The harm done by regulators

When nationalised industries were privatised the intention was to create plcs with private sector shareholders providing the capital to allow the companies to operate free of Treasury restraint and ministerial interference. Thus unfettered, they would be able to invest in modernising their infrastructures and provide a better service to customers while providing a fair return for the shareholders. With Rolls-Royce, BP and Associated British Ports that is what happened.

Sadly, for the utilities such as gas, water, electricity, telecommunications and the railway, the intervention of their regulators has entangled them in various new forms of intervention which are having a damaging effect on their performance, limiting what they have available for infrastructure investment. In some cases these policies have retarded the introduction of technological innovation.

Specific examples are:

Water

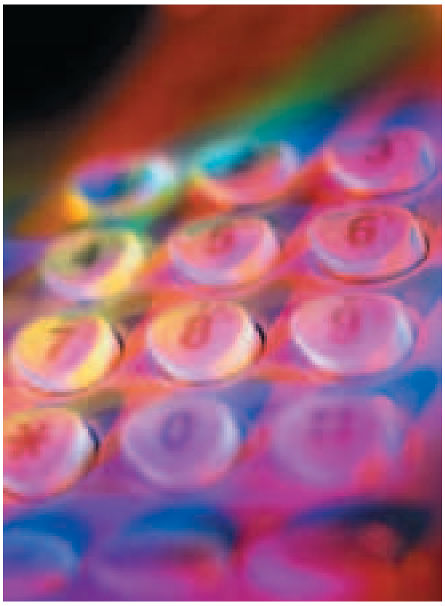
Relentless downward pressure on prices and permitted returns reduced the funds available for investing in long overdue infrastructure modernisation which led to criticism of the regulator by the House of Commons Select Committee. Water companies were driven to divide themselves into regulated businesses earning a modest fixed return and non-regulated businesses developing alternative risk-taking types of activity with prospects for growth. Some of the regulated businesses have been sold off to overseas owners, e.g. Thames Water to RWE, and others to nationalised European companies, who optimistically believed that the regulatory regime here would be more benign than their own, only to discover the reverse to be the case. Some have sold out.

Railways

The regulator has made demands on the rail regulator which have distorted the priorities for restoring the rail network to an acceptable physical standard for the operation of trains in a reliable and safe manner. A complex system of penalties and heavy fines for lapses of punctuality has sucked cash out of Railtrack to an unrealistic extent. Changing policies in strategic planning have wasted investment and introduced delays. Frequent loud criticism of Railtrack management weakened investor confidence, which led to a serious reduction in the Stock Market valuation of the company. In turn, this reduced the company's capacity to raise much needed private sector capital to repair the many years of under-investment bequeathed to Railtrack at the time of privatisation. None of this is intended to imply that Railtrack has been blameless but the company's professional engineers have worked hard to cope with serious problems and the regulator's relentless criticism has been unproductive.The end result was a disaster for shareholders.

Telecoms

The regulator has consistently prevented BT from introducing new services in order to give its competitors time to become established. A specific example was the refusal to permit BT to provