of self-disconnection from water supply (Public Utilities Access Forum, 1990b).

Until an equivalent to the gas and electricity industries' alternative to disconnection can be developed, more conventional measures have had to be applied in the privatised water industry. As a result of a House of Lords amendment to the *Water Bill*, Condition H (*Code of Practice and Procedure on Disconnection*) was added to the licences of the water companies. Under Condition H, the water companies could only disconnect domestic consumers after an application for a county court order on the repayment of the debt and if this order for repayment of the debt was subsequently breached. At the time, this appeared to represent a reasonable protective device for low income consumers. It was also a considerable advance on the pre-privatisation situation, where regional water authorities could disconnect consumers virtually without notice and minus any real form of external accountability.

Domestic water disconnections fell by just over 10% in 1990/91 to 7,560 (OFWAT, 1991i). Total disconnections (domestic & non-domestic) by all 39 water companies fell from 15,255 in 1988/89 to 9,092 in 1990/91 - a reduction of 40%. Despite this substantial drop in the overall number of water disconnections, the Director-General of the Office of Water Services warned that "the picture is a patchy one and the level of disconnections remain stubbornly high for some companies. There is reason to believe that the reduction in the level of disconnections is a temporary phenomena, as companies adapt to the requirements of Condition H, and that disconnections can be expected to increase." (OFWAT, Annual Report, 1991). This, indeed, turned out to be the case.

The Director General's caution, in the face of what looked to be a promising decline in disconnection trends in the industry, was stimulated by firstly, a knowledge that "the companies were going softly, softly over the first couple of years of privatisation" (OFWAT policy officer in interview with researcher, July 1992) and secondly, by evidence of the negative unintended consequences of the operation of Condition H (Perchard, 1992). Through precipitately issuing summons for county court determinations (often after only the most minor instances of payment default, NACAB, 1991a; OFWAT, 1991b), many of the water companies were able to breach the protective intent of Condition H.

In 1990/91, 900,000 summonses were issued by the water companies (representing approximately one in every twenty-three domestic and non-domestic premises in England & Wales); of which approximately half were brought to judgement. In a subsequent letter to the managing directors of the water companies (MD54), the Director General pointed out the seeming profligacy of this approach to the use of the courts. And he drew attention to the impost that this style of debt management placed on customers experiencing problems in paying their water bills:

*Because the court's costs and the company's legal costs in serving the summons can be recovered from the customer this means that each of those customers had to pay an additional £30 on top of their existing bill - a not inconsiderable burden for families struggling on a low income.*  
OFWAT (1991b) pp. 32-3

The regulator also announced the setting up of a special working group to review the implementation of Condition H and to recommend changes to its operation. The working group published its report in April 1992. While the working group rather surprisingly stopped short of recommending an immediate overhaul of Condition H, it indicated that this could occur in the future if the water companies failed to implement the published guidelines. Unfortunately, OFWAT appears to be making only a half-hearted effort to

check company compliance with the Guidelines, leaving it essentially up to the relatively ill-equipped regional Customer Service Committees to monitor their implementation. A synopsis of the OFWAT Guidelines on Debt and Disconnection is produced below, not only because it summarises the flaws in present industry practice but also because it is viewed by some members of the community sector as being a useful 'model' code of practice.

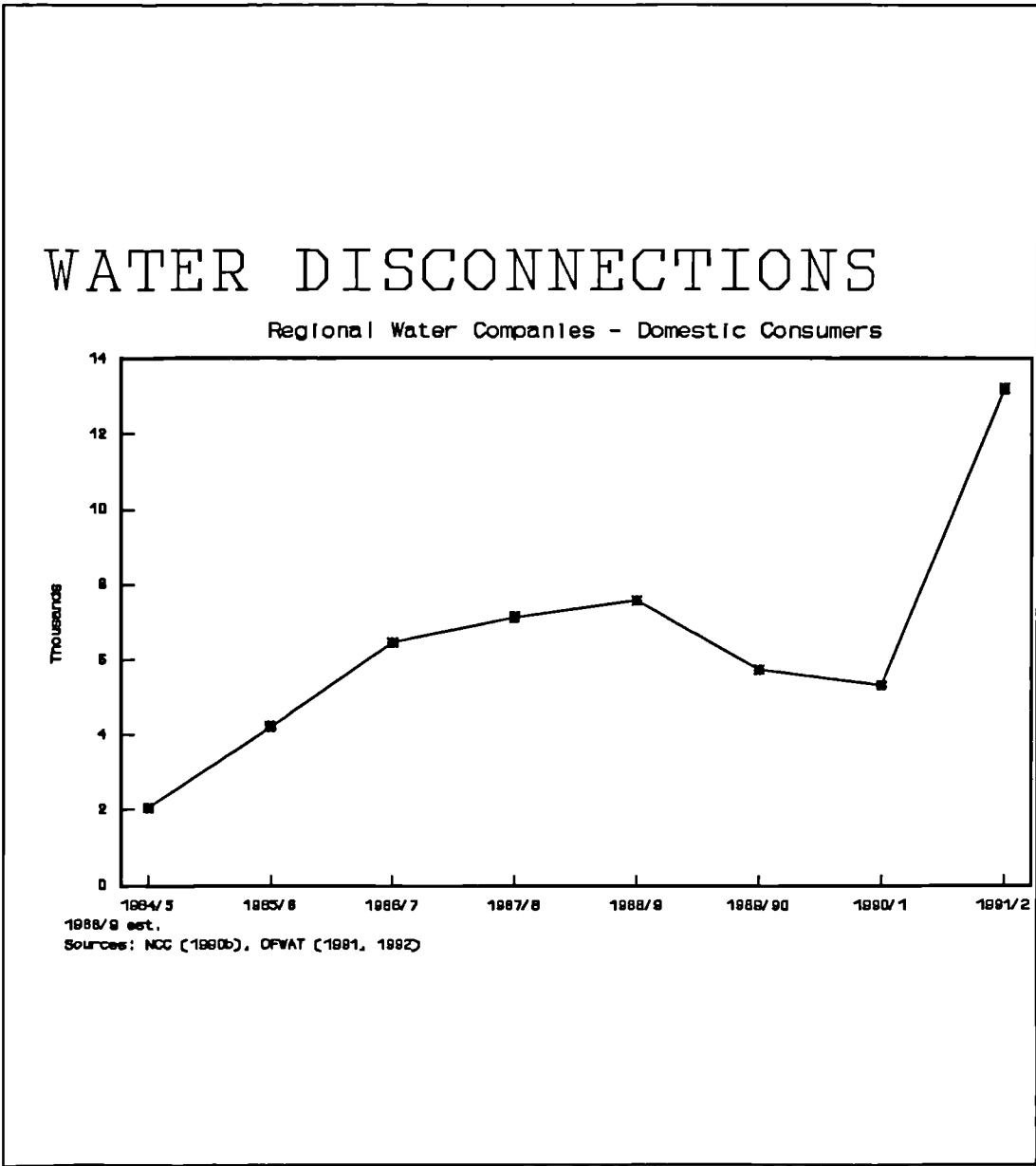
**OFWAT Guidelines on Debt and Disconnection (1992g)**

Reports on deliberations of a joint regulator/industry/CSC working group. Sets out guidelines for company practice, focusing on eight areas:

1. Contact with customers - to make contact with customers who are in arrears as soon as possible and "seek to agree with them affordable payment arrangements to pay off the arrears." p.3
2. Payment options - companies should consider extending the range of payment options available (generally very limited currently), including introduction of frequent payment scheme.
3. Payment facilities - measures required to assist customers who do not hold bank accounts (reports PSI finding that 20% of adults do not have bank or building society accounts); including assisting customers to meet the costs of "individual transaction charges" (e.g. in Post Office, 70p counter fee charged).
4. Debt recovery timetable - considerable variation in company practice currently: "The approach currently adopted by some companies can only be described as leisurely." p.9 "Companies should avoid delay whilst giving customers adequate time to respond to the various stages in the debt recovery timetable." p.4 Timetable should consist of at least 5 stages (see p.4) and "...the disconnection visit should be preceded by at least one attempt to make direct personal contact with the customer." p.4
5. Information - sets out details of the information that should be provided to customers at the reminder (or final notice) stage and at the pre-summons warning stage (p.4) and includes an example text.
6. Direct payment from income support - "Companies should take positive steps to find out whether or not customers in arrears are in receipt of income support and, therefore, eligible for direct payments from benefit." p.5
7. "Non-standard" payment arrangements - "...it is both reasonable and sensible that companies should take into account ability to pay when negotiating payment arrangements to clear arrears." p.12 Suggests seeking advice from local advice agencies and money advisers in relation to this.
8. Pre-disconnection visit - "Few companies attempt to make contact, prior to the visit to disconnect, other than by letter or other written communication." p.13

**Figure 7.5: OFWAT Guidelines on debt and disconnection**

The need for urgent action to deal more effectively with the mounting problem of water-related debt was reinforced less than two months after the release of the Guidelines with the publication of the disconnection figures for 1991/92. Over the space of a year domestic disconnections rose from 7,673 to 21,286; an increase of 177 per cent. In proportional terms, water disconnections had reached a level akin to those for gas and electricity (over one in every thousand domestic water consumers). Over the same period, the number of summonses issued by the companies fell to just over 600,000, although the actual number of judgements remained roughly the same as the previous year (in excess of 400,000). Figure 7.6 overleaf shows the trends in water disconnections since 1984.



**Figure 7.6: Water disconnections**

The variable disconnection practices of the water companies, alluded to by the Director General in MD54, is illustrated in Figure 7.7 on the page that follows. The variations are even more extreme in the water only companies - with six companies having a rate of disconnection in excess of two per thousand domestic customers in 1991/92. The South Staffordshire water company in the Midlands led the way with a disconnection rate of almost eight in every thousand households.

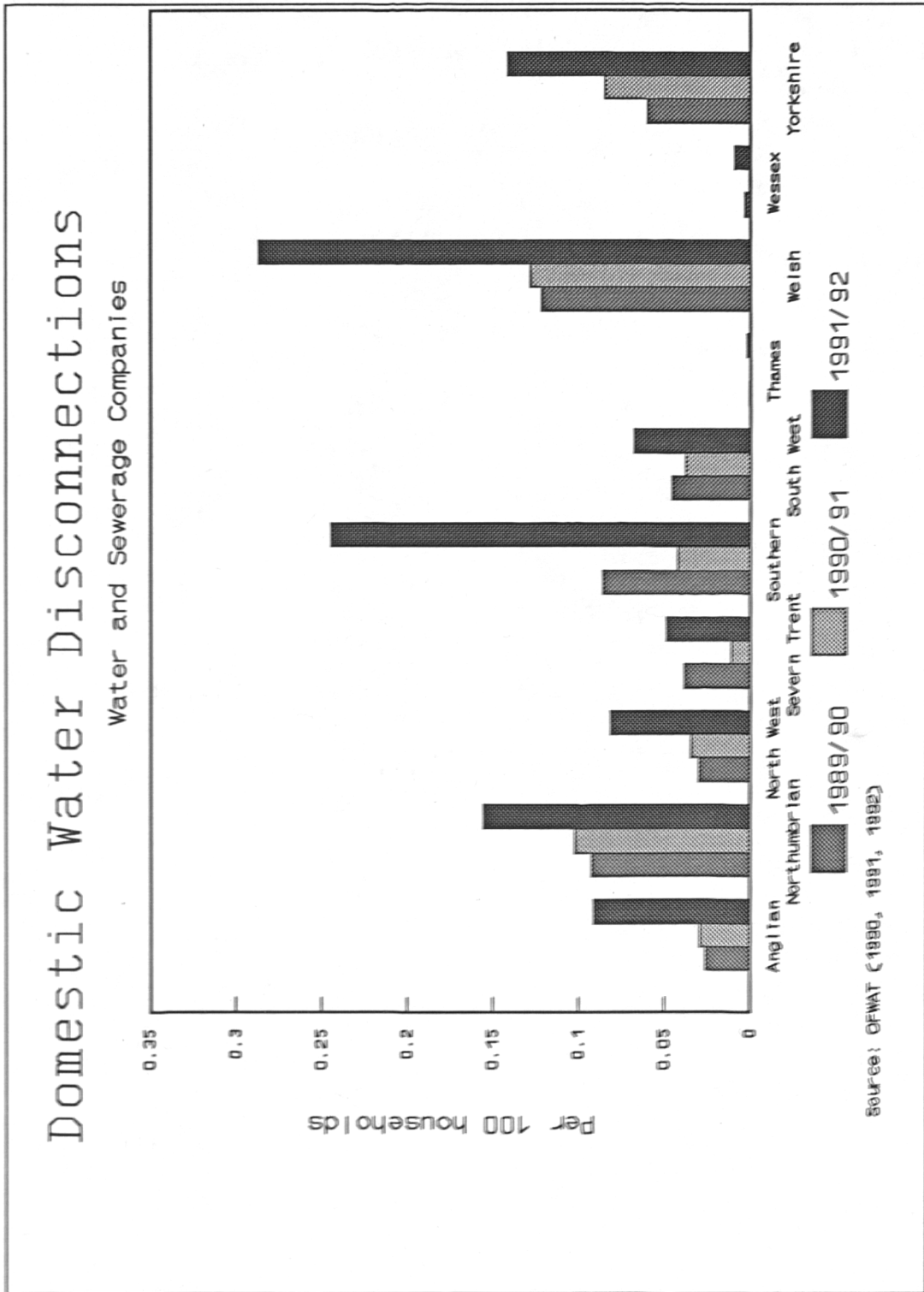


Figure 7.7: Domestic water disconnections since privatisation

As a device for protecting water consumers from disconnection, Condition H has been a signal failure, and as a mechanism for assisting low income consumers in debt negotiate arrangements based on capacity to pay, it has "made the plight of customers worse" (OFWAT Director of Consumer Services, PUA meeting, September 1992). John Winward sums up the misadventure of Condition H well when he says:

*For many years, consumer organisations argued that disconnection by water undertakings should only be allowed after recovery for debt had been sought through the county court. Since the passage of the Water Act 1989, this has effectively been the policy applied to the industry. It rapidly became apparent, however, that the policy was flawed. Rather than providing an independent body which could review the facts of each case and establish a repayment schedule, the courts have proved an extremely blunt instrument. The great majority of cases are never reviewed in detail; the consumer either clears the debt or fails to respond to the summons. At the same time, the courts have imposed additional costs on the consumer, and in some cases introduced significant delays.*  
Winward (1992) pp.2-3



(iii) Related issues in debt and disconnection

Action to retrieve serious debt is, in effect, the **terminus** in the relationship between the consumer and the utility company. It can either represent the end of the contractual relationship (at least temporarily) through disconnection, which in the context of essential services, leads to deleterious consequences for the consumer concerned. Or it can form the beginning of a re-negotiated relationship - one that is more attuned to the financial circumstances of the utility consumer. Therefore the measures that make up the chain of interventions to resolve the problem of utility debt are as important to the framework of consumer protection as are specific prescriptions about disconnection itself. Indeed they may be even more important for, from Berthoud's work in the early 1980s through to the operation of Condition H in the water industry, the message is clear. Action to circumscribe the disconnection powers of the utilities will be ineffective at best and positively harmful to the indebted consumer at worst, unless it is complemented by an array of measures aimed at confronting the underlying problem of managing fuel and water payments on a limited income.

The problem of fuel and water debt has been conventionally perceived by the utility industries to be one for the social security system to deal with, and along the demand dimension (i.e. whether households can obtain access to requisite amounts of water and energy and whether they have sufficient income to continue paying for these services) this view has some, but by no means incontestable, validity (see Chapter 8). On the supply side, however, (i.e. how utility services are provided and how low income consumers can be assisted to marshal their limited resources to maximum effect in purchasing and paying for utility services), the utilities have a direct and significant role to play. The provision that the utilities make for flexible and varied payment options,

the method and frequency with which they bill customers, the levels of debt repayment set, the extent to which they engage the assistance of social security and social services agencies in support of the consumer in financial difficulty and the general attitude that they adopt to customers in debt, all exercise a considerable influence on the epidemiology of fuel and water debt.

Studies that have sought to document or assess the performance of the privatised utilities in this area suggest that the energy and water industries have some way to travel before the rubric of "customer care" attains much meaning for low income consumers (NACAB, 1991b, 1992; Birmingham Settlement et al, 1992; OFWAT, 1992g; Berthoud & Kempson, 1992). It should be said, however, that many of the defects identified mirror those exhibited over many years by the nationalised precursors of the present utility companies (see Annexe 1 Part 3). In their modus operandi regarding low income consumers, the publicly-owned energy and water industries were generally no better, and possibly in a number of respects, worse than their privatised counterparts.

In relation to payment and billing methods, analyses of current practice have shown that some utility companies have been reluctant to develop payment schemes which meld with the budgeting requirements of low income households; the water industry in particular has displayed a marked reluctance to move away from the annual and bi-annual billing cycles towards more frequent payment systems. Untoward reliance is placed on estimated readings, which often results in low income households having to confront unanticipated large utility bills. Estimated readings are particularly rife amongst the RECs and the Director General of Electricity Supply has stated that the original performance standard (at least one "firm reading" a year) requires revision (OFFER, 1992x).

The actual terms of an agreement reached by the company and the customer for the recovery of debt will have a major bearing on whether the agreement succeeds or not. But the logic of setting a debt repayment timetable in line with the customers capacity to pay in order to optimise the prospect of debt recovery, seems to have escaped a number of companies. Case evidence from CABx and the Birmingham and Bristol study (Birmingham Settlement et al, 1992) indicates that the short-term commercial imperatives of the utility companies often overrides their longer-term commercial interests (i.e. the eventual recovery of the outstanding debt and maintaining the customer on supply), and seriously undermines the fragile budgeting systems of low income households. Most companies aim to complete the debt recovery process within twelve months, irrespective of the size of the debt or the customers capacity to pay. Often the level of repayment is set well above the standard used by the Benefits Agency for direct payments (£2.15 per week for each utility debt). Access to fuel direct itself is a problem for some eligible consumers i.e. those on income support with arrears greater than £42.45. This is notably the case for electricity consumers, as the RECs have balked at the additional administrative costs involved, preferring instead the prepayment meter option (PUAF, 1990a, 1991b; Birmingham Settlement et al, 1992).

Disconnection action is an expression of a fundamental breakdown in the relationship between the utility and the consumer. If the debt recovery systems used by the companies were being applied effectively and sensitively, it would be a rarely applied sanction, as the gas and water regulators have often pointed out. Although, in a context of rising utility tariffs (as in water), even the most dexterous of debt recovery methodologies will run up against the reality that some households lack sufficient income to meet their utility and other debts. When disconnection does occur it should follow a process that is both transparent and accountable, and should not penalise the

consumer beyond the termination of supply. Yet neither of these conditions presently apply in the utility industries.

Transparency and accountability in the process is precluded by the fact that the disconnection codes of practice are not published (and hence not subject to public scrutiny), nor are they generally made available to consumer and welfare organisations who are often in the position of needing to advocate on behalf of customers who are facing imminent disconnection <sup>12</sup>. The argument used by the companies - and by, implication the regulators - that the publication of the disconnection codes (or "methods") would enable certain customers and their advocates to exploit the system, is based on the false premise that the utility consumer world is inhabited by masses of 'wont pays', and it looks particularly frail when juxtaposed against the common law principle of "due process". It also ignores the infinite human capacity for ingenuity. It would take, for example, little more than the studied observation of a neighbour's experience of disconnection to unpick the lock of the Manweb code set out on the next page.

Currently, the disconnected consumer effectively confronts a situation of 'double jeopardy', for in addition to losing supply, he or she is required to meet punitive disconnection costs. In water, for instance, disconnection charges range from £25.50 (Yorkshire) to £73 (Wessex) amongst the water and sewerage companies, and from £15 (York, Chester and Cambridge) to £80 (Hartlepoons and North East) amongst the water only companies [CRI, 1992, Table B.7]. These financial penalties are obviously designed to act as a deterrent against the wilful non-payment of utility bills. But in their impact they primarily serve to compound the financial difficulties of those groups of consumers whose problem is not one of wilfulness, but lack of income.

## MANWEB'S CUSTOMER IN DEFAULT PROCESS

### BILL SENT

16 DAYS LATER NO RESPONSE

REMINDER/FINAL NOTICE SENT [Unless customer who has paid last three most recent bills prior to a reminder "sent a polite notice instead of the Reminder/Final Notice"]

17 DAYS LATER NO RESPONSE \*

NOTICE (CP1): ADVISES CUSTOMER OF CODE OF PRACTICE & OFFERS THEM A CHOICE OF EITHER (a) A SPECIFIC PAYMENT ARRANGEMENT OR (b) A CARD METER

12 DAYS LATER STILL UNPAID \*\*

DISCONNECTION NOTICE SENT (CP2) BY FIRST CLASS POST "notifying them of the date on which we intend to visit the premises to disconnect the supply and remove the meter"  
"The CP2 notice states that at this visit we will be prepared to install a card meter unless it is not safe or practical to do so"

5 WORKING DAYS LATER

DISCONNECTION VISIT

TOTAL = 50-52 DAYS

[\* "where the bill remains unpaid 33 days after billing"; \*\* "by the 45th day after billing"]

NO EFFECTIVE CONTACT

"If there is no adult at home with authority to give our disconnection operative access or if access is refused, he will leave a letter (CP3) at the premises which advises the customer that we now intend to apply for a Warrant of Entry under the Rights of Entry (Gas and Electricity Boards) Act 1954. The cost of this visit will be added to the customer's account

"The customer will always be notified, by first class post, of the date on which we intend to visit the premises with a Magistrates Warrant"

Additional expense of obtaining and actioning the Warrant added to customer's account

BUT NOTE: "For customers who are continually late in settling their bills or late in agreeing to payment arrangements, it would be impractical to follow Procedure 1 every quarter. Therefore, we will only apply it once in any 12 month period". p.5 Procedure 2 brought into play - more 'streamlined': Disconnection Notice sent after 28 days from billing (see p.5f)

Source: Manweb Licence Condition 19: Methods for Dealing with Domestic Credit Customers in Default

Figure 7.8: Manweb's customer in default process

Despite the substantial defects in the debt management procedures of the utilities, there are signs that some modest improvements are being effected in this area; although this varies across the industries and between the companies. The slow transformation of British Gas is probably the best exemplar of 'improving practice' (Birmingham Settlement et al, 1992; Berthoud & Kempson, 1992; interviews with consumer and community sector organisations). Whether this has much to do with the forces for change within the companies themselves is a moot point. Certainly, the contribution of the regulatory bodies, underpinned by vigilant and effective advocacy of the community sector, has been important. The same applies to the development of systems of consumer protection generally across the three industries, as the next part of the chapter reveals.

### PART 3: CONSUMER PROTECTION AND CONSUMER REPRESENTATION

*Consumer protection is meaningless if it is so complicated and inaccessible to ordinary people that they remain either unaware of their rights or unable to act on them.* Whitworth (PIRC, 1989, p.14).

With respect to consumer rights, and to a lesser extent, service quality, the privatised utility industries began from what was a relatively unambitious base. During their forty years or so under public ownership, the water, electricity and gas industries had often been perceived as complacent, and even dismissive, in their approach to 'customer care'.

In the context of the 'new consumerism'<sup>13</sup> of the late 1980s and 1990s (Taylor 1990; Keat, 1991), demands have been placed on the providers of public and essential services to display a greater consciousness of consumer matters. The Conservative Government's *Citizen's Charter* (1991b) is symbolic of the rhetorical shift from producer-led to customer-driven models of service delivery. The changes effected in the consumer orientation of the privatised utility industries then, have to be viewed against this broader socio-political and cultural canvas.

Policy and organisational change, driven by consumerist objectives, often seem to be premised on an assumption that there is a homogeneity of interest amongst all consumers which transcends social class, income or relative need. But programmes built on this assumption stand the danger of overlooking the different, and at times even conflicting, sets of interests that exist amongst particular groups of domestic consumers, in their desire to respond to a dominant and standardised 'customer prototype'. Consumerist approaches also tend to focus more on procedural rights (e.g. the keeping of appointments and the answering of complaints) than on questions of access,

affordability and equity. An examination of the 'social division' of service standards and quality prescriptions is an important dimension in the analysis of consumer protection and consumer representation in the privatised utilities. It will be introduced into the discussion in section (ii) below and taken up at greater length in Chapter 8.

(i) Consumer protection: the convergence of regulatory responsibilities

Regulating for quality is every bit as important as regulating price in monopoly settings. In the absence of quality regulation, monopoly service providers have an opportunity to offset the impact of price controls on profits, by making savings in the level and quality of service provided to the consumer (Helm, 1988 and in evidence to the Energy Select Committee, 1992c). In the first period of utility privatisation, with British Telecom and British Gas, the Government adopted a 'light touch' or 'hands off' approach to quality regulation; with the regulators being given quite muted consumer protection powers (Rovizzi and Thompson, 1992). The regulatory provisions for consumer protection were strengthened in the water and electricity privatisations; and more recently, the *Citizen's Charter* legislation affecting the utilities, the *Competition and Service (Utilities) Act 1992*, has added further weight to the quality regulation powers of the four utility regulatory bodies. The decision by the Major Government to 'top up' the powers of the regulatory bodies would seem to indicate a belated recognition that the original powers given to a number of the regulators were insufficient for the task of quality regulation.



Partly because of the limitations in the regulatory framework, privatisation was initially attended by very few service-related gains for domestic consumers. This was emphasised in a number of well-publicised surveys by organisations such as the Consumers' Association, which showed that most consumers believed that very little had changed in the service performance of the utilities in the years immediately after privatisation. For example, the *Which?* survey taken in July 1989 (i.e. some three years after the birth of British Gas Plc.) found that "only one in ten said the service had improved [since privatisation] - the majority thought nothing had changed, or thought it was too early to say" (p.312).

The late 1980s and early 1990s witnessed an accretion of power by both the telecommunications and gas supply regulators in the area of consumer protection, as they sought to correct the deficits in their statutory powers *in situ*. Through a combination of negotiation, persuasion and threat, the telecommunications and gas regulatory bodies managed to stretch the boundaries of their legislative mandate. Both regulators have had success in incorporating quality of service criteria into the price control mechanism - directly in the case of OFGAS, indirectly in the case of OFTEL - (OFGAS, 1991e; OFTEL, 1992a, 1992b), despite the fact that they have encountered resistance and opposition from the companies concerned:

*Because of British Gas' resistance to change and a lack of a purposeful, dynamic approach to customer service it has been a slow, difficult process to reach agreement with the company on many of these [i.e. customer protection] issues. OFGAS Annual Report, 1991, Section 1*

The additional duties imposed on British Gas by OFGAS, including the introduction of "key service standards" along the lines of those in the electricity and water industries (see below), following its 1991 review of the gas tariff formula (OFGAS, 1991g) is a concrete illustration of the evolving strength of the regulatory machinery.

In the tariff review, the gas regulator sought to correct a fundamental deficit in the original Authorisation of British Gas, namely that "there is no guarantee that lower prices will not be achieved at the expense of lower standards of service" (OFGAS, 1991g, p.3). Persistent calls by the regulator over the previous couple of years for the voluntary introduction of a clear and comprehensive system of service standards, had drawn an inadequate response from British Gas. Even though British Gas published a long-awaited customer standards statement in 1990, *Our Commitment to Banishing Gripes*, this was seen to lack both clarity and measurability:

*OFGAS did not consider that the published commitment ["Our Commitment to Banishing Gripes"] covered the full area of services. Furthermore the services described in the document were qualified in relation to service delivery by the use of words like "normally" and "so far as possible". OFGAS (1991f) p.2*

The inability of British Gas to evaluate its service performance was further compounded by the absence of an effective information base on customer services:

*The review of the tariff formula revealed that British Gas did not operate an adequate system for monitoring and controlling the provision of specific services. Thus British Gas has no assurance at present that best practices are consistently applied by all its service sector staff in its gas supply business, or that it is meeting service performance targets. If British Gas itself is unable to have that assurance it is in no position to provide it to its customers and OFGAS. OFGAS (1991f) p.3*

In order to overcome the limitations of the 'rolling negotiation' approach to standard-setting (and in order to move towards a position of regulatory parity with the water and electricity industries), the Director-General OFGAS introduced a new condition (Condition 13A) into the British Gas' Authorisation in October 1991, with effect from 1st April 1992. Condition 13A places a duty on the monopoly gas supplier to establish, publish and monitor a set of tariff customer performance standards relating to:

- # Customer contact
- # Obtaining a gas supply
- # Continuity of supply

- # Emergency services
- # Appointments
- # Customer accounting

The performance standards required under Condition 13A were subsequently published by British Gas in a series of brochures in 1992 (British Gas, 1992e, 1992f, 1992g). These new standards of service cover both overall and individual performance targets. Overall standards encompass broader areas of practice - such as the recording of customer contacts, answering telephone calls within a specified period of time, capacity to deal with gas escapes and monitoring differences between actual and estimated gas usage by tariff customers - where the company is required to meet service targets between 90 and 100 per cent of the time (British Gas, 1992e). Individual standards establish a more testing target (100 per cent in all cases) and relate to selected areas of the direct interface with consumers, for example, replying to correspondence, keeping appointments, connecting and interrupting supply, and requests for special meter readings. Failure to meet an individual standard can result in the payment of compensation, **on request** to the customer concerned, generally in the form of a credit to the customer's account (British Gas, 1992e).

Provision has been made in seven of the 18 designated individual standards for fixed compensation payments to customers (£10-£20). In the tariff review, the Director General of Gas Supply decided against setting the level of compensation himself (as is done, effectively, by the water and electricity regulators <sup>14</sup>) and left it up to British Gas to determine:

*OFGAS' examination of customer services in other countries during the review indicated that the imposition of external penalty payments would not suit the operation of the Total Quality Management concept [being introduced by British Gas]. It is also self evident that externally imposed penalties are by their nature somewhat inflexible and could be expensive to administer. They could also be open to abuse by either British Gas or its customers. OFGAS, (1991e), p.5*

The quality regulation powers secured by OFGAS in the tariff review were subsequently formalised, in the separate *Citizen's Charter* policy initiative of the Government under the *Competition and Service (Utilities) Act 1992* (resulting in amendments to section 33 of the *Gas Act*). Ironically, this belated move by the Government to correct the deficit in the gas regulator's powers was not particularly welcomed by OFGAS:

*..it created something of a dilemma for us, we had to decide do we scrap what we've got and transfer it over to regulation under the Act or to continue with 13A..it muddied the waters and personally it was a bit of a nuisance. (OFGAS officer in interview with researcher, July 1992) <sup>15</sup>*

As shown in Chapter 1, the privatisation of the water and electricity industries was accompanied by a stronger framework for quality regulation than that established for gas in 1986 <sup>16</sup>. The extensions to the consumer protection mandate of the water and electricity regulators in 1988/89 might be viewed as a manifestation of regulatory 'policy learning' in what is still a comparatively new field of public intervention in Britain.

The three primary regulatory devices adopted for influencing service delivery by the water and electricity utilities are: (i) enforceable codes of practice and (ii) overall standards of performance and (iii) guaranteed standards of performance schemes.

The codes of practice form part of the conditions of the operating licences of the companies, and are hence enforceable. Within the electricity industry, the RECs are obliged to produce and publish codes of practice in relation to:

- the payment of bills e.g. information to consumers re. how bill constructed, security deposits, alternative systems of payment, process for handling disputed bills (Licence Condition 18)
- methods for dealing with domestic tariff customers in default, including disconnections procedure, arrangements for paying outstanding debts, referrals to social security & social services (Licence Condition 19)

- services to the elderly and the disabled i.e. that companies identify and respond to the particular needs of these consumers (Licence Condition 20)
- complaint handling procedures i.e. company mechanisms for dealing with consumer grievances (Licence Condition 23)
- a code on the efficient use of electricity i.e advice to consumers on the efficient use of electricity, including the provision of a telephone advice service (Licence Condition 22)

The three codes of practice in the water industry are broadly similar, with Conditions G & H in the *Instrument of Appointment of the Water and Sewerage Undertakers* being equivalent to Conditions 18, 19 & 23 in the Public Electricity Suppliers' licence.

The third code relates to the procedure for dealing with leakages in metered domestic premises. Curiously, no provision had been made in the licence for a code on services to the elderly and the disabled; a situation which the Director-General drew attention to in his 1990 Annual Report:

*British Telecom, British Gas and the electricity supply companies are each required under the terms of their respective licences to produce a code of practice on services for the disabled and elderly. Similar provision has not been made in respect of the water companies, even though the need for it is arguably every bit as important. Ofwat has completed a survey of the services provided by the water companies for the disadvantaged. The results are very disappointing. Only a handful of companies would seem to recognise the particular problems faced by such groups of customers.. OFWAT (1991) p.52*

In September 1991, OFWAT produced a set of guidelines on services for disabled and elderly customers, which imitated some of the features of the British Gas code for these two groups of consumers - for example, setting up a register of disabled and elderly customers, providing a password system for company staff calling at the customer's home, assisting with aids and adaptations, and helping with bill reading (OFWAT, 1991r)). However as guidelines, they have none of the regulatory force of enforceable codes.

In the case of both the water and electricity companies the initial drafts of most of the codes of practice were rejected by the regulators, partly at the behest of the community sector:

*None of the submitted customer or disconnection codes were sufficiently well written, complete and accurate to meet the basic requirements of Conditions G and H. Suggested modifications were sent to the companies and as a result revised drafts were submitted. OFWAT Annual Report (1991) p.51*

*The initial submissions made by the companies were disappointing and the Director General declined to approve them. OFFER made suggestions for improvements to each of the Codes. OFFER Annual Report (1991) pp.57-8*

The statutory consumer committees were formally involved, with varying degrees of success, in the screening of the draft codes of practice (see section (iii) below).

After representations to the regulators, selected national consumer and community sector organisations and bodies such as the Public Utilities Access Forum, were given access to some of the draft codes. There was general agreement amongst these organisations that the draft codes were defective and required substantial reworking. Although the re-drafted codes of practice were finally approved by the water and electricity regulators some fifteen months and nine months respectively after the date of privatisation, disaffection was expressed about the limited nature of the consultative process. This was directed, in particular, at the electricity regulator:

*..community representatives [other than the regional consumer committees] were only invited to comment on a limited number of draft codes. No response to our comments were received from OFFER, although a response was promised by the summer of 1991, nor were our comments sought before the finalised Codes were approved and published. Barbara Montoute in Foreword to Fuel Rights Handbook 1992/93*

The efficacy of codes of practice as instruments for protecting consumers is ultimately dependent upon the rigour with which they are monitored and enforced. With the partial exception of the flawed Condition H code (water customers in default), the regulators have been dilatory in initiating action to monitor the codes of practice. The reason for this, on the part of at least one of the regulators, appears to be a reluctance to move too deeply into the operational domain of the privatised companies:

*It is a feature of the regulatory regime as a whole that regulation (including monitoring) is kept to a minimum consistent with the Director General's statutory duties. Accordingly, the framework for the monitoring of the Codes of Practice will reflect the Director General's wish that information requirements from the Companies should be kept to the minimum possible consistent with effectiveness.*

OFFER (1991e) section 11

The other two primary weapons in the regulators' consumer protection armoury are the setting of overall and individual standards of performance (the latter are usually described as "guaranteed standards schemes"). The standards of performance in water and electricity operate in a manner broadly similar to those devised more recently for British Gas; although in the former, the overall standards, up to this point in time, have been based on targets set by the companies themselves. In the electricity industry, eight overall standards of performance have been set by the regulator: reconnection of supply following faults, correction of voltage faults, new connections, reconnection after payment of bill (for disconnected customers), moving, changing and reading meters, and responding to written complaints. Different targets have been established for each of these eight standards and for each of the RECs, with the target rate of completion for most of the standards in the range of 85 to 100 per cent (OFFER, 1992x, pp.17-21).

The guaranteed standards cover nine areas of service, which are listed below. In contrast to existing similar schemes in the water and gas industries, compensation 'payments' (usually deductions from electricity bills) are automatically made in all but two areas for failure to meet the requisite standard.

In the second half of 1992, the electricity and water regulators made proposals for modifying aspects of the guaranteed standards schemes in their respective industries (see section (ii) below).

#### **ELECTRICITY GUARANTEED STANDARDS OF PERFORMANCE**

1. Supplier's fuse failures: repaired within 4 hours of notification during working hours (£10)
2. Restoring electricity supplies after faults: supply to be restored within 24 hours (£20)
3. Providing supply and meter: within 3 working days (£20)
4. Estimating charges: within 10 working days for simple jobs or 20 working days for most others (£20)
5. Notice of supply interruption: at least two days notice of supply interruption required (£10)
6. Meter problems: visit or reply within 10 working days (£10)
7. Voltage complaints: visit or reply within 10 working days (£10)
8. Charges and payment queries: a "substantive reply" within 10 working days (£10)
9. Appointments: all appointments to visit on a day must be kept (£10)
10. Payments owed under Standards: write to customer within 10 working days of failure (£10)

Note: The penalty payment amounts are those for domestic customers only

Source: OFFER (1992x) p.1

**Figure 7.9: Electricity Guaranteed Standards of Performance**



Prior to the *Competition and Service (Utilities) Act* in 1992, the formal enforcement powers of the utility regulators varied substantially; with the strongest powers held by OFFER and the weakest by OFGAS. As part of the 'levelling up' intent of the 1992 Act, all three regulators now have similar powers of enforcement. This includes the ability to determine disputes between customers and the utility companies and to rule on these disputes with a force equivalent to that of a county court decision. The regulators can also issue enforcement orders on the companies for breaches of the codes of practice and for failure to meet the specified standards of performance. In the event of serious breaches of the licence conditions, the regulators can make references to the Monopolies & Mergers Commission. In theory at least, major breaches of the licence conditions could lead to the offending company having its operating licence revoked.

While there has been a convergence in the instruments for quality regulation and in the powers of the regulators over the past twelve months, the potency of the consumer protection regime is still likely to be heavily dependent upon how each of the Directors General interpret their mandate as 'stewards of the consumer interest'. In defending the interests of domestic consumers, the consumer protection zeal of the regulator will be as significant as the statutory framework in which he/she operates. This has been exemplified in the past by the Director-General of Gas Supply, who has managed to compensate for the deficits in his legislative powers by adopting a vigorous and publicly-visible consumer advocacy approach to his relations with British Gas <sup>17</sup>.

(ii) Consumer protection - outcomes

*We have not been able to conduct a detailed examination of the new standards and codes, nor to examine their effectiveness or compare them with what existed before. We believe that they offer a prospect of improved standards of service, particularly if they are well published and enforced, but it is too early to assess their effectiveness.*

HoC Select Committee on Energy (1992a) para 28

As illustrated previously, the framework for protecting consumers from reductions in service quality in the privatised utilities has evolved around the three key instruments of codes of practice, overall and individual performance standards. This section will examine preliminary evidence on the quality-related outcomes of the privatised utilities from the perspective of domestic consumers, including an assessment of the extent to which these instruments appear to be working. It is still quite early days in the implementation of these measures and therefore much of the discussion needs to be qualified. In the case of British Gas, most of the relevant regulatory schemes have only been in place since April 1992 and hence information on their impact is obviously extremely limited at this point <sup>18</sup>.

At a macro level, public opinion data on the quality outcomes of the privatised utilities is ambiguous. In the three MORI surveys carried out in 1990 and 1991 for the National Consumer Council and in late 1991/early 1992 for OFWAT, there was evidence that the level of satisfaction with the overall service received from the utilities had increased over time (see Figure 7.10 overleaf). In contrast, the poll conducted by ICM for *The Guardian* in July 1991 indicated that the vast majority of respondents interviewed believed that the utilities had either remained the same, or got worse since privatisation (gas: 73%, electricity: 88%, water: 85%).

How satisfied are you with the overall service you receive from..			
	Net satisfaction %		
	March 1990	March 1991	Nov 1991- Jan 1992
British Gas	77	80	85
Local electricity supplier	77	78	83
Local water supplier	58	63	69

Source: NCC (1991a, p.13); OFWAT (1992h, p.2)

**Figure 7.10: Satisfaction with public utility levels of service**

The differences in these survey results might be explained by the nature of the questions put to the interviewees. In the ICM survey, people were asked to compare the performance of the utilities under private and public ownership, whereas in the MORI surveys, respondents were not asked to draw this comparison. Also the MORI survey question was focused on perceptions of service, while the ICM survey asked a more generic question which would have picked up people's reactions to factors such as price. In fact, when specific questions on price were included in the earlier MORI survey for the NCC (1990a) and in the OFWAT study, the level of customer satisfaction declined quite sharply.

A closer examination of the MORI survey data shows that responses to questions about the general and specific aspects of the performance of the utilities (most notably in relation to prices) vary according to variables such as social class and income. This is illustrated in data from the most recent MORI survey for the electricity and water industries in Figures 7.11 and 7.12 overleaf.

# ELECTRICITY

Consumer Satisfaction - MORI 1992

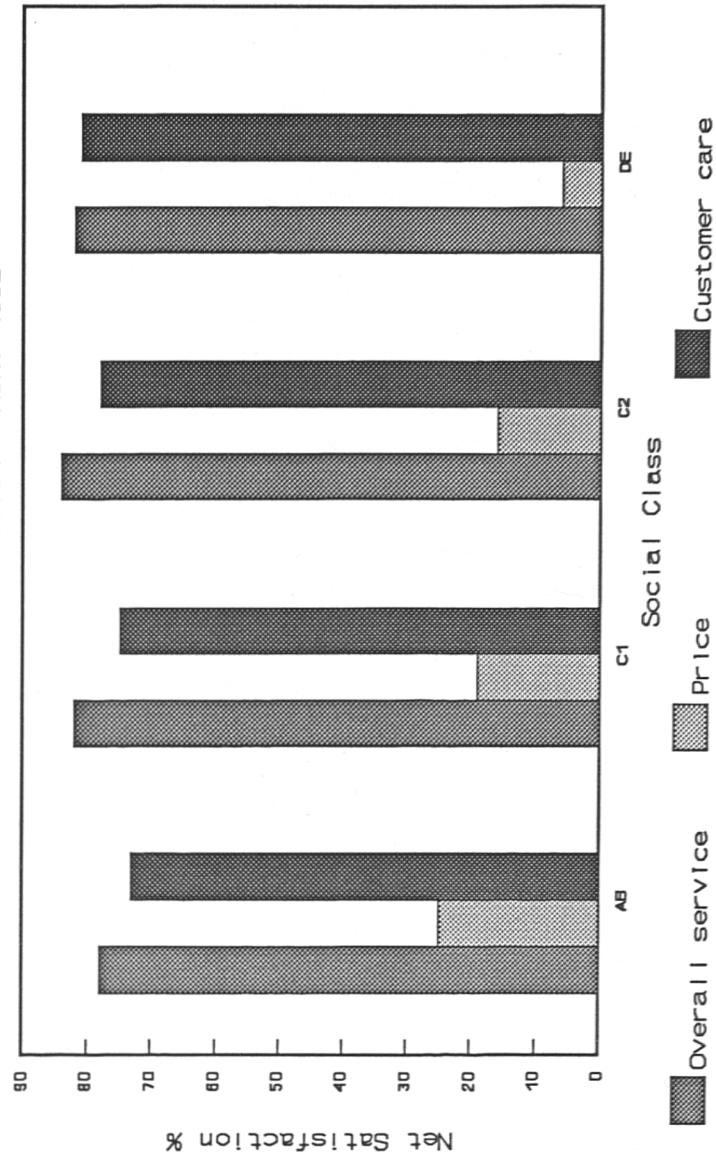


Figure 7.11: Consumer satisfaction by class: electricity

# WATER

Consumer Satisfaction - MORI 1992

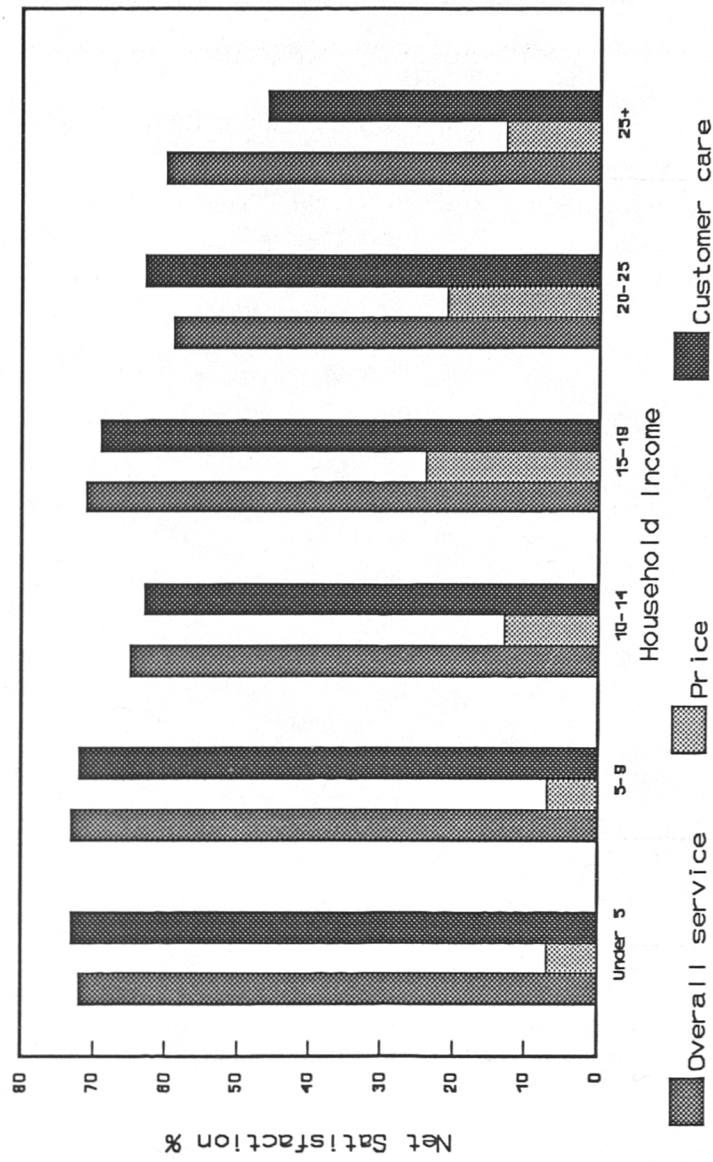


Figure 7.12: Consumer satisfaction by income: water

Another indicator of the performance of the utility industries might be found ostensibly in the volume of domestic customer complaints received by the regulators and their associated consumer committees over the past couple of years. The most recent published data is shown below, where it can be seen that the number of domestic consumer complaints has risen across all three utility industries over the last twelve months. Significantly, account or billing disputes constitute the largest category of complaints in all cases. The Gas Consumers Council has recently reported that complaints about British Gas have dropped by 7 per cent in the first half of 1992 compared to the same period in the previous year, which may indicate that the new service standards set in the tariff review are beginning to have some effect.

Consumer complaints to the regulatory bodies	
OFGAS:	Increased by 136% [918] in 1991 - largest single category of complaints: account disputes
GCC:	Increased by 4.6% [22,428] in 1991 - largest single category of complaints: gas bills
OFWAT:	Increased by 128% [8,748] between 1990/91 & 1991/92 - largest single category of complaints: charges or billing related
OFFER:	Increased by 19% [16,679] April 1991-March 1992 - largest category of complaints: disputed accounts
Sources: OFGAS (1992); GCC (1992); OFWAT (1992); OFFER (1992x)	

**Figure 7.13: Consumer complaints to the regulatory bodies**

While the data on increased complaints to regulatory agencies seems clear enough (with the recent exception of British Gas), attempts to draw general conclusions about the performance of the privatised utilities from it is fraught with hazards. The increase in complaints may have, for instance, as much to do with the increasing profile and visibility of the regulatory bodies as it does with the behaviour of the utility companies. This may well explain part of the increase in complaints to the newer regulatory bodies like OFWAT and OFFER. Conversely, formal complaints to regulators, or indeed to the industries direct, will not necessarily capture the full extent of dissatisfaction with service quality amongst consumers. This is particularly likely to be the case amongst low income consumers. In the OFWAT customer survey, for example, 17 per cent of customers with incomes below £5,000 stated that they were aware of the existence of the water regulatory body (only 2% of whom were able to name it), compared to 37 per cent of the full sample (15%) [MORI, 1992, Tables 251 & 253]. The study also found that the same group was far less likely to make contact with their local water supplier (8% compared to 20% of the full sample) [MORI, 1992, Table 37].

At a qualitative level, the evidence on standards of service in the privatised utilities is hardly conclusive, one way or another. This contrasts with the rather sharper outline of change in the areas of prices and debt and disconnection since privatisation. The Select Committee on Energy was unable to conclude, after its investigation into the consequences of electricity privatisation, whether the quality of service provided to the domestic consumer had improved or not. Positive accounts of the incipient transformation of the utility companies into customer care-driven organisations (e.g. Boys, 1992; Lockwood, 1991; United Research, 1990) need to be counterbalanced against the views of welfare rights and advice workers in the field (interviews with the researcher) and the experiences of a number of low income consumers themselves

(Birmingham Settlement et al, 1992), which suggest that at the level of day-to-day practice at least, very little appears to have changed. Indeed some organisations maintain that in certain cases service delivery has deteriorated. The National Right to Fuel Campaign in its evidence to the Select Committee on Energy concluded that "the standard of service provided by Public Electricity Suppliers has declined: there are more estimated bills..in some areas reduced staffing means long delays for telephone queries" (HoC Energy Committee, 1992b, p.82). And the electricity company with the most ambitious labour-shedding programme - Manweb - admitted that customer services had suffered initially as a result of staffing cuts, but claimed that this has since been rectified (interview with researcher, August 1992).

There are though, two common themes running through these seemingly contrasting evaluations - (i) that practice varies enormously between and even within the utility companies, and (ii) that considerable potential exists to improve the quality of utility service provision. For many people in the consumer and community sector the key to promoting 'best practice' is held by the regulators and resides in the way in which they optimise and carry forward their consumer protection function <sup>19</sup>. This will necessitate changes in regulatory instruments employed.

The regulatory instruments - codes of practice, overall and individual performance standards - in their original form are defective, both as a means of protecting the interests of domestic consumers generally and for protecting low income consumers in particular. The codes of practice lack sufficient regulatory clout (as evidenced by the failure of Condition H in the water industry) and most consumers are unaware of their existence - in part because many companies have been parsimonious in their approach to the dissemination of copies of the codes. In an ad hoc survey on the availability of



electricity codes of practice in company outlets in three cities, the National Right to Fuel Campaign found that "none of those visited in London or Manchester had any copies of the Codes, and in Liverpool only 25 per cent had copies" (Barbara Montoute in Preface to *Fuel Rights Handbook 1992/93*).

The standards of performance, particularly in the water and electricity industries, provide relatively unchallenging targets for the companies to achieve. A leading example of which is the untaxing electricity meter reading standard, and recently the Director General of Electricity Supply has flagged his intention to raise this standard (OFFER, 1992x). They have also been established with only minimal referencing to the views and service priorities of consumers, and doubts have been expressed about whether the standards actually address those areas of service of greatest importance to consumers themselves (e.g. National Right to Fuel Campaign, HoC Energy Committee, 1992b; OFWAT, 1992i). The requirement, added to the *Competition and Service (Utilities) Act*, after lobbying by organisations like the Consumers' Association and the National Consumer Council, that the regulators undertake consumer research prior to the setting of industry performance targets, should go some way towards rectifying this in the future.

The guaranteed standards of performance schemes seem to have had more force as public relations aids than as regulatory instruments designed to act as a deterrent to service failure. The water industry is the most striking illustration of this, where the total compensation paid out by all water companies in 1990/91 was less than £3,500 and OFWAT estimate that "no more than 1%-2% of customers eligible for payments submit a claim" (OFWAT, 1992y) <sup>20</sup>. The poor 'take up' rate in the scheme might be attributed, amongst other things, to the derisory level of compensation available. The

companies can, of course, award higher payments, but this is entirely at their discretion. British Gas has shown more imagination and responsiveness in this regard than the electricity or water companies. During the framing of the *Competition and Service (Utilities) Bill*, OFWAT sought to include a provision giving the regulators power to direct companies to award levels of compensation in line with the amount of damage or distress suffered by the customer experiencing service failure, but this was rejected by officials at the Department of Trade and Industry (OFWAT policy staff in interview with researcher, July 1992) <sup>21</sup>.

In recent reviews of the existing standards of performance in their industries, the water and electricity regulators have proposed a number of changes to the guaranteed standards schemes, including adding the requirement that companies make more specific appointment times and a doubling of the compensation payment in many instances (OFFER, 1992x and OFWAT, 1992i). The Director General of Water Services has also proposed automatic compensation in a number of cases and introduced several additional provisions, including compensation for flooding from sewers. Notably, he has removed two inequitable aspects of the original scheme - the barrier to tenants, and customers more than six weeks in arrears, being compensated under the scheme.

On the whole, the provisions of existing guaranteed standards schemes are weighted substantially towards the interests of middle class consumers. This is not meant to suggest that aspects of service delivery like the keeping of appointments and replying to correspondence are irrelevant to low income households, but that there are other aspects of their relationship with the utilities that are likely to take precedence.

This was underlined in the OFWAT customer survey, where for example, low income consumers showed less interest in specific appointment times than did more affluent

consumers in the sample, but expressed a higher degree of dissatisfaction with the choice of payment arrangements than other income groups.

During the passage of the *Competition and Service (Utilities) Bill* in the House of Lords, a NACAB-initiated amendment to require the regulators to prescribe standards of performance specifically relevant to the needs of low income consumers was rejected by the Government on the grounds that "..under this Bill the directors general can already set standards for any groups they choose, so that in effect the amendments would give the directors general no greater powers than they already receive under the Bill" (Lord Reay, HoL, 5/3/92, col. 1030).

Amongst the regulators, only the Director General of Gas Supply has shown any inclination thus far to exercise these latent powers. As part of the tariff review, the regulator introduced a standard requiring British Gas to be more proactive in its efforts to assist customers in debt:

*No later than 3 months after an unpaid bill has been despatched, clear action will be taken in accordance with Condition 12A to prevent debt build up.* British Gas (1992e, Key Standard No. 27), p.12.

The other two regulators have resisted proposals made by the Public Utilities Access Forum (e.g. PUAFF meeting 22/9/92), to introduce company performance standards specific to low income consumers. Although the hand of the water regulator may be forced in this respect, if implementation of the voluntary guidelines on debt and disconnection fails to have the desired effect.

(iii) Consumer representation

In the context of monopoly supply of essential services, it is important that domestic consumers be given structured opportunities to influence the policy and practice of the utility industries. In the absence of conventional consumer prerogatives, such as the power to exercise choice and the ability to adjudicate on service quality through changing supplier, formal mechanisms for representing and articulating the interests of consumers become a form of consumer sovereignty proxy.

Effective consumer representation is also vital to the integrity of the regulatory system. Without regular consumer input, the regulators are likely to become detached from the concrete concerns of the users of utility services. Unless the perceptions of the utility industries are counterbalanced by the views of consumers, the information asymmetry problem endemic in regulation will become more acute. Consumer representation should act, in effect, to keep the regulators honest and accountable; an objective that is rendered all the more important in the prevailing situation where the regulators' responsibility for protecting the interests of consumers is secondary to other concerns.

Privatisation provided an opportunity for the extant structures of consumer representation in the nationalised industries to be substantially revised and enhanced. This was most particularly the case in the water industry, where the industry-dominated local consumer committees established under the 1983 *Water Act* were viewed, almost universally, as desultory and defective mechanisms for consumer representation.

As Chapter 1 has shown, there was considerable debate during the passage of the privatisation legislation about the most appropriate consumer representation model, with the consumer movement (the Electricity Consumers Council apart) arguing strongly for the creation of national, industry-specific bodies independent of the regulator. This model was adopted for the gas industry, but displaced in the subsequent water and electricity privatisations by a regional, integrated-with-the-regulator's office approach. More recent attempts by the National Consumer Council and the Consumers Association (during the passage of the *Competition and Service (Utilities) Bill* (see HoC, 16/1/92, col.1129) and the Energy Committee (1992a, para 138) to have the Gas Consumers Council model replicated in the water and electricity industries have not been successful.

While the dichotomy is usually drawn between the GCC model and the rest, it is possible to identify subtle differences in the structure and operation of the consumer committees in the water and electricity industries, which might suggest that there are three, rather than two, operational models of consumer representation in the privatised utilities. Recent changes in the way that the OFWAT CSCs operate, with for example the chairs taking on an executive function (involving the supervision and appraisal of secretariat staff, and a degree of delegated control over the committees' budgets), distinguish them further from their ostensibly 'look alike' counterparts in the electricity industry. The three models of consumer representation is shown in Figure 7.14 overleaf.

In addition to different structural arrangements, there appear to be significant differences in the style of the consumer representation bodies. This is exemplified in the contrast between the customer service committees (water) and the consumer committees (electricity). The OFWAT committees have the reputation of being much more open, domestic consumer-focused and independent than those in the electricity industry.

The latter rarely publicise their meetings, limit the distribution of agendas and relevant papers and do not encourage non-member attendance and participation (the London electricity consumers' committee is the one apparent exception to this). The quality and content of the annual reports of the two sets of committees also reflect a very different philosophy of information dissemination and openness <sup>22</sup>. The national council meetings of the Gas Consumers Council are not open to the general public.

<b>Consumer representation in the Utilities</b>	
<i>Gas Consumers Council</i>	<i>national structure with regional branches; organisationally separate and independent of the regulator; budgetary and staffing control; functions: policy advice, advocacy, research, complaints handling; aspects of 'consumer brief' wider than that of the regulator; national council members appointed by the Secretary of State for Trade and Industry</i>
<i>CSCs - OFWAT</i>	<i>regional structure (CSC secretariat); ad hoc national forum of CSC chairs; structurally linked to regulator; CSC chairs exercise limited budgetary and staffing control; functions: policy advice, advocacy, complaints handling; members appointed by the Director General on the recommendation of the CSC chairs</i>
<i>CCs - OFFER</i>	<i>regional structure (OFFER regional offices service committees); legislative requirement for national forum of chairs (National Consumers' Consultative Committee); no budgetary or staffing control; functions: policy advice, advocacy, complaints handling, delegated determination powers; members appointed by the Director General on the recommendation of the CC chairs</i>

**Figure 7.14: Consumer representation in the utility industries**

Despite the virtual unanimity of support within the consumer movement for the structurally independent model, the superiority of this approach to consumer representation is not necessarily as self-evident as many of its proponents seem to suggest.

Manifestly, the siting of consumer committees within the structure of the regulator's office presents significant threats to the autonomy and independence of action of these committees. And the experience of at least one of the committees in the water industry, where the regulator attempted to exercise a degree of censorial control over the sensitive issue of metering (interview with researcher, September 1992) <sup>23</sup>, is illustrative of the inherent tensions in the unitary model of regulation and consumer representation.

But it does not follow that the existence of these tensions make the model unworkable, or should cause it to be dismissed out of hand.

While the regulatory body locus for consumer representation presents problems, it also brings with it particular advantages. Among other things, it structurally reinforces the regulator's responsibility for social as well as economic regulation and it should make for a freer two-way flow of information between the regulator and the consumer committee than would be the case were the bodies are organisationally separate. But most important of all, the presence of the Director General in the background, potentially places the consumer committees in a far stronger position of influence with the regulated companies than would otherwise be the case. Certainly it would seem that the Customer Service Committees in the water industry believe this to be the case <sup>24</sup>.

The performance of the Gas Consumers Council and OFGAS (the archetypal model favoured by the consumer movement) partly confounds and partly supports the arguments above. The record of the Gas Consumers Council shows that generally it has been able to use its independence to good effect on behalf of domestic and industrial/commercial gas consumers; as evidenced for example in its role as a catalyst for Condition 12A and in the OFT review of British Gas' industrial market. However, despite its structural autonomy, the GCC has had to exercise caution in deviating from the policy positions of the Director General of Gas Supply (let alone openly criticising him), for at the end of the day, it has been substantially reliant upon him to provide the regulatory leverage to effect change in the gas industry.

It would seem that the Director General of Gas Supply has not required the presence of consumer committees within his own organisation to alert him to his responsibilities for social regulation. But as Sir James McKinnon has become more involved in the affairs of domestic consumers, the respective roles of OFGAS and the GCC have become increasingly blurred and difficult to disentangle. This gives rise as a consequence to the danger of either duplication in the functions of the two bodies (e.g. in handling consumer complaints), or to the possibility that a vacuum will be created in some areas, as both bodies incorrectly anticipate that the other will take action in particular instances. Something similar to the latter occurred after the introduction of Condition 12A, where OFGAS assumed that the GCC was pursuing the monitoring of British Gas' implementation of the new code of practice (and vice versa), with the effect that there was an unwarranted delay in the follow up action on this important licence change.



Regardless of the debate over which set of structural arrangements constitute the best model, the efficacy of consumer structures will hinge ultimately upon the extent to which they (i) marshal the support and participation of the major groupings within the domestic consumer population (i.e. their representativeness), (ii) provide a proactive, independent and informed analysis of the policy and practice issues at the centre of the consumer-utility interface and (iii) are able to back up their advocacy with powerful enough sanctions so that the industries take them seriously. And each of the existing consumer structures in the three industries, as they are presently constituted, is deficient in one or more of these respects.

The composition of the OFWAT customer services committees is shown on the next page. The CSCs have been chosen, not because they are better or worse than the other bodies, but simply because in contrast to the others, information on the backgrounds of the members of each of the CSCs is published in their *Annual Reports*. It can be seen from Figure 7.15 that the proportion of members with a background in business or commerce is high relative to those with experience in consumer advocacy organisations. The composition of the electricity consumer committees is unlikely to be any different in this respect; for a similar profile of strong business representation juxtaposed against a smaller base of members with consumer advocacy experience is indicated in the two electricity consumer committee annual reports where membership information is provided (there are, however, a larger number of members from the pre-existing nationalised consumer structures on the electricity committees). The absence of direct representation from low income consumers and minority groups is characteristic of the water and electricity consumer committees, as well as the Gas Consumers Council. In recent times, the water and electricity regulators have both declared an interest in broadening the representative base of the consumer committees.

Composition of the 10 OFWAT Customer Service Committees	
	% of all members (n=122)
Female members	34 [2 out of 10 chairs are women]
Non Anglo-Saxon background	1
Consumer organisation background	15
Community organisation involvement	37
Current or ex-local government	27
Associated with water industry	11
Business/commerce background	37
Farming background	7
Academics	6
Declared interest in disability	3
Note: CSCs as at 31/3/92	
Sources: CSCs Annual Reports (1992)	

**Figure 7.15: Composition of the Customer Service Committees**

The National Consumers Council and NACAB, amongst others, have argued that the brief of the regulatory body consumer committees and the Gas Consumers Council should be restricted to protecting the interests of domestic consumers only. This is based on a view that industrial/commercial consumers often have the means and the structures to influence the utility industries and the regulators independently of the formal consumer bodies. There is also a belief that the mandate encompassing all consumers creates an inherent conflict of interest for the committees, with the consequential fear that the interests of the least powerful and most disadvantaged will be overlooked.

As in any consumer representation process, the level of resourcing and support given to the committees impacts directly on the effectiveness of their work. To date, very little attention seems to have been given to the need to provide training to the members of the electricity and water consumer bodies, despite the fact that the majority of members appear to have had little background and experience in the area of consumer advocacy.

The difficulties faced by relatively inexperienced consumer representatives in the complex terrain of the regulated industries was amply illustrated in the electricity consumer committees' inauspicious encounter with the first drafts of the codes of practice. In 1990, the Director General gave the newly-established committees the task of examining the draft codes of practice produced by the RECs, which they subsequently endorsed. Following an outcry from external consumer organisations about the quality of the codes, the Director General - against the earlier advice of his own consumer representatives - sent them back to the companies to be re-written. This incident affected the confidence of the committees and severely dented the credibility of the committees in the eyes of the consumer movement. The Energy Committee recommended that the Director General of Electricity Supply examine the level of training and information provided to the OFFER consumer committees (HoC Energy Committee, 1992, para 138).

The electricity and water committees are serviced by the regional staff of OFFER and OFWAT respectively; but unlike their peers in the gas industry, they have no capacity to commission research at a local level on consumer matters. The complaints handling function of the committees provides an extremely useful casework data-base on consumer concerns, but without a research budget, they are limited in their ability to explore issues in greater depth, or to investigate areas of utility policy and practice independent of those identified by the regulatory agencies. Also in the absence of

resources for research, the committees have little capacity to check the verisimilitude of the information provided by the local utility companies. One of the criticisms levelled at the electricity consumer committees is that their analysis of the utility-consumer interface is too heavily dependent on the information provided by the RECs themselves (interviews of consumer sector workers with researcher, July-August 1992).

The British regulatory system has been criticised on the grounds that it is excessively secretive and closed, and certainly it suffers by comparison with the more open approach to regulatory decision-making that is generally found in the United States (as Chapter 3 showed). However, for all this, a greater degree of regulatory transparency - from the perspective of the ordinary consumer - now exists than was the case when the government acted as the regulator of the utilities. Despite the fears enunciated in Chapter 3 about the possible impact of privatisation on the availability of information, there appears to be more information about the operation of the utility industries in the public domain than there was hitherto. And the quantity and quality of data on the industries, being produced under the auspices of the regulators, could be seen as one of the emerging strengths of the post-privatisation regime. In this respect, the Office of Water Services is somewhat ahead of the field.

The availability of better information on the operation of the utility industries means that the scope for consumer bodies to comprehend, and hence to influence, the policy context in which the utilities operate has probably increased over recent years. Arguably, the consumer committees directly attached to the regulatory agencies (i.e. the OFWAT and OFFER committees) have an information edge over the Gas Consumers Council, as they are more likely to be privy to 'in house', and possibly even commercially sensitive, information in addition to that released for public consumption.

Although the Directors General of Electricity Supply and Water Services convene regular meetings (usually quarterly) of the chairs of the committees, these national fora have yet to develop any real visibility or force. It is unlikely that this will happen until such time as they are given, or take, a more substantive and independent role in the overall regulatory framework.

The potential exists for more effective consumer representation under the regulated utilities than was the case when they were nationalised. This is almost entirely due to the buttressing function of the regulatory agencies in support of formal consumer interactions with the utilities. The Gas Consumers Council has realised some of this potential, yet whether this can be attributed to its independent status or to its superior resource base (compared to the other bodies) is debatable. The scope for this potential to be realised in the more recently established water and electricity committees is uncertain, although the signs look somewhat more propitious in the former - largely due to their more open style - than they do in the latter.

## GENERAL CONCLUSION TO THE CHAPTERS ON THE CONSUMER INTEREST

On the evidence available to date it would be impossible to conclude that the Government's bold prediction, at the time of privatisation, that consumers would benefit in terms of lower prices and better services, has been realised. Equally, the evidence does not support the conclusion, sometimes drawn by political opponents of the Government, that privatisation of the public utilities has been an unmitigated disaster.

The outcomes for consumers in general, along the four key dimensions of prices, debt and disconnection, consumer protection and consumer representation, appear to have been mixed. For the average consumer, privatisation has been the proverbial 'curate's egg', with a gain in one area seemingly counterbalanced by a loss in another. There is clear evidence, however, that low income consumers have been affected more adversely than the generality of consumers, primarily as a result of rises in water and electricity tariffs, but also because there has been a failure to recognise their particular needs in the formulation of service standards. Even in the area where low income consumers appear to have done best - i.e. energy disconnection practice - the gains may turn out to be illusory, if the changes effected lead to an increase in the incidence of self-disconnection.

In a number of instances where negative outcomes for domestic consumers have been apparent, it is difficult to separate out the 'privatisation effect' from other contextual variables. This is exemplified in the changes to water tariffs; although even here there is strong evidence to support the view that consumers have been paying a 'privatisation premium' in their water bills over the past five years.

The same problem of delineating the 'privatisation effect' holds with even more force in those areas where positive outcomes have been achieved. The structural changes to the utilities may well have blown away some of the debris accumulated over decades of nationalisation. Yet clearly factors such as declining gas and coal purchase costs (not all the benefits of which have been passed through to domestic consumers) and technology (in the ambiguously beneficial area of prepayment meters) have made an important, and from the Government's point of view timely, contribution. Also against the backdrop of rising consumer expectations, it was probably inevitable that the utility industries would be required to respond to the demand for improved services, irrespective of the variable of ownership change.

But unequivocally the primary force for change has been the influence of the regulatory bodies. To this extent, the results of the utility privatisation programme to date also illustrate a striking paradox. In that the developing framework of stronger protections and procedural rights for utility consumers, has been constructed using the instruments of the State (i.e. public intervention via the regulatory bodies), with the 'invisible hand' of market forces playing very much a secondary, and by no means always a supportive, role.

The contribution of the regulators has not, of course, been uniform. The Director General of Gas Supply and the Director General of Electricity Supply could be seen to represent the two ends of a continuum of regulatory effort on behalf of domestic consumers; a continuum ranging from tenacity to torpidity. The water regulator appears to fall somewhere in between.

The prospect for future changes to the advantage of domestic consumers will also be substantially conditioned by the character and vigour of regulatory intervention. In the case of gas, this will depend as much on the deliberations of the Monopolies and Mergers Commission as it will on the strong advocacy of the gas regulator. The Director General of Water Services' incremental incursions into the capital structure of the water companies and his positioning of consumer concerns towards the forefront in the Periodic Review could be interpreted as a positive sign for domestic consumers. Although, his commitment to full economic pricing - in which metering is seen to occupy a central place - may act to negate any future gains for domestic consumers under revisions to the price formula. The ability of the electricity regulator to secure a improved settlement for domestic consumers could well be retarded by his implicit faith in the power of the market to advance the consumer interest.

The broader implications of the outcomes of the first phase of utility privatisation are considered in the next Chapter.



## ENDNOTES TO CHAPTER 7

1. A fourth important factor - the impact of energy efficiency measures - has been excluded from the discussion here as it is well documented elsewhere e.g. Boardman, 1991a, Boardman, 1991b, Boardman and Houghton, 1991.

2. "Mr Barclay [Social Security Advisory Committee chairman] said water rates although seemingly a small sum, were a cause of growing concern to income support claimants as a significant part of weekly outgoings; water rates had increased by nearly 16 per cent over the past year, but income support only by 7.6 per cent". *The Guardian*, 1/8/90

In its report *Direct Deductions and Water Charges* (October 1990) the Social Security Advisory Committee recommended:

*..that an early opportunity should be taken to increase the rates of income support by an amount greater than would otherwise be the case in recognition of the increasing burden caused by the exceptional rise in water charges. p.16*

3. In 1991/92, Welsh Water had the highest rate of disconnections amongst the 10 water and sewerage companies. This is despite the fact, according to OFWAT consumer affairs division staff, that the company is probably the most progressive in the country in its approach to assisting low income customers in debt (interview with researcher, September 1992).

4. Disconnection figures for the 29 statutory water companies over this period are not available. In 1988/89, the total number of disconnections (domestic & non-domestic) carried out by these companies was 6037. This had fallen to 3531 in 1989/90. OFWAT (1990).

5. *Whether or not the 17,710 customers disconnected without making contact with British Gas genuinely wanted to forfeit their rights to sympathetic treatment, or would have preferred to discuss a means of keeping their supply, is not known. Until more light is shed on this issue, OFGAS cannot be satisfied that the arrangements under Condition 12A are working as they should. OFGAS (1991) Section V*

6. It is usually argued that prepayment meters provide savings compared to credit payment (e.g. in terms of interest foregone). With the cashless token meters, which are now becoming the norm, consumers pay for their gas in advance when they purchase the tokens. In the gas tariff review, however, OFGAS after analysing British Gas figures on the cost of operating token and coin meters ".. found no justification in the representations made that token meter costs are less than those of coin meters, and that token meters should therefore be accorded special treatment". At the same time, the regulator acknowledged that "..further work is necessary to study the difference in structure and level between the prepayment and credit tariffs currently used by British Gas". OFGAS (1991c) p.9

7. The RECs have an added incentive to extend the use of prepayment meters because currently "the additional revenue associated with the provision of these meters is treated as an excluded service and is not subject to the supply price cap" (OFFER, 1992y, p.38).

8. NACAB has cited this as being a particular problem for electricity consumers in rural areas (NACAB, 1991b). In his response to the NACAB submission, the Director of Consumer Affairs, OFFER, stated:

*I am particularly concerned by the suggestions that key/card meters are being forced on customers who live significant distances from dispensing machines or who have mobility difficulties. OFFER (1991)*

9. In their study of the operation of the social fund, Huby & Dix explored aspects of the budgeting behaviour of the low income household sample who had applied to the social fund. Electricity and gas bills were "the second most common concern identified by respondents". Like the Birmingham & Bristol study there was evidence of "the prepayment meter as 'double-edged' sword" i.e. - budgeting device and source of self-disconnection:

*The constant need to economise was an inherent part of managing income. This was sometimes achieved by imposing limits on consumption. Fuel consumption, for example, could be set to a maximum of £10, run on fuel cards. Throughout the week efforts would be made to stay within that limit. For many in-depth interview respondents, the amount they chose to pre-allocate provided only a minimal supply which was controlled by going without heating for parts of the day, not using the central heating at all, sitting in the dark in the evenings, or going to bed early. p.27*

10. The water industry has adopted the term "budget meter", because according to the Director of Consumer Affairs OFWAT, as most water bills are paid in advance, the term prepayment meter has no real currency (PUAF meeting, September 1992).

11. Severn Trent experienced strong resistance from the Birmingham City Council and had to delay the commencement of the trials on a number of occasions. A £26 fee will be levied on customers using the meters (payable at .50p per week). According to OFWAT staff, the company has made a very poor fist of the trials thus far (interview with researcher, September 1992). Severn Trent was awarded a "Chartermark" by the Prime Minister for its prepayment experiment in late September 1992.

12. The Scottish fuel poverty lobby organisations, Right to Warmth and Fuel Policy Forum, have documented the major stages in the debt collection and disconnection process (which is essentially the content of the codes) for Scottish Power and British Gas in their recent publication *Paying for Fuel* by Rachel Harrison.

13. "Consumerism is defined as the organized reaction of individuals to inadequacies, perceived or real, of marketers, the marketplace, market mechanisms, government, government services, and consumer policy." Forbes, 1987, p.4 The term, as applied in this thesis, incorporates this dimension, but is used more broadly to characterise the relationship between the individual and the market in the satisfaction of wants.

14. In water and electricity, the levels of fixed payments for breaches of the individual standards were set originally by the Government. However subsequently, the regulators have the power to apply for variations in the level of payments, as well as for variations in the provisions of the guaranteed standards schemes themselves. In late September 1992, the Director General of Water Services made an application to the Secretaries of State for the Environment and Wales for modifications to the scheme in the water

industry. This included a request that the level of compensation in some cases be increased (OFWAT, 1992x).

15. OFGAS' ambivalence about the re-framing of the regulators' powers under the *Citizen's Charter* was commented on by an officer from one of the other regulatory bodies who was a member of the steering group set up by the Department of Trade and Industry to draw up the legislation:

*They were rather reluctant, they thought they had achieved all that they'd wanted in the tariff review.* Interview with researcher, July 1992.

16. Until the advent of the *Competition and Service (Utilities) Act* the electricity regulator was generally perceived to have the most developed repertoire of consumer protection powers and the provisions of the *Electricity Act* were used as the reference point for 'levelling up' the powers of the other three utility regulators:

*In most respects the electricity regulator, as the latest to be established, has the best powers. So part I brings the powers of the telecom, gas and water regulators up to the level of that of the electricity regulator.*

Peter Lilley, Secretary for Trade and Industry in Second Reading speech, Competition and Service (Utilities) Bill, HoC, 18/11/91, col.41

17. Chapman (1990) describes the Director-General, James McKinnon, as the joint holder along with Professor Bryan Carlsberg (OFTEL) of the "prize for the most combatative and most visible of the regulators". p.121. He also eulogises the "British gas consumer has good cause to thank James McKinnon..But for him gas prices would be higher, and British Gas would still be sheltering behind the protective monopolistic shell with which the Government foolishly endowed it upon privatisation". p.122

18. The Director General of Gas Supply initiated a review into the British Gas service package at the end of June 1992. The results of the review are due to be announced towards the end of the year (OFGAS, Letter to agencies on Monitoring and Review of British Gas' Standards of Service, 29/6/92).

19. The Select Committee on Energy concluded similarly about the electricity industry.

20. In the ESI for the year ended June 1992, the amount paid out under the Guaranteed Standards scheme was £155,610 (13,711 payments), which "shows that these payments have not so far represented a significant cost to the RECs" (OFFER, 1992y, p.32).

21. OFWAT's interest in the issue was stimulated by Southern Water's rejection of the Director General's recommendations on the awarding of compensation in two cases of foul flooding in 1991 (see OFWAT, 1992, p.25). In July 1992, the CSC chairs issued a press release calling for stronger compensation powers for the regulator (OFWAT, 1992i).

22. None of the Electricity Consumer Committees 1991/92 Annual Reports were in the OFFER library (30/7/92), which possibly may be symbolic of a different attitude to consumer committees compared to OFWAT, who diligently collect and disseminate theirs.

Only about half of the 12 Electricity Consumer Committees seem to have produced Annual Reports in 1990/91 (going by the content of the OFFER library); most of which

are amateurish little productions (often stencil-type, small, distinctly unglorious). A summary of the activities of the ECCs are, however, contained in the Director General of Electricity Supply's annual reports. The Select Committee on Energy recommended that "the [National Consumers' Consultative] Committee publish an annual report separate from the Director General's, containing the reports of individual committees and commenting on the Director General's work where appropriate" (1992a, para 138).

23. According to the chairperson of one of the CSCs, the Director General of Water Services reacted angrily to the committee's advocacy of alternatives to the compulsory metering of new domestic properties and tried unsuccessfully to persuade the committee to change its view.

24. The issue of structure was debated at a recent meeting of the CSC chairs and according to one of the participants, the chairs strongly supported the retention of the existing integrated structure because they believed that it placed them in a stronger bargaining position with the water companies (interview with researcher, September 1992).

## CHAPTER 8: PUBLIC UTILITY PRIVATISATION IN PERSPECTIVE: POLICY AND PARADIGM CHANGE

### INTRODUCTION

The previous three chapters have shown that a substantial hiatus exists between the promise and delivery of privatisation in the field of energy and water services, up to this point in time. One of the explanations for this can be traced to the flaws in the terms of the privatisation settlement, set by the British Government over the period 1986 to 1991. But even more importantly, the current, and in all probability the continuing, gap between the rhetoric and reality of utility privatisation may suggest that there are endogenous and irresolvable problems in the model of privatisation and in the paradigm of consumerism as applied to the provision of essential services like water and electricity supply.

At the same time, the privatisation of the public utilities has been attended by a number of positive outcomes for domestic consumers, particularly in the area of explicit service standards. As illustrated in Chapter 7, these gains could be largely attributed to the influence of independent regulation; although it would be churlish to deny any part in this by the utility companies themselves, in their drive for a greater level of 'customer consciousness'. In substance though, the positive results of the privatisation programme underline the important function that independent regulatory bodies can play in utility policy-making and organisation. And this is likely to be the case irrespective of the ownership and structural configuration of the utility industries.

This concluding Chapter will seek to draw together a number of the primary threads in this thesis by answering two sets of questions which get to the nub of the issue of privatisation of the public utilities in Britain, namely (i) what are the limitations in the privatisation settlement and the model of utility privatisation and how might these be corrected?, and (ii) is the paradigm of consumerism appropriate to the domain of public utility services or should it be replaced with an alternative paradigm of citizenship?

## **PART 1: THE LIMITATIONS IN THE PRIVATISATION SETTLEMENT AND MODEL**

In assessing the character of the privatisation settlement and the efficacy of the model of utility privatisation introduced in Britain, it is necessary to make a distinction between the outcomes of privatisation at the point of sale on the one hand, and those that have arisen subsequently as a result of the implementation of the privatisation regime, on the other.

As Chapter 5 showed, the financial settlement 'negotiated' by the Conservative Government on behalf of British taxpayers during the sale of the three utilities was defective in a number of significant respects. As such it would be hard to conclude other than that the sale of the utilities represented a net financial loss to the British public (both in terms of current valuation of assets and future revenue stream) and importantly, that the management of the share flotation programme had adverse distributional effects. Despite the negative outcomes of the sale process for the British population at large, there is little from a public policy perspective than can now be done to correct this earlier failure, other than the politically unsustainable action of renationalising the utility companies without compensating shareholders. However, the "social welfare losses involved in the transfer of money from the state (i.e. UK citizens) to those who obtained shares" (Waterson, 1988, p.129) does provide a salutatory lesson to the British Government and to governments elsewhere about how not to proceed with privatisation sales in the future.

In contrast, the impact of the post-sale enactment of the privatisation model warrants further analysis, both because the outcomes in some instances are more equivocal than is the case with the privatisation sales and because there is scope for introducing policy changes aimed at correcting existing defects. In this section, four major features of the privatisation settlement/model introduced in Britain will be briefly discussed; namely (i) the financing rules of the utility companies, (ii) the regulatory framework, (iii) competition assumptions, and (iv) market-led utility policy making. These features reveal problems both in the original privatisation settlement and in the way that the current model of public utility privatisation has evolved over time.

(i) The financing rules of the utility companies

Under a privatised model of public utility practice, the price - and hence the affordability - of utility services is ultimately conditioned by the financial structure within which the utility companies operate. Consequently, policy action aimed at influencing or moderating utility tariffs (other than through direct public subsidies) can not be pursued in isolation from the question of what constitutes an appropriate set of financing rules for private utility providers. These financing rules include such matters as allowable rates of return on capital, efficiency targets, capacity to 'pass through' purchasing and other costs, and the 'ring-fencing' of expenditure on core areas of service provision from non-core activities (diversification).

In Chapter 6, it was shown that the terms of the original settlement between the Government and the privatised companies substantially favoured the companies, particularly in respect to the setting of inflated rates of return on capital, unchallenging



efficiency targets, and generous provision for cost-pass-through (with the exception of the RECs over the first three years of privatisation in the case of cost-pass-through). This has resulted, as a consequence, in artificially high tariffs for consumers and substantial profits for the companies.

The 'privatisation premium' that utility consumers have been paying over the past several years could be viewed as a follow-up to the income transfers made to company shareholders at the time of privatisation; although this time as consumers rather than taxpayers.

The key to the formulation of 'fair' utility tariffs for domestic and other consumers (i.e. where benefits are evenly distributed between consumers and shareholders) lies in a trilogy of measures involving (a) the determination of rates of return on capital which recognise the low risk and relatively secure customer base of the utility industries, (b) the setting of targets which directly reflect the assumptions on efficiency gains to be achieved through conversion to plc status, and (c) the structuring of cost-pass-through provisions in a way that provides an incentive for economic and efficient purchasing. The Government singularly failed to apply these measures at the time of privatisation for each of the three utilities.

In their various ways, the three utility regulators have expressed muted criticism of the privatisation settlement (OFGAS, 1991d; OFWAT, 1992o, 1992z; OFFER, 1992y). In the last eighteen months, the gas and, to a lesser extent, the water regulator have taken action, via adjustments to the price formula, aimed at striking a better deal for tariff customers.

The Director General of Water Services has been somewhat more explicit in his criticisms of the original set of financing rules than have his regulatory colleagues, presumably because under the original price formula in the water industry he has been presented with the difficult task of 'selling' continuing tariff increases well above the rate of inflation. But it may also have something to do with the more open communication style that he has adopted. The water regulator has foreshadowed major changes following the 1994 Periodic Review of the price formula, although it remains to be seen whether these can be delivered. It would be most surprising if the electricity regulator did not seek likewise to stiffen the efficiency targets for the regional electricity companies in his reviews of the supply and distribution price controls. To this extent, the corrective action of the regulators could well represent a triumph for independent public regulation over political expediency and the accumulation zeal of private enterprise.

It is by no means certain that regulatory action will continue to move irresistibly in a direction favouring domestic consumers over the longer-term, however. The regulated companies, shareholders and the City are likely to become increasingly restive about what they perceive as 'over-regulation' (see, for example, *Investors Chronicle*, 8/5/92; *Financial Times*, 31/7/92; BG chairman, Robert Evans in *The Observer*, 15/11/92).

Some commentators are already claiming that the modest advances made by the regulators breach the "regulatory bargain" struck between the government and shareholders at the time of privatisation:

*regulators..are railing against the original regulatory bargain by progressively edging the rules against the utilities. Veljanovski (1991) p.22*

(ii) The regulatory framework

The merits in overlaying the operation and management of public utility services with a system of independent public regulation is probably the most positive lesson to have emerged thus far from the privatisation programme. Although the regulators have been hamstrung by a defective structure, they have been able to forward the case of the general consumer interest. This is not to suggest, however, that all of the utility regulators have been equally vigorous or effective in championing the cause of domestic consumers, let alone that of low income households (as illustrated in the previous two chapters). Indeed the variability in the performance of the regulators - which relates, in large part, to how they interpret and balance their statutory duties - is an endemic weakness in the British model of regulation.

The model of public utility regulation in Britain has evolved considerably over the life of the privatisation programme. From its beginnings in the Office of Telecommunications and the Office of Gas Supply as a limited device for price regulation and an even more limited device for social regulation, it has been re-shaped, over time, into a rather more comprehensive vehicle for economic regulation and consumer protection. The fact that this has occurred owes at least as much to the energy and dynamism of the leading regulators (particularly, the past Director General of Telecommunications and the Director General of Gas Supply) as it does to the graduated refinement of the statutory framework in later privatisations. As suggested previously, the need to introduce legislation to supplement the powers of the regulators, well after the last of the three privatisations had been concluded, could be seen as an implicit admission by the Government that the regulatory structure introduced as part of the privatisation settlement was inadequate to the task.

Under the *Competition and Service (Utilities) Act 1992*, the powers of the four utility regulators (including OFTEL) have been standardised and this is likely to lead to a more uniform approach to consumer protection across the utility sectors in the future. A 'best practice' model constructed from the existing strengths of the regulatory bodies would incorporate the advocacy and community outreach/networking attributes of the Office of Gas Supply with aspects of the decisional transparency and information dissemination of the Office of Water Services and, to a lesser extent, the Office of Electricity Regulation. OFWAT's practice of publishing MD letters and comprehensive comparative pricing data, and OFFER's excellent customer accounting statistics are features which should be replicated by all of the regulatory bodies.

Despite a sense of progression in the development of the regulatory framework, and notwithstanding the endeavour of the individual regulators and their staff, the British model of regulation continues to display a number of serious flaws which serve, in aggregate, to denude its strength in the field of consumer protection. These include (i) the treatment of the consumer interest as a secondary and contingent dimension of regulation, (ii) the absence of a specific requirement to protect low income consumers, (iii) the limited power of the regulators in respect to strategic development and management of utility industry resources, (iv) variable transparency of decision-making, and (v) the opaque lines of regulator accountability. It will be recalled from Chapter 1 that each of these areas was identified, in one form or another, as substantive gaps in the regulatory system by community and consumer sector organisations at the time of privatisation. The fact that they remain unresolved indicates that the degree of regulatory progression is nowhere near as great as it may seem at a superficial glance.

It could well be argued, by the Director General of Gas Supply for instance (see for example, OFGAS Annual Report 1991, p.8), that the absence of formal powers in each of these areas is essentially academic, as he has been able to achieve progress in most of them despite the apparent deficiencies in the regulatory framework. And that the virtue of the British model lies in its ability to adapt to the particularities and circumstances of each of the utility sectors at any given point of time. But the weakness in this argument is that the scope and strength of the regulatory regime is substantially dependent upon the character, values and capacity of the Director General. In the hands of a Sir James McKinnon this may present no real difficulties, but in the hands of a lesser regulator, it is may well expose domestic consumers to considerable risk.

Each of the five problems in the existing regulatory structure, mentioned above, have been considered at some length in Chapter 3, and hence it is unnecessary to reproduce those arguments here. However, two issues require additional comment - the absence of a specific duty to protect low income consumers and the constraints on regulatory involvement in strategic policy-making - the first in the light of the material in the previous two chapters, and the second as a result of recent events in the coal industry. This latter issue is considered in section (iv) below.

During the passage of the *Competition and Service (Utilities) Bill* the Government rejected an amendment to place a specific duty on the regulators to protect low income and vulnerable consumers of utility services. The amendments were consistent with the "standard setting" (Gilbert & Gilbert, 1989, p.174) model of British regulation, as opposed to a more active "redistributional" (ibid) approach to regulation (where, for example, the regulator would intervene to influence company practice on pricing and energy efficiency vis-a-vis low income households:

*The purpose of this group of amendments is to enable each of the Regulators to require that standards of performance to be met by the suppliers in individual cases are relevant to the needs of the most vulnerable consumers, and particularly to those who may experience difficulty in paying for supply. Such standards could include, for example, procedures to be followed prior to disconnection, information to be supplied to customers in debt, offering a choice of payment methods to low income consumers, and access to token supply points for coinless pre-payment meters. NACAB (1992b) p.1*

Yet, in refusing to admit the amendment on the grounds that the regulatory bodies had sufficient powers under the legislation to address the needs of this group of utility consumers if they so desired, the Government missed (consciously or unconsciously) the essential point of the amendment. For while the Bill gave the regulators discretionary power to set performance standards in reference to any sector of the consumer population, the purpose of the amendment was to ensure that each of the utility regulators would actually make use of their latent powers on behalf of those groups most disadvantaged in their interactions with utility service providers.

The rejection of the unexceptional NACAB amendment expressed a continuation of the dominant British theme of maximising regulatory discretion, as well as a disinclination to treat domestic consumers as other than a homogenous group. Although in saying this, the Government seems, on earlier occasions, to have had no qualms about explicitly directing regulatory attention towards the needs of elderly, disabled and rural consumers.

While there may be a case for providing a relatively wide field of regulator discretion in particular areas of their engagement with the utility industries, the maintenance of lifeline services to the most disadvantaged group of utility consumers is not one of them. This is particularly so in a context, where through a combination of factors (not the least of which is the rise in tariffs), the level of utility debt has increased steeply in recent years.

In the absence of a statutory duty to institute measures to protect this sector of the consumer population, an untoward reliance is placed on the 'social responsiveness' of the individual regulator. This is rendered all the more problematic by the constraints on community sector involvement in the relatively closed process of regulatory decision-making process. Apart from the Director General of Gas Supply, the performance of the regulators, to date, has hardly been of a character to inspire unreserved confidence in their ability to act as guardians of the interests of low income consumers. Yet even OFGAS has been relatively complacent about monitoring the impact of the prepayment meter 'solution' to debt and disconnection on the consumption behaviour of low income households. The Director General of Electricity Supply has displayed little observable interest in the welfare of low income consumers *per se*. And although the water regulator has continually alluded to the deleterious impact of environmentally-driven water tariff increases on the budgets of low income customers, he has at the same time actively promoted an approach to water charging (i.e. metering) which acts to the greatest disbenefit of low income households.

The failure to mandate an explicit role for the regulators vis-a-vis low income consumers also, arguably, sends exactly the wrong message to the utility companies. It implies that like the regulators they do not need to give particular attention to consumers who are poor. The companies should be responsive, of course, to the needs of all their customers, but because of the particular characteristics of some consumers this responsiveness will often need to be more proactive and sensitive. Nowhere will this be more so than in regard to those on low incomes. Yet the commercial unattractiveness of the low income sector of the market (and particularly that sub-set of low income consumers which Fitch, 1992, describes as "difficult customers") will in many instances inhibit the development of such an approach, unless it is supported by regulatory sanction.

(iii) Competition assumptions

*It is one of the unpleasant facts of life that certain capacities (and also certain advantages and traditions of particular organizations) cannot be duplicated, as it is a fact that certain goods are scarce. It does not make sense to disregard this fact and to attempt to create conditions "as if" competition were effective. Hayek (1960) p.265*

*competition...is the Government's ark of the covenant..*

Lord Stoddart of Swindon, HoL Second Reading Debate on the *Gas Bill*, 10/4/86, col.318

The utility privatisation programme is premised centrally on a form of 'competitive utopianism', that is, an intuitive belief in the emergence and efficacy of competition in the utility industries. The advent of competitive forces into the erstwhile monopoly arenas of gas, electricity and water supply, it is held, will open up new horizons for industry efficiency and consumer sovereignty, and ultimately eliminate the need for external regulation altogether.

The extent to which competition will actually become a pervasive feature of the utility industries in the future, particularly in the area of domestic supply, is unknown at this stage. Yet as Chapter 6 showed, there is a degree of scepticism amongst commentators (including members of the past Select Committee on Energy) about whether competition will flourish in the domestic sector. However, even if competition does develop, it does not necessarily follow that it will be an unequivocal benefit to domestic consumers in generality, and to low income consumers in particular. A sense of agnosticism regarding the merits of competition might be derived from the *a priori* observation that the competitive market place has conventionally done little to promote access and equity objectives; but it can also be supported by more specific concerns related to the particular characteristics of the utility industries.



The consumer is currently at a considerable information disadvantage in their relationship with utility providers and imperfect information, or the problem of being able to select amongst competing suppliers on the basis of an informed assessment of price and service quality, is seen as a fundamental barrier to the attainment of consumer sovereignty:

*Without perfect information, however, agents are unable to exercise their choice rationally; nor can they tell whether competitive cost reductions are associated with an unacceptable reduction in quality. An important conclusion follows - that the efficiency advantages of competition are contingent on perfect information. Barr (1987) p.82*

Consequently, the present high level of information asymmetry between utility suppliers and consumers would need to be addressed, in order for competition to function to the benefit of domestic consumers. Perfect information is expecting perhaps a bit too much, but certainly consumers would need to be markedly more informed about the utility market place, as well as their own pattern of consumption and expenditure than currently appears to be the case (see DoE, 1991a; OFWAT, 1992b).

This will mean, in turn, that consumers are likely to incur higher "transaction costs" ("transaction costs refer to such costs as those associated with discovery, information gathering, bargaining and enforcement." Miller, 1990, p.722). In contrast to the supermarket or shopping mall, where the array of consumption choices are laid out before prospective purchasers, utility consumers will probably need to go to some trouble to become more fully informed. For some consumers, these transaction costs will outweigh the benefits gained in terms of price or service quality. For others, either because of disability, language, or the sheer complexity of the task, the opportunity to 'shop around' for utility services is likely to be foreclosed.

Future advances in technology, under the Littlechild scenario (OFFER, 1992b), may well obviate these information search problems for many domestic consumers. But technology will come at a price, and there is a clear danger that low income consumers may be excluded from the possibility of exercising choice (via advanced metering technology) because of an inability to afford access to the technology. This, along with the prospect of utility suppliers targeting the more commercially attractive and income elastic sector of the domestic market, would act to entrench the present 'social division' of utility services in Britain. The removal of the obligation to supply (which would seem to be a necessary pre-condition for the introduction of open competition in the domestic sector) could also mean that customers with a track record of debt and payment default may experience problems gaining access to supply at all.

The received wisdom in competition theory is that the introduction of multiple and competing suppliers almost invariably leads to decreases in prices. But for some consumers of utility services, the advent of competition is likely to have the reverse result. This will be particularly the case for consumers in some rural areas, and may well also apply - in relation to electricity supply - to consumers in the south of England, as most electricity is currently sourced from the north of the country. The removal of uniform tariffs and the elimination of geographical cross-subsidisation would seem to be an inevitable corollary of the removal of monopoly franchises in the gas and electricity industries. Under a competitive regime, utility tariffs for customers who have hitherto been the beneficiaries of a degree of cross-subsidisation will almost certainly increase, unless public expenditure is deployed to maintain a level of uniform pricing. On the obverse side, the removal of cross-subsidies will potentially result in a welfare gain (in the form of lower prices) for consumers who live in areas where the distribution and supply costs are relatively low.

creation of a competitive market in domestic utility services, the framework of regulation will need to be retained and, in some areas, extended if consumers are to be effectively protected.

There are lessons to be learnt in this respect from the American experience, and in a highly critical account of the history of telecommunications regulation in the United States, Melody (1989, p.685) dismisses the idea of replacing regulation with competition:

*Competition is not a substitute for policy and regulation. It is a potential tool of policy that, under some circumstances, can facilitate the achievement of the objectives both of economic efficiency and universal telephone service; under other circumstances it can promote efficiency at the expense of social policy; under still other circumstances it can promote neither..*

*Despite a definite shift toward an increased role for market forces, the primary influence upon future developments will not be the "invisible hand" of the competitive market, but rather the more visible hands crafting policy and regulatory decisions.*

At a minimum, additions to the regulators' powers in the area of protection for low income consumers will be necessary, as they are likely to be the group most exposed under competitive conditions. This will need to be complemented with an extension to the existing mechanisms for consumer representation, through, for example, strengthening the resource base and national fora in the electricity and water consumer bodies, for as McHarg (1992, p.396) states:

*Both regulation of monopoly and regulation for competition are complex tasks which have already required increased, rather than less, regulation..In the improbable event of full competition developing, however, there will still be a role for consumer "voice" alongside "exit", in order to influence the range of services on offer as well as the ability to choose between them and to protect those disadvantaged in the marketplace: utility services are too important for us to be able to contemplate market failure.*

House of Commons Select Committee on Energy, and in the Government's unwillingness to cede anything more than a peripheral function to the regulatory bodies in the domain of energy industry strategic planning.

The limitations of an essentially *laissez faire* model of energy policy making, as well as the interconnectedness between major energy-related decisions and other areas of public policy, were substantially exposed in October 1992 in the Government's decision to close thirty-one of the fifty remaining coal mines in Britain.

The intersecting factors leading to this decision were extremely complex and included:

- # the increasing lack of interest of the major generating companies and the RECs (all but one of whom are currently investing in electricity generation) in purchasing locally produced coal as a result of the availability of cheaper imported coal and because of extensive investment in gas-fired electricity generating plant

- # the Government's interest in maximising the return on the sale of its 40 per cent stake in National Power and PowerGen sometime after April 1993 - a new contract between the generating companies and British Coal, involving a reduced intake of coal at cheaper prices, would further this end by enhancing the profitability of the generators

- # the plans to privatise British Coal have created an imperative to close unprofitable pits in order to turn British Coal into a saleable commodity

Putting aside the question of the relative influence of each of these factors, the clear message to emerge from the announcement on the future of British Coal was that energy policy set adrift in the turbulent waters of the market place will inevitably collide, at some point, with broader issues of economic and social policy, and the national interest.

The deleterious impact of the privatisation of the electricity industry on British Coal had been predicted by a number of energy commentators well ahead of the events of October 1992 (see for example, Vickers & Yarrow, 1988; Robinson, 1989; Fells & Lucas, 1991; HoC Energy Committee, 1992a). But electricity privatisation has had other negative policy-related consequences as well, as Fells and Lucas outline in their forthright analysis of *UK Energy Policy Post-Privatisation* (1991):

*The short-term commercial perspective of the privatized electricity supply industry conflicts with the public interest in several ways: insufficient attention to environmental externalities, insufficient or inappropriate R&D, inappropriate choice of fuel especially by ignoring long term security from domestic coal or nuclear power. p.vi*

*The limitations of the market apply especially to climate change; market forces do not transmit the signals to make the proper allocations. Given that nuclear energy and renewable energies are the only means of expanding supply outside the fossil fuel corset; given that they can only practically be introduced into the electricity supply system: it makes no sense to burn high grade fossil fuels like natural gas for power generation. p.77*

In their report, Fells and Lucas emphasise that energy policy is simply too important to leave in the hands of the private sector (and indeed, too strategically significant to delegate to the industry regulators), and they call for the development of a "comprehensive energy strategy" (op cit, p.ix) involving direct government intervention.

A more recent review of the state of British energy policy in the wake of the coal debacle (Jones, 1992) similarly advocates the development of a clear public policy framework on strategic energy issues, complemented by energy regulatory bodies directly accountable to Parliament with responsibility for overseeing "tactical issues of market conduct" (p.38). Although, to delineate between "strategic" and "tactical" issues in this way ignores the critical interaction between policy making and policy implementation, and overlooks the important function that economic and social regulation performs in the practical formulation of utility industry policy.

In the aftermath of the coal 'non decision', the electricity regulator has been publicly castigated for not intervening to prevent the exponential growth in gas-fired generating capacity (the so-called "dash for gas") and for failing to take a strategic view of current and future energy needs in Britain (e.g. *The Guardian*, 5/11/92, 7/11/92, 18/11/92, 19/11/92). Yet Professor Littlechild has a point when he argued in his defence that it is the role of Government rather than the regulator to determine the broad parameters of energy policy:

*For the regulator to have that responsibility would be to confer enormous power on that person to shape the market and dictate the investment decisions on which future generations of customers will depend. If there is to be more general direction about the form and pace at which the generation market evolves surely it would be better to take that forward in a more democratic framework. OFFER (1992z)*

And in letting the market dictate the character and resource content of electricity generation, the regulator could be seen to be simply adhering to the contours of the Government's extant energy policy.

The Government's enforced decision to conduct an inquiry into the energy market, following the clamorous reaction to the coal mine closures, may result in the development of an energy policy with more substance to it than the vague outline of the market. But if it is to engage with key areas of economic, environmental and social policy it will require a substantial redrafting of the original blueprint of electricity privatisation. At the same time, the Government could constructively use this 'policy space' to re-think the fundamental paradigm upon which privatisation is based.

## PART 2: REFORMULATING THE PARADIGM

*..the project of the 1990s is surely to think and to popularize the task of reform and reconstruction of free market economies in the name of social justice but also in the interest of the authentic, rather than merely ideological, attainment of efficiency in the production and distribution of goods in a modern international economy. Taylor (1990) pp.3-4*

Privatisation of the public utilities has involved more than the transfer of ownership and the physical re-structuring of the water and energy industries in Britain. It has also sought to re-define the relationship between the individual and the State and the way in which individual needs for essential utility services are met. At its heart, the privatisation programme is founded on the paradigm of consumerism.

Consumerism is built on the central dynamic of 'commodification', involving the ascription of the products and services in society, designed to meet human needs, as commodities which can be priced and sold through market-based interactions. Consumerism gives expression to this core relationship of the 'individual in the marketplace' and articulates a set of procedural rights designed to protect the individual in engagement with the market. The corpus of these rights are choice, information, the power of 'exit' and the ability to seek redress in the event of service failure (e.g. through complaints procedures and compensation measures). This paradigm of consumerism is enshrined in the privatisation legislation and the Citizen's Charter-related supplements to the original legislation (the *Competition and Service (Utilities) Act 1992*).

But in the context of public utility services characterised, as Chapter 2 showed, by a composite of features which distinguish them from other commodities (e.g. essentialness, substitution problems, inelasticity of demand, natural monopoly and positive and

negative externalities) is the paradigm of consumerism appropriate? It will be argued here that it is not, both because the consumerist model breaks down when applied to utility services and because consumerism fails to address the central issue of 'entry' or access. It will be suggested that a superior alternative paradigm lies in the conception of citizenship, or more specifically, social citizenship.

(i) The limits of consumerism

The efficacy of consumerism as an organising principle in the public utility arena ultimately rests on the extent to which choice and 'exit rights' can be realised in practice. The other procedural rights are in effect secondary and contingent rights, whose power is only fully realised once the choice and exit conditions are met. For example, the right to information has little meaning (from a consumerist, 'shopping around' perspective) if there is no capacity to choose between different service options and providers. Equally, the ability to complain is likely to have rather less potency in a situation where the service provider, against whom the complaint is being directed, is aware that the complainant does not have the option of taking their business elsewhere, or of substituting one product with another. A right to compensation in the event of service failure can assist as a proxy in this regard, but unless it is extremely punitive, it will have none of the power of actually losing custom through customer 'exit'.

It will be obvious from the reading of this thesis, just as it will have been obvious from the reader's experience as consumers of utility services, that the field of choice available to domestic consumers of electricity, gas and water services in contemporary Britain is no wider now than it was prior to the industries being privatised. The inability to choose



between different water or energy service providers, in tandem with the non-substitutability of utility services (with the exception of some areas of household energy use), also manifestly forecloses the opportunity for consumers to exercise their 'exit rights'.

In essence, the present structure of the utility industries gives domestic consumers about as much chance of expressing the key attributes of consumerism as did those seventeenth century travellers seeking to hire a horse from the Cambridge carrier - the eponymous Mr Hobson - where the choice on offer was the one nearest the door, or nothing!

It is anticipated, of course, that these severe impediments to the consumerist ideal will be removed by 1998, in the case of electricity, and probably much earlier in the case of gas. Only the future will tell if this environment of choice will be created in the domestic energy sector, although there is some doubt as to whether many of these hopes will be realised. But leaving aside the issue, to paraphrase Prospero, as to whether this is such stuff as dreams are made on, it is important to ask whether the extension of choice will be all that useful to many domestic consumers of utility services. As suggested in the earlier section, the manufacturing of choice in utility services will be attended by costs as well as potential benefits. The opportunity costs involved in becoming informed and discerning consumers may well be high, and the transaction costs in switching between suppliers could outweigh, for some consumers, the savings made in reduced tariffs or improvements in service quality. The advent of competition could also discriminate against those groups of domestic consumers who might be described as 'information poor', as well as households who are materially poor (they are in practice, of course, often the same).

In addition to these practical issues, which cast doubt on the universal benefits of, and indeed prospects for, choice, in public utility services, the elevation of choice as a valued end in itself needs to be questioned. The image of the village market, where sellers openly ply their wares and where customers pick and choose amongst a wide array of consumption possibilities, has been an important symbolic metaphor of the market economy in liberal political thought from Adam Smith onwards. But water and energy services are not like commodities traded in the village market or the late twentieth century variant, the hypermarket. The capacity to select one's utility services on the basis of an immediate visual evaluation of the price/quality combination obviously does not exist. But more importantly, consumers are likely to want a utility service that is reliable, safe, and value for money, rather than have the ability to exercise fine graduations of choice equivalent to making a decision between a white striped shirt or a white plain one. It is the end product rather than the means of getting there will be of most importance to consumers of energy and water services. Dowding (1992) places the relevance of choice in perspective when he says:

*Increased choice, as opposed to better products or efficient markets, is not necessarily something to be valued at all. Firstly, the whole notion of 'increased choice' is problematic and, secondly, it is not obvious that we should always value it anyway. Rather what we value is getting what we want. Markets are often good at that, and they do it by offering us a choice of products; but it is the goods we value, not the choice itself. In any particular area of public policy the usefulness of the market must be examined in relation to the ease of shifting from one alternative to another, the costs of making decisions and the ability of individuals to have clearly defined preference schedules. Whether or not it brings greater choice is not something to be valued at all. The value of choice in the market is merely instrumental in that it enables preferences to be revealed or discovered. p.314*

Even if the conditions of actual, as opposed to rhetorical, choice and 'exit rights' were to be satisfied in the future, it would still leave untouched the fundamental flaw in the consumerist paradigm; namely its failure to address the question of access/entry rights.

Access to water and energy services, sufficient to meet personal needs, is generally perceived to be the one of the most basic human requirements. Yet clearly, the capacity to gain, and retain, access to requisite levels utility services is not equally shared by all individuals and households in contemporary Britain. The 'social division' of utility services characteristic of Britain (as well as other countries) is related substantially to the prevailing structure of income inequality, and the consequent disparities which exist in the ability to pay for energy and water. In addition, most notably in relation to energy consumption, higher demand costs are imposed on many low-income households as a result of their living conditions i.e. poorly insulated housing, expensive forms of heating, inefficient appliances and the like (Boardman, 1991).

Yet in the face of these structural barriers to entry and access, the consumerist paradigm is mute. Procedural rights are important, but in themselves they are insufficient. A panoply of procedural rights is largely ineffective in assisting consumers negotiate their way through the utility service system when, at the core, is the fundamental problem of fuel or water poverty; as the regulatory bodies are finding out. Consumerism is essentially an expression of the negative, one-dimensional view of citizenship alluded to in Chapter 4, it constitutes a repertoire of individualistic protections for those able to make their way in the economic system. It undercuts the very notion of public utilities in the sense of collective provision for the collective good. For a more positive framework of social, as well as consumer, protection we need to look elsewhere.

(ii) Social citizenship

*..it [social citizenship] implies some limit to commodification and commercialisation, in the sense that the basic welfare goods to which individuals have rights are not ultimately to be subject to the market mechanism, since the market cannot guarantee the provision of these goods, as of right, on a fair basis to all citizens. Plant (1992) p.16*

It is hardly likely to be coincidental that after well over a decade of New Right ascendancy in Britain, academic commentators and politicians alike have begun to search for different answers to contemporary social and economic problems. A fertile source of material in this post-Thatcherism debate about the nature of the British polity has been found in the theory of citizenship, involving *inter alia* a return to T.H. Marshall's seminal account of citizenship written in 1949 (Marshall, 1992). The resurrection of citizenship as an intellectual counterpoint to neo-liberal ideas is evident, at the political level in the formulation of citizens charters by each of the three political parties (see Taylor, 1991/92, for a useful comparative analysis of these three charters), and at an academic level in the proliferation of published works on the subject (e.g. Heater, 1990; Andrews, ed., 1991; Marshall & Bottomore, 1992; Mouffe, ed., 1992; Roche, 1992; Coote, ed., 1992).

As well as possibly heralding the beginnings of a shift in the tide of political ideas, the return to citizenship also underscores, interestingly, the hegemony of capitalism in late twentieth-century society. For the template of citizenship - consisting of the triad of political, civil and social rights - is superimposed on the extant structure of the market economy (albeit often re-defined as the 'social market'); and indeed it was for these reasons that Marshall's ideas were generally dismissed by neo-Marxist theorists in the 1960s and 1970s. The immediate relevance of this, for our purposes here, is that the

framework of citizenship is likely to be more congruent with the privatised structure of the public utilities, than would more radical, and possibly more desirable, political formulations.

The present generation of writers on citizenship have sought to apply and adapt Marshall's fairly simple thesis about citizenship to the contemporary era (with Plant, 1991, 1992, Bottomore, 1992, and Ignatieff, 1991 in particular doing an effective updating job). Yet the basic construction of citizenship, with notably its elevation of social rights to an equivalent status with civil and political rights, remains pretty much the same as that originally articulated by Marshall:

*By the social element I mean the whole range from the right to a modicum of economic welfare and security to the right to share to the full in the social heritage and to live the life of a civilised being according to the standards prevailing in the society.* Marshall (1992) p.8

Marshall did not specifically allude to energy and water services in his account of the evolution of citizenship rights (nor, for that matter, do most contemporary commentators), but the character and importance of these services in present-day Britain would place them firmly within the last part of his definition i.e. "to live the life of a civilised being according to the standards prevailing in the society".

Locating public utility services within a paradigm of social citizenship, as opposed to the paradigm of consumerism, changes the theoretical and practical relationship of the consumer to the privatised water and energy industries. It connotes a recognition of *substantive* as well as procedural rights (Plant, 1991, p.58) and mandates public policy and utility company action aimed at ensuring that access rights are guaranteed and protected.

The social security system, energy efficiency programmes and the regulatory bodies would be the key instruments for the enactment of a social citizenship model of utility service provision, at the level of public policy. Over recent years, relatively little effort has been made to target assistance to households experiencing difficulties paying energy and water bills (with the exception of the desultory cold weather payments scheme), and this has been exacerbated by the post-1988 changes to the social security system (Crowe, 1991). A form of fuel and water allowances for social security beneficiaries with disproportionately high bills, or discounts made at source by the utility companies (which would subsequently be reimbursed out of public revenue) would seem to be a minimum requirement.

The causal link between housing quality, in terms of energy efficiency, and fuel poverty is well established (e.g. Boardman, 1991a, 1991b; DoE, 1991b). Therefore, without concentrated action to deal with the demand side of the energy equation in many low income households, through a comprehensive domestic energy efficiency strategy, fuel allowances would, in a sense, be simply throwing good money after bad. An energy efficiency-led approach to fuel poverty would also, as Boardman (1990, 1991a) has persuasively argued, intersect with the public policy objective of reducing energy-related environmental externalities.

It is, of course, little more than wishful thinking to airily propose increases in public expenditure in the current political and economic climate in Britain; a view underlined by the knowledge that the Major Government apparently gave serious consideration to - but ultimately rejected - taking action to rescind the statutory requirement to upgrade benefits annually in line with inflation, in its search for public expenditure savings in the 1992 Autumn Statement. This serves to reinforce the point, however, that unless

there is paradigmatic change - not just in relation to the public utilities but in social policy generally - then little progress towards greater equity and social justice will be made. What is needed in relation to public policy programmes aimed at assisting low income households in the field of utility service provision, is a replication of the political will, which over the past three years has sanctioned the surcharging of electricity consumers in order to underwrite the costs of the nuclear power industry by something in excess of £3 billions.

A social citizenship approach to utility services would demand a far more active role for the regulators than has been, with one partial exception, the case to date. This would require, amongst other things, not only the setting of specific service standards to provide a minimum floor of protection to low income consumers, but the delineation of performance targets aimed at promoting competitive 'best practice' in relation to social and environmental responsiveness. These would include targets designed to raise the level of energy efficiency in low income households, to prevent the build-up of consumer debt and to eliminate the extraordinarily archaic practice of disconnection for debt. And like quality standards generally, these measures should be tied to the price formula.

One of the most enduring and disingenuous myths perpetrated by the public utility industries (which well and truly pre-dates privatisation) is that they are a set of basically economic services, with no mandate, nor responsibility, for social welfare. But as Fitch (1992, p.5) cogently asks:

*..what is it that these providers of essential services supply if not welfare. Enjoyment of the services of the water, fuel and telecommunications utilities is the foundation of well-being - of welfare - in modern societies.*

In a very real sense, public utilities are the bedrock of social welfare in contemporary societies and in contrast to the consumerist paradigm, where this is hidden beneath a morass of commercial and technical imperatives, the social citizenship model of the public utilities would explicate and formalise the pivotal contribution of the industries to economic and social well-being.

This does not necessarily mean though, that the utility companies would be required to engage in extensive cross-subsidisation or 'tariff-tilting' in order to facilitate access to services for particular sectors of the population. Measures aimed at giving financial assistance to low income consumers are probably best handled through the taxation/social security systems, for the reason that this is likely to be a more distributionally progressive and transparent approach (although the latter attribute means that they would be exposed to the vagaries of the government budgetary process).

External measures also would *not have the negative impact on efficiency that has* generally been perceived to be the problem with internal price manipulation (see Dilnot & Helm, 1987, for a useful discussion of these issues).

But under the social citizenship paradigm, tariffs would be tightly controlled and constraints would be placed on the companies' ability to generate excessive profits; much of which is derived from the capacity to extract 'monopoly rents'. At the moment only shareholders benefit from efficiency and purchasing savings in excess of those anticipated under the price formula. Provision could be made for the 'clawback' of a proportion of the additional profits made by the utility companies (in the form of lower tariffs), without negating the in-built incentives for efficiency. In this way consumers as well as shareholders would gain a dividend from improved industry performance.



There is much that the companies could do at a service delivery level to help low income households maintain access to utility services, for example, in payment and debt re-scheduling, on the supply side, and in energy efficiency initiatives, on the demand side. This will inevitably involve an element of cross-financing, including the possibility of slightly higher charges for consumers in general; but if the MORI survey commissioned by the water regulator is anything to go by, this is a price that the majority of consumers are willing to pay in order to assist low income households (see MORI, 1992, Table 207).

Above all under the citizenship paradigm, "social responsiveness" (Frederick et al, 1988, p.468) would form a primary criterion, along with commercial success, for adjudging industry performance:

*It will only be possible to create a more socially responsible economy with more socially responsible companies, which recognise social obligations as well as financial and economic ones.*

Leadbeater (1991) p.24

In combination, the public policy and regulatory actions implicit in the adoption of a social citizenship approach would effectively entail a re-negotiation of the terms of the privatisation settlement between the Government, the industries and the people of Britain.

## CONCLUSION

This chapter has sought to draw together a number of the primary themes in this thesis through considering the salient defects in the British model of utility privatisation.

It has been suggested that more than marginal policy tinkering will be required in order to correct these. The paradigm around which the privatisation programme has been framed is inconsistent with the basic function and importance of public utility services in the lives of individuals and families, and in the economy generally. If the rhetoric of privatisation, notably in respect to the provision of new consumer rights and opportunities for all households in the country, is to be matched with concrete outcomes then major changes will be required. In this sense, the privatisation project remains substantially incomplete.

Within the circumscribed frame of reference set for them, the regulatory bodies have made, generally speaking, a positive contribution to the broad welfare of ordinary consumers. The procedural rights that domestic consumers have gained in recent years are certainly superior to those which existed during the decades of nationalisation in Britain. But these have not been delivered by the operation of the market, as the thesis of consumerism asserts, but through public intervention in the market via regulation. However, the regulators have been relatively ineffectual in dealing with the important issues of social equity and strategic policy in the provision and management of public utility services.

The privatisation programme has illustrated that, rather than leading to the withering away of the state, that the mechanisms of public policy need to remain centrally engaged within the milieu of public utility activity, if consumers are to be protected and if the strategic resources of the utility industries are to be optimised to the benefit of society as a whole.

Arguments that the levers of regulation should be released in order to let the markets in energy and water operate without constraints, or that regulation should be progressively displaced in line with the emergence of competition, are based on a set of fallacious premises about the commodity nature, and unexceptional character, of water and energy services. Public utility services are different from other commodities and a failure to recognise this is likely to result in deep and long-lasting economic and social damage.

The British privatisation programme has been rife with contradictions. This was in evidence right at the beginning in the objectives of the programme and it has continued to be a pervasive feature of the programme ever since. To suggest that a social citizenship paradigm of public utility services could be built onto the quintessentially individualistic model of privatisation might be seen to be a contradiction in terms, as well as being wildly unrealistic. Yet, in theory at least, such an approach is possible. It would be a major contradiction indeed if a project designed, in part, to entrench the severely unequal distribution of property rights in this country could be transformed into an instrument for the promotion of social justice and collective welfare in Britain in the 1990s.

## ANNEXE 1: NATIONALISATION OF THE UTILITIES - A HISTORICAL SURVEY

*The nationalised undertakings had been, as a whole, neither an inspiring success nor a hopeless failure. Their uncertain achievement matched the ambiguity of the task they had to attempt. Ashworth (1991) p.208*

### INTRODUCTION

The history of the public utilities as centrally-owned and managed public enterprises, is a relatively recent one. The distinctive features of the public utilities; namely, their **natural monopoly** character and their **essential service** nature had long been recognised, but it was only in the immediate post-war period that comprehensive national ownership was adopted as a public policy strategy for regulating and managing the energy utilities. And the nationalised origins of the water industry dates back only as far as 1974.

While the participation of the central state in utility ownership and management is largely a mid-twentieth century phenomenon, the practice of public regulation and public ownership of the electricity, gas and water services industries is substantially entwined with the history of the utilities themselves.

Public regulation via Parliament, aimed at curbing the abuse of monopoly power, accompanied the development of gas lighting and fuel technology in early nineteenth century Britain and the introduction of electricity generation and supply later in the century. The nascent regulatory regime for the utilities was extended, in the case of the

water services industry in the late nineteenth century, to cover the public health requirements of water supply and sewerage.

Public ownership in a municipal form, was a prominent feature of both the electricity and water services industries in the latter part of the nineteenth century; and although gas remained predominantly in private hands, there was considerable interest in locating all three public utilities within the expanding domain of municipal control.

Yet for all this local authority and Parliamentary pedigree, the structure and character of the publicly-owned utilities from the mid-twentieth century up till very recent times, have been framed around a model that owes its origins not to the "Gas and Water Socialism" of the Webbs and the Fabian Society, but to the centralised "public corporation" concept of Herbert Morrison and others. Under this model neither local government nor Parliament occupy positions of major significance; although the ambiguous position of the latter has been the subject of on-going controversy throughout the 'life' of the nationalised industries. In an important sense then, the history of the contemporary public utilities is the history (or at least, a major sub-part of the history) of the post-war nationalisation programme. Therefore, while historical antecedents will be alluded to, this Annexe will substantially focus on the events subsequent to 1945, as the relevant history of the organisation and management of the utility industries prior to privatisation.

This discussion of the nationalised utilities will be structured in three parts: the **first** provides a thematic account of the approach of British governments to nationalisation from 1945 onwards, the **second** contains a discussion of selected aspects of the history of utility nationalisation, and the **third** explores, via a case study on codes of practice, one dimension of consumer relations in the nationalised utilities over the last decade or so of their existence. The emphasis in the first two sections is on the structural aspects of the industries rather than their specific policy content; so, for example, while the organisation of the energy utilities will be discussed, energy policy *per se* will not.

## **PART 1: A THEMATIC ACCOUNT OF POST-WAR NATIONALISATION**

To attempt to provide a detailed history of post-war nationalisation in Britain would be perilous; for it would extend the scope of this work beyond its already broad parameters, as well as reiterate, in an inferior form, much of the material contained in existing studies of the period, such as Robson (1960), Hanson (1961, 1963), Kelf-Cohen (1969), Tivey (ed, 1973), Chester (1975) and more recently, Sloman (1978), Curwen (1986) and Ashworth (1991). However, in order to understand the political and economic environment in which the utility industries were located prior to privatisation, and to appreciate some of the specific situational influences on their practice and performance, a brief excursion into the historical terrain of the nationalised industries generally is necessary.

The approach adopted here is selective and thematic, covering the following elements:

- \* The Public Corporation model of public ownership
- \* Financial regimes
- \* Non-commercial objectives
- \* Consumer representation.

(i) The Public Corporation model of public ownership

*The public corporation is in my judgement by far the best organ so far devised in this or any other country for administering nationalized industries or undertakings. Allowing for some teething troubles which are still not entirely cured, the public corporation which we have evolved is an outstanding contribution to public administration in a new and vitally important sphere.*

Robson (1960) p.493

The policy and organisational framework for the ambitious and landmark programme of nationalising key sectors of the industrial economy undertaken by the Attlee Government in 1945-51, was substantially founded on the concept of the public corporation. The adoption of a single structural form, for industries as diverse in their history, structure and performance as the railways, coal mining, electricity generation and supply and the manufacture of iron and steel, based on private sector practice rather than conventional models of public administration, reflected the importance of commercial efficiency as a primary objective in the Labour Government's nationalisation programme.

The attractiveness of the public corporation conception of public ownership and management was enhanced by the practical consideration that it was seen to present the only coherent alternative to conventional departmental and municipal forms of administration (Chester, 1975, Morgan, 1985). The Guild Socialist form of worker management (advocated by G.D.H. Cole and The Miners' Federation after the first World War) and the tripartite structure of management-worker-consumer control (expounded by the Webbs) were dismissed as inappropriate models for public ownership by the Labour Party and the Trade Union movement during the inter-war period.

Despite some debate within Cabinet and within the Ministerial committee responsible for the nationalisation programme, about the possibility of utilising traditional departmental structures for the management of the publicly owned industries (particularly, electricity and gas), the public corporation was ultimately favoured, as it offered greater potential for a flexible and business-like approach to the running of the newly-nationalised industries.

A distrust of the commercial competence of the civil service and the development of the limited liability company in the private sector (with its separation of ownership and management), were instrumental factors, according to Chester (1975), in the choice of the public corporation as the preferred model. The strategic position of Herbert Morrison as chairman of the Cabinet's Socialization of Industries Committee, was also apparently significant in determining the form that nationalisation took in 1946-1950.



The municipal alternative was barely countenanced, as the scale of operation required to run the industries efficiently extended well beyond the geographical boundaries and technical competence of most local authorities (exemplified in the case of electricity, for instance, with the evolution of the "national grid" and the technical advances made in power generation).

Herbert Morrison is rightly credited with the theoretical and practical development of the public corporation model - through his creation of the London Passenger Transport Board and his influential account of this in *Socialisation and Transport*, 1933 - although similar ideas on the organisation of public enterprise had pre-dated, in a less developed form, Morrison's formulation.

The Liberal Party, for example, in its 1928 Yellow Book, *Britain's Industrial Future*, strongly supported the establishment of independent public boards for the management of public enterprises. Also arguably, in 1920, the Webbs had anticipated a number of the key elements of the public corporation in their seminal work, *A Constitution for the Socialist Commonwealth of Great Britain* (Kelf-Cohen 1969); although the detail of their conception of public ownership was in many respects at variance with the approach ultimately adopted after 1945 (see Radice, 1984, pp. 219-224). At a policy level, one of the earliest prototypes of the public corporation was instituted by the Conservatives in 1926, with the creation of the Central Electricity Board.

While the act of procreation might not have been Morrison's alone, he is, at the least, entitled to the status of 'senior foster parent'; for his intellectual and practical endeavours, as Minister for Transport in the 1929-31 Labour Government, as Chairman of the manifesto committee prior to the 1945 General Election and as Lord President in 1945-51, did much to consolidate the dominance of the public corporation as the primary means through which public ownership would be enacted. The merits of a small appointed board to run the nationalised industries at "arm's length" from the government of the day, were summarised by Morrison in his retrospective study of policy-making during the period, *Government and Parliament* (1959):

*[Public Corporations] ..seek to combine the principle of public ownership, of a broad but not too detailed public accountability, of a consciousness on the part of the undertaking that it is working for the nation and not for sectional interests, with a liveliness, initiative and a considerable degree of freedom of a quick-moving and progressive business enterprise.*  
p.282-283

For Morrison, the requirement of commercial viability was as axiomatic for "socialised industries" (a term he preferred to nationalisation) as it was for private sector enterprise. But critically, because of the absence of the need to generate profits for private shareholders, self-serving commercial behaviour would be displaced by 'public service-oriented' policies and practices in the publicly-owned industries. Importantly, under Morrison's formulation, this combination of commercial competence and public service would be best achieved through releasing the industries from direct political control and by ensuring that producer (i.e. trades union) and consumer interests were not unduly influential in the day-to-day management of the nationalised industries.

The question as to whether this arrestingly simple paradigm of public enterprise is **itself** fundamentally flawed, or has been flawed through **implementation**, has been and remains, a major axis around which the debate over public ownership has been conducted.

The formal characteristics of the public corporation concept, are outlined by Hanson (1963, p.13):

*(a) it is wholly owned by the state, even though it may raise all or some of its capital by the issue of bonds to the public*

*(b) it is created by special law, and is not subject - except to the extent as may be prescribed - to the ordinary company law*

*(c) it is a body corporate i.e. a separate legal entity which can sue and be sued, enter into contracts, and acquire property in its own name*

*(d) it is independently financed, obtaining its funds by borrowing, either from Treasury or from the public, and deriving its revenues from the sale of its goods or services*

*(e) it is exempt from the forms of parliamentary financial control applicable to government departments*

*(f) its employees are not civil servants, and they are recruited and remunerated on terms and conditions that the corporation itself determines.*

The members of the boards responsible for the management of the public corporations were appointed by the Ministers of the sponsoring departments (with tenure of up to five years) and were selected on the basis of their familiarity with and expertise in the relevant industry, or business management generally. In keeping with Morrison's concern about the influence of sectional interests, board members were not representative of particular organisations or sectors of the industry; but provision was

made for the appointment of members with experience in "organisations of workers" (i.e. the trade union movement).

While their legislative status as quasi-independent organisations provided the boards with considerable room for manoeuvre commercially (including originally, the ability to set charges without the need for government approval), substantial powers were retained by the Ministers of the sponsoring departments (and Treasury) including:

- \* control over borrowing and the use of reserve funds
- \* approval of major capital development programmes
- \* and the important reserve power "to give directions of a general character as to the exercise and performance by a Board of its functions in relation to matters appearing to the Minister to affect the national interest" Chester (1975) p.914

Beyond these legislated powers, relevant Ministers of State were in a position to exercise considerable persuasive authority over the policies of the public corporations during their regular informal contact with the board chairmen. In the view of commentators like Chester (1975), Hanson (1963), Robson (1960) and Tivey (1973), informal ministerial influence was to become a primary route for the application of government constraints on the activities of the public corporations.

Because the public corporations existed as quasi-independent organisations outside the traditional structure of government, the role of Parliament was seen - at least initially - as limited essentially to the receipt of the public corporations' annual reports and to the broad consideration of their financing as part of the Public Accounts monitoring process. Likewise, the accountability of the responsible Minister to Parliament for the performance of the nationalised industries was to be highly circumscribed; with the

Minister answerable for departmental policy relevant to the operation of the public corporation but **not** for the day-to-day policy and practice of the industries themselves.

In Morrison's view, this "hands off" approach was a necessary pre-condition to the commercial freedom and flexibility of the public corporations. The continuing debate on the floor of the House of Commons about the admissibility of questions on the nationalised industries (see Morrison, 1959, pp.256-262 for a detailed review of the issue), and the advent of the Select Committee on the Nationalised Industries (in 1952, but not effectively functioning until 1956), illustrated the mounting restiveness of members of Parliament about their hamstrung role vis-a-vis the nationalised industries. The issue for many parliamentarians at the time, (and an issue that has continued to provide difficulties for advocates of public enterprise) was encapsulated by Hanson (1963) in the following terms:

*The problem universally experienced is to combine such business flexibility with an adequate measure of public control over general policy, without which there would be little point in having the enterprise in the public sector. p.13*

The power of Morrison's vision is attested by the fact that the public corporation concept had a profound impact upon the form of public ownership adopted in Britain and elsewhere (for example, Australia, New Zealand and Canada) for much of the post-war period. Despite extensive internal re-structuring within the nationalised industries themselves from 1951 to 1979, the public corporation retained its ascendent position as the primary operational model of nationalisation.

This does not necessarily mean, of course, that the Morrisonian concept of nationalisation or "socialisation" has been an enormous success. On the contrary, the public corporation model has, from the outset, been plagued by a number of seemingly intractable problems; some of which appear to be intrinsic to the model itself, while others arise from the way that it has been implemented. The policy conundra of the public corporation model of public ownership include:

- \* marrying **public accountability** with commercial freedom and "arms length" control;
- \* reconciling the **public service** ethos with commercial enterprise values;
- \* finding a mechanism for the **expression of worker and consumer interests** and meeting the disparate - and, at times, conflicting expectations of these two major constituencies;
- \* establishing appropriate proxy measures (in place of profit levels) for adjudging **performance**;
- \* and reconciling industry-specific commercial decisions with **macro-economic** policy priorities.

The inability of the public corporation model over its forty-odd year history to deal effectively with these issues - some of which are explored in following sections - explains to an extent, the policy retreat of the Labour Party vis-a-vis nationalisation from the early 1950s onwards (see Hanson, 1963, Tivey, 1973, Sloman, 1978 and Fraser, 1988, for accounts of the shift in Labour Party thinking since 1951). It might also contribute to an explanation for the marked degree of public and political quiescence in the face of the Conservative Government's wholesale dismantling of the nationalised industries in late twentieth century Britain.

(ii) Financial Regime

The system of financial management and control of the nationalised industries changes considerably over the course of their relatively short history.

The strictures of "financial targets" and "external financing limits" (EFLs) introduced in the 1970s and 1980s appeared, on the face of it, to be a long way removed from the simple injunction to "break even over a number of years" found in the Nationalisation Acts of the late 1940s. At one level, the increasingly assertive financial stewardship of the nationalised industries by successive governments from 1961 onwards, represented a clear and irreversible breach of the Morrisonian principle of "arm's length" control. While at another, it expressed a pragmatic refinement of the commercial and efficiency-oriented criteria that, for Morrison and his Cabinet colleagues, explicitly drove the machinery of the nationalised industries from the outset.

Whether Morrison would have seen - with the benefit of hindsight - the need for more specific economic and financial guidance for the industries beyond "that the revenues are not less than sufficient to meet their outgoings properly chargeable to revenue account, taking one year with another" (Gas Act 1948, s.41(i)), is a moot point. However, it is probable that he may have found greater difficulty in concurring with the manner in which successive governments actively interfered with the financial structure of the nationalised industries in order to promote macro-economic and political objectives. Instances of this "hands on" approach to the nationalised industries are manifold; ranging from the anti-inflationary "price pegging" measures of the Heath and

Wilson governments in 1970-75, through the IMF-inspired reductions in the industries' capital development programmes in the mid-1970s, to the setting of inflated electricity, gas and water charges by the Thatcher Government in order to increase revenue for the Exchequer and to improve the commercial attractiveness of these industries prior to privatisation.

The shifting economic and financial rules that have been applied by British governments to the nationalised industries expressed, at the one time, a legitimate desire to introduce greater precision and accountability into the financial policies and practices of the public corporations, and an unwillingness to allow the industries to operate as commercial entities in their own right, without politically-motivated intervention. Paradoxically, the vulnerability of the nationalised industries to political interference, was used by the Thatcher Government - which had interfered as much as any previous government - as a leading argument for their return to the private sector (see Moore in Kay et al, 1986, p.83).

Figure A.1 overleaf provides a summary of the major policy changes in the economic and financial regulation of the nationalised industries from 1946 (when the first Nationalisation Acts were passed) to the 1980s.



### Financial regulation of the Nationalised Industries 1946+

* Nationalisation Acts	Revenue sufficient to cover outgoings "taking one year with another".
* Finance Act 1956	All capital to be raised via Treasury and the issuing of industry-specific guaranteed stocks terminated.
* White Paper 1961	Five-year period introduced as time-frame over which revenue and outgoings to be balanced. Replacement cost as basis for calculating depreciation in place of historic cost. Specified rates of return on capital set (e.g. electricity 12.5%, gas 10%). Yearly Ministerial reviews of capital expenditure and capital development plans established.
* White Paper 1967	Introduction of long-term marginal cost pricing and the "aim of pricing policy should be that the consumer should pay the true cost of providing the goods and services he consumes.." (White Paper, extract in Tivey, 1973, p.80). Test rate of discount on new investment - 8% (increased to 10% in 1969). Introduction of performance indicators.
* NEDO Report 1976	Recommended tighter financial regulation and abandonment of the "arm's length" relationship between government and the nationalised industries.
* White Paper 1978	Required rate of return of 5% on aggregate new investment. Strengthening of industry-specific financial targets. Introduction of non-financial performance targets. External financing limits imposed.
* Extensive use of EFLs post-1979	"Under the Thatcher government, with its much publicised intentions to reduce public spending, the external financing limits became the main instrument of government control of the nationalised industries..Overall by 1984-85, the Conservatives had cut the total external finance of the nationalised industries by 35% in real terms compared to 1979-80, though this was much less than originally intended." Levacic (1987) p.262
* Oil & Gas (Enterprise) Act 1982 and Energy Act 1983	Introduction of "liberalisation" measures designed to raise the performance of the electricity and gas industries through encouraging rival sources of supply.

Figure A.1: Financial regulation of the nationalised industries

Simply listing the financial control changes since 1946 does not, of course, portray the full picture. In a number of instances, these financial regimes were never fully implemented (as in the case of long-term marginal cost pricing), either because they were measures inappropriate to the financial structure of the nationalised industries, or because of resistance from within the industries themselves. Alternatively, some of the measures designed to improve the long-term financial planning of the industries, were quickly superseded by the shorter-term economic and political exigencies of central government.

From the simple - if inadequate - test of financial performance that accompanied their beginnings, the nationalised industries became increasingly embroiled in a confusing and confused web of economic aspiration, financial regulation and political intervention (which, appeared to resemble, at times, a form of national "pork-barrelling"). It is perhaps not remarkable then their overall performance either, in terms of efficiency or public service (Pryke, 1981, Redwood, 1980, National Consumer Council, 1976b, 1989a) has been less than Morrison and his colleagues might have hoped as the Chancellor of the Exchequer, Hugh Dalton introduced the Second Reading of the Cable and Wireless Bill: "Yesterday it was coal; today it is cables. The Socialist advance, therefore, continues" (quoted in Morgan, 1985, p.101).

(iii) Non-commercial Objectives

*The test of commercial viability was no doubt offensive to those who wanted the industries to be run as a public service. It was never made apparent, however, what was involved in the public service concept.*  
Chester (1975) p.1054

The relationship between the commercial and non-commercial objectives of the nationalised industries has been a matter of contention since the industries were first taken into public ownership. The extent to which the industries have obligations beyond efficient commercial production and practice - for example, in the redistribution of income and wealth (through cross-subsidisation amongst categories of consumers and through 'progressive' wage policies for their workforces), or in contributing towards national economic planning objectives (such as directing capital development towards regionally disadvantaged areas) - is a question that has, in practice, only been 'resolved' negatively in recent years via the Conservative Government's denationalisation programme.

Although commercial competence was of paramount importance to the post-war architects of nationalisation, the goal of public ownership was generally viewed as something more than this. With differing degrees of emphasis, public ownership was seen as an essential lever for national economic planning and as a route to economic freedom and equality. For Morrison, Shinwell, Dalton and Bevan, the view expressed some thirty years later by Sloman (1978) would have struck a resonant chord:

*Many of the most persuasive arguments for public ownership are based on a recognition of the inadequacies of the price mechanism. The idea that nationalised industries should be entirely commercial in character is totally at odds with this justification for public industry. p.105*

Yet for all their apparent commitment to the attainment of non-commercial outcomes - for workers, consumers and the nation alike - from the operation of industrially efficient and service-oriented public corporations, Morrison et al. expended little mental energy on the issue of how this might be achieved in tandem with the dictum of commercial pre-eminence.

The assumption, apparently made by Morrison et al, that a devotion to 'public service' and its corollary, 'the pursuit of the public interest', would be sufficient to guide the public corporations through the dilemma of how to reconcile commercial and non-commercial objectives, has proved to be flawed. This initial failure to define the basis and expression of the social mandate of publicly-owned enterprises, has substantially contributed to the uncertain place that non-commercial objectives have had in the operational practice of the nationalised industries.

Succeeding governments acted ambiguously in relation to the putative non-commercial obligations of the nationalised industries. On the one hand, they urged, with increased vigour, the industries to adopt an explicitly commercial approach to the management of their human and capital resources and to pricing policy. While on the other, they sought to influence industry policy-making (and modify commercial prerogatives) in order to achieve macro-economic and distributional aims.

A resolution to this ostensible contradiction in the management of public enterprise was sought through the twin device of (i) separately identifying non-commercial activities and (ii) shifting the financial burden for non-commercial obligations from the industries

directly to the taxpayer generally. The following selected quotes from relevant sections of the series of White Papers, alluded to earlier, illustrates how successive governments attempted to deal with the problem of the non-commercial dimension of the nationalised industries.

White Paper 1961:

*They cannot..be regarded only as very large commercial concerns which may be judged mainly on their commercial results: all have, although in varying degrees, wider obligations than commercial concerns in the private sector.. These [non-commercial] activities will, so far as practicable, have been taken into account in fixing the financial standard for each undertaking. To the extent that commercially unprofitable activities are subsequently imposed from outside, a Board would be entitled to ask for an adjustment of its financial objectives.*

(extract in Tivey, 1973, p.73, author's emphasis)

White Paper 1967:

*Where there are significant social or wider economic costs and benefits which ought to be taken into account in their investment and pricing these will be reflected in the government's policy for the industry: and if this means that the industry has to act against its own commercial interests, the government will accept responsibility. (Where necessary the government will make a special payment to the industry or make an appropriate adjustment to its financial objectives).*

(extract in Tivey, 1973 p.87, author's emphasis)

White Paper 1978:

*The Government intends that the nationalised industries will not be forced into deficit by restraints on their prices. When help has to be given to poorer members of the community it will be given primarily through the social security and taxation systems and not by subsidising nationalised industry prices.*

(quoted in Curwen, 1986, p.79, author's emphasis)

The evolution of government policy on the non-commercial practices of the nationalised industries therefore, consisted of a series of ad hoc, but cumulative, departures away from the vague founding principle of generic 'public service'. The position by the late 1970s appeared to represent a marked dilution of the broader purpose of public ownership as envisaged by its original proponents. For not only were the nationalised industries substantially relieved of financial responsibility for non-commercial activities, they were effectively released (in the conceptualisation of their mandate, if not in actual practice) from social and other non-commercial obligations altogether.

The explicit commercialisation of the nationalised industries may have been valid and indeed necessary, from a purely economic perspective; but manifestly from a wider public policy lens, it brought into question the fundamental *raison d'être* of public ownership in the industrial sector in the first place. The process of eliminating all but the commercial essence of public enterprises, also acted to eliminate the philosophical and conceptual dividing line between public and private forms of industrial ownership and management.

(iv) Consumer Representation

*The amount of consideration given by Ministers and civil servants and even by Parliament to the consumer in the nationalisation legislation was much less than that given say to the position of the workers and Trade Unions and very much less than that given to such general aspects as compensation and the role of the Minister. Chester (1975) p.641*

As this thesis has argued, the monopoly character of the utility industries - whether in public or private ownership - requires that particular attention be given to the position of the consumer. In contrast to the notional prerogatives of the consumer in arenas characterised by multiple producers and suppliers and a competitive environment, the consumer of utility services has few 'natural' safeguards with respect to service quality and price. The ultimate sanction of withdrawal of custom is clearly not an option for consumers of electricity, gas and water, where there is an absence of alternative supply. The problem is further compounded by the fact that the products of the industries are, by their nature, largely essential services. In the absence of the regulatory power of demand therefore, forms of proxy market regulation are required in order both to promote efficient commercial practices by monopoly providers and to protect the interests of consumers. Conventionally, the establishment of consumer watchdog bodies has been seen as one means of applying quasi-market controls and a form of external regulation.

The one-sided commercial power of private utility monopolies was fully recognised by the leading figures in the post-war nationalisation programme and this formed a potent motivating force in the drive for public ownership. Yet characteristically perhaps, their analysis of the dysfunctions of monopoly provision was translated only tangentially to

the new order of public enterprise. While it was recognised that publicly-owned utilities could theoretically - like their private sector predecessors - exploit their dominant market position at the expense of the consumer, it was generally believed that the 'public service' orientation of the public utilities would ultimately preclude this from happening. The following extended quotation from Morrison (1959) illustrates the view, prevalent at the time, about the intrinsic merits of the public corporation as a protector of the consumer interest:

*In the case of a public concern, whether monopoly or not, the consumer does, I think, start with certain advantages. The very fact that the Board is a public authority appointed by a Minister responsible to Parliament should, and I think does, give it a special sense of public responsibility and therefore of the rights and interests of the consumer. It does not aim to provide high profits for investors. Moreover the Board is, and knows it is, more likely to be shot at in Parliament and in the Press than is a private undertaking. There is much more public argument about increases in charges and prices by a public than a private undertaking.. Generally speaking, one would expect public concerns to be more consumer-conscious than similar undertakings not publicly owned. Certainly they should be. p.266*

Under such an idealised model of public enterprise, the need for elaborate mechanisms of consumer representation and advocacy was inevitably seen to be of secondary importance. In addition, Morrison's reluctance to admit sectional interests into the decision-making structure of the public corporation, served to relegate consumer perspectives to the periphery. As a consequence of these factors, the Webbian view of 'consumer partnership' in the management of publicly-owned enterprises, drew little support within the ranks of the Attlee Government.



Nevertheless, despite what might arguably be seen as, a mixture of idealistic complacency and consumerist antipathy, each of the major Nationalisation Acts included provision for the establishment of some form of consumer consultative structure. But even these limited measures, particularly in the case of the electricity and gas nationalisations, may have had more to do with a desire to placate the local authorities, following their loss of utility functions and revenue, than to an appreciable interest in consumer representation. According to Chester (1975, p.656) "..the 'consumers' committees' which emerged in the [nationalising] Electricity Bill were more the result of the Ministry's worries about the opposition of the Local Authorities to nationalisation than any greater concern about the need to protect the consumer .." (and the Gas Bill was based very largely on the detail of the Electricity Bill).

The structure of the consultative councils paralleled the organisational structure of the nationalised electricity and gas industries (i.e. area bodies); with the significant exception that there were no national consumer equivalents of the Central Electricity Authority and the Gas Council. The ministerially appointed membership was dominated by local government representation and the chairman of each area council was given ex-officio status on their respective area board. The functions of the councils encompassed:

*(a) the examination of complaints from individual consumers;*

*(b) the consideration of the factors likely to influence the supply of electricity [and gas] in a general way;*

*(c) the discussion, criticism or approval of the policies and programmes of the operating bodies concerned with the supply of electricity [and gas].*  
Robson (1960) p.255

Significantly though, tight boundaries were drawn around the scope of the consultative councils to take up broader energy policy issues, and to advocate outside the extant structure of consultation, at a very early stage.

[See Chester, 1975 pp. 698-700, for an instructive account of the government's position on the prerogatives of the councils following an early "test case" arising from the extra-organisational lobbying of a number of gas consultative councils for the removal or reduction of the purchase tax on gas water heaters].

Although a number of important changes were introduced to the structure of consultative councils after this (including, the establishment of national consumer bodies in the electricity and gas industries and the belated introduction of regional consumer bodies in the water industry in 1983), the broad framework for consumer representation in the nationalised industries remained substantially the same up to the period when they were abolished under privatisation legislation.

The limited effectiveness of the structures for consumer representation and advocacy in the nationalised industries was repeatedly highlighted in a series of reports and commentaries in the decades following their establishment, including two major critiques prepared by the Consumer Council in 1968 and its successor, the National Consumer Council (1976). Amongst the identified problems of the consultative bodies were:

- \* **poor public awareness** of their existence e.g. the National Consumer Council (1976b) surveys found that only 4% and 5% of the public knew (without prompting) of the existence of electricity and gas consultative councils respectively. Interestingly, this was less than half the proportion of people who could identify these bodies in a previous survey in 1966.

- \* **limited public use** of the consultative councils in the negotiation and settlement of **complaints** and disputes e.g. only 1% of people with electricity complaints took them to an electricity consultative council; although the figure was somewhat higher in the case of gas (NCC, 1976 p.34)

**\* lack of information** from the industries regarding their policies and plans and lack of industry receptivity to consumer viewpoints

**\* deficient staffing** and access to technical expertise

**\* and, a problem** that the consumer bodies shared with the nationalised industries themselves; namely, **lack of access to decisions taken outside the industry** (i.e. by government) that have substantially affected consumer interests.

While the role of consumer organisation never appeared to occupy a particularly salient place in the minds of the original protagonists of nationalisation, the outcomes achieved through the structures for consumer representation, would probably have been viewed as desultory even in their eyes. From one perspective, the problem could be seen to reside, as Morrison (1959) presciently saw, in the nature of public participation:

*But if the Consumer Councils are to succeed there must be active public participation. They will not have sufficient life and vigour if the consumers fail to make proper use of them.. p.267*

For other viewpoints though (for example, Sloman, 1978) the problematic nature of consumer representation in the nationalised industries, was seen to relate to a different dimension. Namely to way in which the interests of consumers were substantially overlooked under the producer-driven and corporatist conception of public ownership developed by Morrison et al. The structural nature of the problem is also perceived by critics of a different ideological ilk; but for them, the disadvantaged position of the consumer arises endogenously out of the structure of public ownership itself (see for example, Redwood, 1980).

## PART 2: A SHORT HISTORY OF UTILITY NATIONALISATION

*The public utility era, which began in the mid nineteenth century, saw the town council (by whatever name it was called) invested with power to own and operate water, gas, electricity, and street transport undertakings, and a great deal of municipal trading in these spheres still exists in many countries. But in general the areas of administration needed for the most efficient operation of these services have expanded, whereas the areas of local government have remained static. In consequence, municipal enterprise is declining and public utility services are being projected on to a regional or national scale. Nationalization of these services in France and Britain and their provincialization in Canada, are only municipal trading writ large.*

Robson (1960) pp.24-25

### (i) Background

In a structural sense, the nationalisation of the electricity, gas and water industries completed a process of public ownership that had been started in the middle of the nineteenth century. In the period preceding nationalisation (in 1947 and 1948 in the case of electricity and gas, and in 1974 in respect to water), the utility industries were already characterised by a high level of public ownership, via municipal control and management. The growth in municipal involvement in the utility sector, which paralleled the full flowering of local government in Victorian Britain, was driven by a trio of concerns: namely, (i) the elimination of competitive duplication and waste and the minimisation of disruption caused by infrastructural development (i.e. laying of pipes, constructing sewers etc.), (ii) the avoidance of private monopoly domination and the concomitant effect that this might have on service quality and charges, and (iii) the protection of public health.

In addition to the evolution of municipal ascendancy in the utility industries, a formative structure of controls was put in place to regulate the practice of private utility undertakings e.g. limits on the level of profits generated by gas companies.

Effectively then, by the beginning of the twentieth century, the battle for public control of the utility industries, through ownership and regulation, had been won. This 'victory' was further consolidated - in the case of electricity at least - by the establishment of the Electricity Commission in 1919 and the Central Electricity Board in 1926. In addition to their importance for the organisation of the electricity supply industry, these two initiatives put utility management firmly on the **national** policy agenda.

#### (ii) The Rationale for Nationalisation

The primary arguments used to support the economic and social case for nationalisation of the utility industries mirrored those employed by the Thatcher Government to justify privatisation some four decades later. These included (i) the need for greater levels of **efficiency** (through rationalisation and re-structuring), (ii) the requirements of sustained **capital re-development**, (iii) the raising of **service standards**, and (iv) the **protection of the consumer** from manipulative monopoly practices. Among these the most persuasive factor, for the Attlee Government and for the Heath Government (in the case of water), was the substantial gains in efficiency that would accrue - in terms of economies of scale, concentration of capital, and technology research and development - from amalgamation, co-ordination and integrated management.

In each of the three utilities, a convincing technical case for nationalisation (or at least, for a radical restructuring of the industry) had been in place for some time prior to the act of nationalisation itself. In electricity and gas, the critical groundwork had been laid by the MacGowan and Heyworth reports published in 1936 and 1945 respectively. While in the water services industry, a series of legislative and administrative measures from 1945 onwards (including, the Water Act, 1945; the River Boards Act, 1948; and the Water Resources Act, 1963) stimulated a momentum that led inevitably to the creation of the regional water authorities.

In combination, the incontestable technical case for re-organisation and the already strong presence of public ownership in the industries, served to dull both the ideological dimension in nationalisation, and political opposition to the dramatic changes proposed.

To a large extent then, the nationalisation of the utilities represented a technical rather than an ideological triumph. This may appear obvious in the action of the Conservative Government under Ted Heath to nationalise the water industry; yet it is only marginally less sustainable in the earlier instances of nationalisation under the Attlee Government. In analysing the driving motivations in all three nationalisations, it would not be difficult to conclude (albeit anachronistically) as Day and Klein (1987) have, in relation to water:

*Water authorities are the product of the search for national efficiency through institutional reform that marked the decade from 1965 to 1975. They are a monument, as it were, to technocratic rationality. p.135*

### (iii) The Mechanics of Nationalisation

In the eyes of critics of nationalisation, the vesting date for the three pieces of nationalising legislation (1st April 1948, 1949 and 1974 respectively) may seem amusingly apposite. Be that as it may, the legislative provisions for the nationalisation of the electricity, gas and water industries share a number of similar features - beyond their 'birthday'; despite the quarter century that separated the Electricity Act and the Water Act.

The three nationalised industries were structurally and operationally based on the **public corporation** model (although Morrison may have looked askance at the quasi-representative structure of the original regional water authorities), with both central and regional/area units of organisation. However, important differences existed in relation to the role of the central body vis-a-vis its regional counterparts and in the degree of autonomy accorded the sub-national units of each industry. Figure A.2 (on the next page) summarises the major organisational features of the three industries immediately following nationalisation.

In accord with their status as public corporations, the Minister of the sponsoring department, was responsible for board appointments, although local authorities were given the ability to nominate representatives in the case of the RWA's. In addition, the Minister exercised the range of prerogatives outlined earlier in Part 1. All three industries were subject to similar "break even" financial requirements. This is despite the fact in the case of the water industry, that it was nationalised subsequent to the

### The Original Structure of the Nationalised Utility Industries

INDUSTRY	UNIT OF ORGANISATION	FUNCTIONS
ELECTRICITY	Central authority (BEA)	<ul style="list-style-type: none"> <li>* Power generation</li> <li>* Co-ordination and policy (including, tariff-setting, raising of capital)</li> <li>* Responsible for managing "break even" requirement entire industry</li> </ul>
	14 Area boards	<ul style="list-style-type: none"> <li>* Distribution</li> <li>* Semi-autonomous, but subject to central constraints</li> </ul>
GAS	Central authority (GC)	<ul style="list-style-type: none"> <li>* Circumscribed role, confined to central wage negotiations and research &amp; development</li> </ul>
	12 Area boards	<ul style="list-style-type: none"> <li>* Virtually autonomous</li> <li>* Responsible for setting tariffs, capital development and "breaking even" individually</li> </ul>
WATER	Central authority (NWC)	<ul style="list-style-type: none"> <li>* Largely advisory role</li> <li>* Pension scheme and central wage negotiations</li> </ul>
	10 Regional boards	<ul style="list-style-type: none"> <li>* Integrated river basin management (water services and regulation)</li> <li>* Virtually autonomous</li> <li>* Responsible for setting tariffs, capital development and "breaking even"</li> </ul>

**Figure A.2: The original structure of the nationalised public utilities**



introduction of the financial reforms outlined in the 1961 and 1967 White Papers. The establishment of consumer representative bodies in the electricity and gas industries was not replicated in the nationalisation of the water utilities - the emerging "consumerism" of the late 1960s and early 1970s notwithstanding. Another novel feature of the 1973 Water Act, was the continuation of a private sector role in water supply, through the retention of the statutory private water companies, supplying approximately 25 per cent of consumers nationally.

The structures set out in Figure A.2 above were changed in a number of significant respects in the years following nationalisation, and these will be considered in the next section.

In light of the unsuccessful claim by some local authorities in England and Wales for central government compensation, when their pre-1974 water and sewerage assets are sold through privatisation (see, for example, *Municipal Review and AMA News*, March 1989, p.257), a brief allusion to the **compensation provisions** contained in the nationalisation Acts seems appropriate.

In the nationalisation of electricity and gas, the compensation terms for private utility owners (which Morgan, 1984, describes as "remarkably generous") were similar. After the difficulties encountered in applying Morrison's preferred formula of "net reasonable maintainable revenue" in the transfer of the coal industry into public ownership, the Attlee Government opted for the more straightforward method of basing compensation on the market value of shares (as quoted on the Stock Exchange). Compensation was not generally, however, paid in cash, but in the form of guaranteed government stock,

at a fixed percent of return. The cost of compensation was £542 millions and £220 millions in the electricity and gas industries respectively. In relation to local authority assets, the Government's initial inclination was to simply take over the net outstanding debt of the public sector utilities. However, after intensive lobbying by the Association of Municipal Corporations, payments of £5 millions (electricity) and £2.5 millions (gas) were made to the local authorities to compensate them for revenue foregone and "for the reduction of the field over which overhead expenses could be spread" (Chester, 1975 p.326). In terms of their actual value, local authority electricity and gas assets were acquired at 'bargain basement' prices.

The acquisition of local authority water services assets in 1974 was achieved at even less cost (in relative terms) to the Treasury. On the basis of the argument that the nationalisation of water represented, in large part, a direct transfer of assets from one part of the public sector to another, local authorities received no financial compensation beyond the transfer of outstanding debt. It is against this backdrop then, that local government peak organisations in the late 1980s sought to win support for the view, that because of the changed status of water services assets under privatisation (i.e. they will no longer held in the public sector), local authorities were entitled to some form of retrospective return on their historical investment in water services-related capital.

#### (iv) Subsequent Structural Changes

The original structures of the nationalised utility industries were subjected to considerable modification and revision in the years following their introduction. This was always likely to be the case in the electricity and gas industries given that "organisation received least attention of all the aspects of nationalisation" (Chester, 1975, p.387). Aside from the changes required due to flawed design, the search for new organisational solutions was stimulated by technological and/or political challenges to the industries. Notable among the series of major and minor changes to the industries were:

- \* the **de-centralisation** of the electricity supply industry following the report of the Herbert Committee in 1956
- \* the **centralisation** of the gas industry in the early 1970s
- \* the "**streamlining**" of the regional water authorities in 1983
- \* and the "**liberalisation**" of the energy industries in 1982-83

Each of these structural changes will be outlined very briefly in turn.

In July 1954, the Herbert Committee was set up "to inquire into the organisation and efficiency of the **electricity** supply industry" and it reported in early 1956. As well as foreshadowing the revised approach to the financial management of the nationalised industries that was introduced in the two White Papers in the 1960s, the Committee recommended major changes in the structure of the electricity industry. The basic formula for change proposed by Herbert was included in the 1957 Electricity Act, namely: (i) the abolition of the Central Electricity Authority (the name had been changed

from the British Electricity Authority in 1955) and its replacement by the Central Electricity Generating Board and the Electricity Council, and (ii) the provision of greater financial and operational autonomy to the Area Boards. The purpose of these legislative changes was firstly, to separate electricity generation and bulk supply (CEGB) from overall co-ordination and control (EC); and secondly, to expand the operational freedom of the Area Boards responsible for electricity distribution. In effect, the restructuring of the electricity supply industry moved it substantially towards the model adopted in the nationalisation of the gas industry in 1948.

Paradoxically, the gas industry itself, had in the years subsequent to nationalisation been moving in the opposite direction. The de-centralised structure of the industry had initially been premised on the belief that - unlike electricity with its national grid - there were no significant advantages to be gained from a centralised mode of operation. Yet, in practice in the 1950s, the industry moved towards a more centralised approach:

*As early as 1953 the Gas Council reported that the benefits of planning and control of production and distribution over far larger areas than was previously thought necessary were leading to more centralized forms of organization. Vickers & Yarrow (1988) p. 246*

The discovery of major natural gas reserves in the North Sea Basin in the mid-1960s and the subsequent development of a 'national grid' for natural gas transmission, served to accelerate the process of centralisation. The technology-led changes in the structure of the gas industry were formally recognised in the 1972 Gas Act, with the amalgamation of the Gas Council and the twelve Area Boards into a unified organisational entity - the British Gas Corporation. In marked contrast with the 1957

changes to the electricity industry, the autonomy of the Area Boards had been exchanged for greater central co-ordination and control.

The changes introduced into the water industry in 1983 were less visible and dramatic, but in their own way of equal significance to those effected in the electricity and gas utilities. As indicated earlier, the boards of the regional water authorities established in 1974, were quasi-representational bodies with substantial provision for local government representation. In the view of Kinnersley (1988a) the provision of extensive opportunities for local government participation on the RWAs was inspired by a desire to placate local authorities, following their un-compensated loss of water assets, as well as a need to establish "a degree of political validation" (p.99) for the new regulatory and multi-purpose authorities.

Aside from the problem of establishing gargantuan boards to satisfy the representational requirements of local authorities (one RWA, for example, had a membership of fifty-eight), this mixture of public corporation and 'representative committee' in the structure of the RWAs was seen to present formidable accountability difficulties:

*The result was a political tension..between the constitutional position of water authorities as bodies accountable to central government and the traditions of local accountability by elected members.*

Day & Klein (1987) p.137

Buttressed by a report from the influential Monopolies and Mergers Commission, the Conservative Government introduced legislative change in 1983 (*Water Act*) aimed at creating smaller, Ministerially-appointed, and 'business-like' boards. The provision for local government representation was abandoned; although local authorities were to be

represented on the newly-created divisional consumer consultative committees. In addition, "...meetings were closed to the press and public, and a series of chairman vacancies filled by people with experience of industry rather than of public or environmental affairs" (Kinnersley, 1988a, p.112). In essence, the changes introduced by the 1983 Water Act were designed to stimulate the development of a more rigorous commercial ethos in the management of the water industry.

The final structural modification to the utility industries was more one of intent than realisation. It relates to the passing of two pieces of legislation in 1982 and 1983, explicitly oriented at breaking the monopoly hold of the [then] nationalised gas and electricity industries. This legislation,

*..reflected a shift in public policy toward an increased emphasis on the use of competitive forces as a method of influencing the performance of the nationalized industries. Vickers & Yarrow (1988) p.257*

The 'liberalisation' measures, contained in the *Oil and Gas (Enterprise) Act* and the *Energy Act*, opened the way for private suppliers of gas or electricity to sell energy, and to gain access to the public transmission and distribution network. In the event, the partial 'deregulation' of energy supply, implicit in the legislation, was overtaken by the Government's decision to privatise the British Gas Corporation and the electricity supply industry. Interestingly, as an indicator of the prospects for competition in the energy industries following privatisation, neither legislative measure stimulated much interest or activity from potential alternative suppliers.

Symbolically, the 'liberalisation' initiatives in the energy industry, along with the 'commercialisation' of the water authorities, represented important historical milestones

in the structure and orientation of the public utilities. For in substance, they completed a process of gradual disengagement from the principles of public provision and public service that underlay - however fragilely - the original nationalisation programme. Politically, the policy actions of the Conservative Government in the early 1980s vis-a-vis the utilities, set the scene for their ultimate privatisation.

### **PART 3: NATIONALISED PUBLIC UTILITY PRACTICE - A CASE STUDY OF THE CODES OF PRACTICE**

*At present the [energy] industries can, and sometimes do, inflict injustices on disadvantaged citizens with the full support of the law. Berthoud (1983) p.142*

As voluntary and 'stand alone' measures (i.e. without supporting policy actions aimed at addressing the causes of fuel and water poverty, and minus a system of enforceable sanctions for code violations), codes of practice are likely to be ineffective in responding to substantive access and equity issues. They may enhance the image, and some aspects of the practice, of the industries' 'customer care' role, but codes of this sort will, at the very most, only be ameliorative in their impact. The history of the voluntary code of practice introduced (initially with reluctance) by the nationalised energy industries in Britain in 1976 provides illustrative evidence of this.

The 1976 code of practice was formulated in the wake of that watershed event in recent world history - the 1973 'oil crisis' - which at the one time revealed the fragility and inter-dependency of Western economies, and the vulnerability of domestic energy prices

to the vagaries of the international marketplace. The pervasive impact of the 'crisis' invariably stimulated popular and political interest in domestic energy issues.

Contrary to public perceptions, at the time, there was no evidence of a dramatic increase in the number of domestic disconnections over the first half of the 1970s, despite the sharp rises in energy tariffs (Berthoud, 1983). Popular opinion was not entirely askew though, as there had been a steady growth in the aggregate number of gas and electricity disconnections in the period 1973/74 to 1975/76. The empirical situation on domestic disconnections notwithstanding, a heightened consciousness of energy costs focused public and political attention on the newly-defined phenomena of 'fuel poverty'. Much of the direct stimulus for elevating fuel poverty as an item on the public policy agenda in the mid-1970s came from organisations such as the National Consumer Council and nascent activist groups such as the National Right to Fuel Campaign.

In contrast to the fuel boards, the social policy role of the water authorities attracted remarkably little attention. The mid-1970s concern about the ability of low income households to access (or more particularly, to maintain access to) essential services, in a context of escalating prices and an apparently vigorous approach to debt management and the use of disconnection powers, was not mirrored in the water industry. This might be attributed, firstly, to the fact that water tariffs up to this period and beyond represented a very small component of the expenditure of most households. To borrow a phrase, used with notorious inaccuracy by the advocates of nuclear power in Britain until 1989, water was seen literally as "too cheap to meter". Secondly, as reflected in the following quotation from the National Consumer Council's report on fuel poverty,



the water authorities were perceived as taking a rather different approach to disconnection compared to their energy counterparts:

*Strictly speaking, the water industry has the powers to cut off supply for non-payment. But these powers are scarcely ever used; as the water industry acknowledges, the consequences of depriving a household of its water supply would be appalling. Instead, debts are pursued through the courts.*

National Consumer Council (1976a) p.81 footnote

The position of the water industry in respect to both tariff and disconnection policy, and certainly public consciousness of these dimensions of water industry practice, was to change quite dramatically during the mid-to-late 1980s.

In 1976, the then Secretary of State for Energy, Tony Benn, commissioned an 'informal inquiry' to examine the "payment and collection methods for gas and electricity bills". The report of the committee of inquiry (known as the Oakes Report after its chairman) recommended *inter alia* that "the power to disconnect supply to domestic consumers should no longer be exercised and the first opportunity should be taken to legislate accordingly", and that "the industries should agree upon a common code of payment methods" (Department of Energy, 1976, p.10). These recommendations were strongly supported by community sector organisations like the National Consumer Council (in its landmark report *Paying for fuel*, 1976a, pp.81-84) and the National Right to Fuel Campaign.

Whilst the passage of legislation abolishing disconnection as a device for enforcing payment was not realised, a voluntary code of practice on debt management and disconnection was introduced during 1976. In the view of Bradshaw (1983) and

Berthoud (1983) the code of practice was accepted by the fuel industries as a necessary 'trade off' in their successful political defence of the power to disconnect.

The clear intent of the 1976 code of practice was significantly to reduce, if not to eliminate altogether, the incidence of disconnection for payment default as a result of financial hardship. Among the most significant elements of the code were:

- \* a requirement to take the households circumstances and income into account prior to disconnection
- \* the suspension of disconnection action if an acceptable arrangement for clearing the debt was initiated by the consumer
- \* the introduction of stronger liaison and referral procedures between the utilities and welfare organisations
- \* the extension of alternative payment schemes to suit the budgetary needs of low income consumers, including the provision of pre-payment meters and 'budget accounts' (i.e. paying by monthly or weekly instalments, rather than quarterly)
- \* the introduction of a moratorium on disconnections for pensioner households between October and March.

Against the background of the industries' performance prior to 1976, the code of practice (with its two minor revisions in 1978 and 1980) represented a symbolically important, if practically modest, advance in the social responsiveness of the nationalised utilities. But in the light of its original objectives, the code was a significant failure. The impact of the code in the core area of disconnection, was summarised by Richard Berthoud (who led the Policy Studies Institute evaluation of the code of practice in 1980-82) in unequivocal terms:

*..the existing Code of Practice has failed to minimise disconnections in cases of real hardship. Almost all of the customers concerned are in*

*hardship, one way or another. The electricity industry has a relatively high rate of disconnection, and a poor record, compared to the gas industry, over the implementation of the letter and spirit of the Code. But the gas industry, with its better record and lower disconnection rate, has not managed any better to winnow out the hardship from the non-hardship cases. A radical reform of the Code of Practice is needed.*

Berthoud (1983) p.84

Disquiet about the effectiveness of the code of practice as a mechanism for enabling low income households to manage fuel debt and retain supply was crystallised in a major review of the code by the Policy Studies Institute. The review, which was commissioned by the fuel industries and the electricity and gas consumer bodies, reported in 1981 and among its conclusions and proposals for overhauling the provisions of the code were the following:

- \* the fuel boards should make more strenuous attempts to establish personal contact with consumers in debt prior to disconnection
- \* an explicit offer concerning the repayment of debt should be made to consumers with payment problems (under the old code, the onus was on the debtor to propose a repayment arrangement)
- \* the automatic installation of a prepayment meter in lieu of disconnection. The meter could be also calibrated to recover previous debt.
- \* the introduction of a standardised schedule for the repayment of debt in hardship cases
- \* the partial writing-off of large accumulated debt amongst low income consumers
- \* the development of an effective system of independent monitoring the code of practice

The PSI review did not support a total abolition of the industries' power to disconnect, primarily because this measure, in itself, was viewed as a deficient response to the problem of fuel debt:

*[the] problem is to ensure that electricity and gas are paid for with the minimum of expense to the suppliers and the minimum of hardship to the consumers. It is in the interest of both parties that payment is clearly unavoidable, and that the procedures for ensuring debt payment should be sufficiently rapid to present [sic: prevent?] the build-up of debt. The simple and unilateral abolition of disconnection, without substitution of an alternative system, will not achieve either of those essential aims. Berthoud (1983) p.139*

An extension of the winter moratorium on disconnection for groups other than pensioners was not supported for similar reasons. Interestingly, in light of the failure of the water industry code of practice introduced at the time of privatisation (Condition H - see Chapter 7), the review also identified flaws in the proposal made by a number of consumer organisations, that the court system be used as the arbiter of debt management agreements between the industries and consumers (as is the case in most other instances of consumer debt). In Berthoud's (1983) view, the 'courts solution' was likely to be both expensive and protracted (hence leading to the build-up of further fuel debt over the period of court action), without any guarantee that they would be any more adept in dealing with debtors in hardship than the industries had been.

The use of prepayment meters as an alternative to disconnection was seen as the most satisfactory compromise to the problem of reconciling the industries' need to recover debt with the desire to secure supply for low income consumers with debt problems. Limited empirical evidence (such as that produced by the National Consumer Council in its 1976 survey) indicated that prepayment meters were popular amongst low-income households as a means of controlling fuel expenditure. But the proportion of households in Britain paying for electricity and gas via prepayment meters had fallen sharply over the 1970s.

In 1966-67, two million electricity consumers in England and Wales, and over six million gas consumers in Great Britain paid for their fuel through prepayment (mainly coin-operated) meters. By 1975-76, this had fallen to one and a half million and three million respectively (NCC, 1976a, Table 4.1). In 1975-76, 23.7 per cent of domestic gas consumers used prepayment meters, whereas the proportion had dropped to 12.6 per cent by September 1981.

Cost and security factors underlay the explicit desire of the energy industries to move away from the use of prepayment meters as a major revenue collection method. In addition, the industries were possibly responding to a preference by the bulk of domestic consumers for credit, quarterly payment, arrangements. However, through withdrawing prepayment meters, and in discouraging their future use, the industries were effectively removing the payment option seemingly favoured by (and arguably, most suitable to) many low-income households. In the view of the Policy Studies Institute, prepayment meters represented a legitimate payment method for domestic consumers, and for low-income consumers in particular. And despite the compulsion involved in the industries' "insisting on the installation of a prepayment or other automatic meter" (Berthoud, 1983, p.140), it - like the Oakes Committee previously - argued that this was immeasurably superior to disconnection from supply.

The reaction of the electricity and gas industries to the PSI Review recommendations was mixed. Although some of its' recommendations were ostensibly accepted in full, a number of the more significant changes proposed in the Review were excluded, at the behest of the industries, from the re-drafted code of practice published in July 1982. In

particular, the industries rejected the suggestion of a partial write-off of large-scale consumer debt, and the introduction of a standard formula for determining payment agreements in hardship cases. In the latter, the industries argued that "rigid formulae would be too inflexible" and that consumers should be treated "on a individual basis [and] assessed according to his circumstances" (The Industries' Response to the Policy Studies Institute's Reports' Recommendations, in National Gas Consumers' Council, 1985, Appendix 3).

Most significantly, in light of the subsequent implementation of the Code, the industries did not agree to the automatic installation of prepayment meters in lieu of disconnection; instead they agreed to install them "..on request where it is safe and practical" (ibid). The energy utilities also saw the responsibility for monitoring the code of practice as falling within the ambit of the existing regional electricity and gas consultative/consumer councils, and held the view "[it] is unlikely that the establishment of additional bodies to undertake the work..would give the customer any additional protection" (ibid).

As in the case of its predecessor code, the 'bottom line' in measuring the success of the 1982 Code of Practice is the extent to which it reduced - and ideally ultimately eliminated - disconnections from supply amongst households experiencing fuel debt problems due to financial hardship. But despite some initial modest success in electricity, the overall level of domestic energy disconnections remained high up to end of 1986, when British Gas was floated on the Stock Exchange.

In 1981, almost 138,000 households were disconnected from supply by the two industries; in 1986, this had risen to approximately 145,000 households. The marginal decline in electricity disconnections over this period was more than offset by a sustained rise in gas disconnections, which was to reach its peak in the twelve months after privatisation.

In his study of disconnection, as part of the PSI Review, Berthoud found that more than 90 per cent of disconnections occurred in households with hardship problems. If this pattern continued in the period 1981-1986 - and there is no evidence to suggest otherwise - then the great bulk of those disconnected in the first five years under the new Code would have been households falling into the hardship category. In this respect then, the 1982 Code of Practice appears to have offered little more protection to financially vulnerable consumers than the one which preceded it.

The resistance of the fuel industries to the use of prepayment meters as a generic 'solution' to fuel debt is reflected in the monitoring reports of the electricity and gas consumer bodies on the Code of Practice, published in 1985 (ECC, 1985; NGCC, 1985). Although an upward trend in the number of electricity prepayment meters installed was reported by the Electricity Consumers' Council, "...too many consumers are still refused a prepayment meter, when technical alternatives are available" (ECC, 1985, p.45).

Little apparent attempt was made by the gas boards to match even the electricity industry's very modest progress towards meeting the commitment in the Code to extend the availability of prepayment meters for consumers in debt. The installation of prepayment meters dropped sharply, from a peak of almost 70,000 per year in 1983, to less than 40,000 in 1986. This could hardly be attributed to reduced demand or need for this form of payment arrangement, for as indicated above, disconnections were rising steadily over the same period.

The monitoring reports of both consumer bodies indicated that the industries adherence to the provisions of the Code had much in common with its historical antecedents in other respects as well. Compliance with the letter - let alone the spirit of the Code - was extremely variable across the country, with a few region/area boards substantially out-performing their peers in their endeavour to implement the Code. Conversely, boards in other parts of the country displayed an almost blithe contempt for the objectives of the code of practice. This was particularly evidenced in the practices initiated by individual boards to establish contact with consumers prior to disconnection. In general, however, measures to establish contact were unsatisfactory:

*No contact cases represent a significant proportion of disconnections, and the considerable efforts made by the gas industry to contact consumers do not appear to be sufficient to ensure that contact is made. NGCC (1985) p.7*

*..most boards only seek to communicate with their consumers by means of letters and little else is done to establish personal contact. ECC (1985) p.16*



In conclusion, the voluntary code of practice approach to the stimulation of greater social responsiveness amongst the nationalised utilities, as manifested in successive British Codes over the 1970s and 1980s, could hardly be seen to have been anything more than a marginal success. As policy initiatives essentially designed to eradicate the use of disconnection amongst poor fuel consumers, the 1976 Code and its 1982 successor, were dramatic failures.

At a lesser order of ambition, as mechanisms for promoting greater sensitivity within the utility industries for the circumstances of disadvantaged consumers, and for stimulating greater accountability in the management of debt collection, the British codes probably contributed to some modest advances being made. But in the context of the increased commercialisation of the nationalised utilities and in the absence of an effective regulatory infrastructure (and complementary central government income and energy efficiency policy measures), the voluntary codes were always likely to be incapable of addressing residual and deeply-entrenched equity and access problems in the supply of utility services.

Perhaps most of all, the history of the codes of practice underlined the gulf between the rhetoric and reality of "public service" as a ruling principle in the nationalised industries, and illustrated that public ownership is not in itself a sufficient condition for the enactment of a citizenship model of utility service provision.

## ANNEXE 2: A NOTE ON THE RESEARCH FOCUS, FIELDWORK AND DATA SOURCES

### (i) Research focus

This study began its 'career' as a comparative analysis of the social consequences of public utility policy and management under different ownership conditions. Originally, it was envisaged that the research would compare social policy-related aspects of the performance of public utilities in Britain and Australia under privatisation and public ownership respectively. However, after an initial period of data gathering in both countries this approach was abandoned, for two reasons. First, the changes effected in the public utility arena in Australia over recent years, involving 'corporatisation' and a move towards privatised models of operation (see Ernst, 1992), reduced the validity of the Australian system of public utility organisation as a structural comparator with Britain. Second, a detailed study of the three public utilities in Australia, in addition to the utilities in Britain, would have extended the scope and complexity of the research task considerably. Ultimately, it was decided that the research would be likely to achieve greater coherence and depth by focusing exclusively on the British experience.

A decision was also taken, at an earlier stage, to exclude telecommunications from the field of research enquiry. The energy and water industries display similar features along the important dimensions of natural monopoly, essentialness, demand inelasticity and externalities. A number of these features are not as strongly in evidence in the telecommunications industry, and the network character of telecommunication services is being transformed dramatically as a result of technological change. In addition, the

energy and water utilities have a degree of interconnectedness which they do not share with the telecommunications sector. This is evident at the point of production (e.g. the use of water and gas in electricity generation) but also, increasingly, at an operational and ownership level e.g. Welsh Water's substantial shareholdings in South Wales Electricity and British Gas' involvement in electricity generation in Northern Ireland.

(ii) Fieldwork and sources of information

Much of the data contained in this thesis has been gathered during two periods of fieldwork, where the researcher (a) conducted semi-structured interviews with key informants and (b) directly accessed relevant documentary material. The primary focus of data collection in phase 1, from July to October 1989, was on the privatisation process i.e. the events leading up to and immediately following, the passage of the major privatisation legislation; whereas in phase 2, during July and August 1992, the interviews were specifically focused on the implementation and outcomes of the privatisation programme and on the operation of the new framework of public utility regulation. In addition, the researcher had been a participant observer in the Public Utilities Access Forum (1989-1991, second half of 1992), the National Right to Fuel Campaign (1989-1991), meetings with the regulatory bodies, the Yorkshire Customer Service Committee, and over the period in Australia, a correspondent with members of a number of the major community sector organisations and the regulatory agencies.

Interviews were held with individuals from the following organisations and groups over these two periods of field work:

- \* Age Concern
- \* Association for the Conservation of Energy
- \* Association of Metropolitan Authorities
- \* Birmingham Money Advice Centre
- \* British Gas
- \* Centre for Regulation Policy, University of Oxford
- \* Child Poverty Action Group
- \* Community Technical Services Agency, Liverpool
- \* Consumers' Association
- \* Electricity Supply Trade Union Council
- \* Environmental Change Unit, University of Oxford
- \* Gas Consumers Council
- \* House of Commons Select Committee on Energy
- \* MANWEB
- \* NALGO
- \* NACAB
- \* National Consumer Council
- \* NCVO
- \* Neighbourhood Energy Action
- \* Northern Electric
- \* Office of Electricity Regulation
- \* Office of Gas Supply
- \* Office of Water Services
- \* Sheffield City Council
- \* Winter Action Against Cold Homes
- \* Yorkshire Customer Service Committee

In most cases at least two separate interviews were held with members of these organisations.

As the text of the thesis indicates, the researcher has made substantial use of a diverse range of primary and secondary documentary sources. Major sources of primary documentary material have included:

- \* Company Annual Reports, codes of practice and other customer-related information
- \* Reports, letters and press releases published by the three regulatory bodies

- \* Reports, position papers and other written material produced by consumer and community sector organisations
- \* Hansard, White Papers and government policy statements
- \* Press reports

Wide use has been made of secondary data, in the form of official statistics, government-commissioned research reports, statistical data from the regulatory bodies, research studies by organisations such as the Institute for Fiscal Studies and extant survey data on consumer perceptions etc. The literature on privatisation and economic regulation has been extensively accessed.

The Bibliography contains a full citation of the written material used in the course of the research.

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*So study evermore is overshoot:  
While it doth study to have what it would,  
It doth forget to do the thing it should;  
And when it hath the thing it hunteth most,  
'Tis won as towns with fire, so won, so lost.*

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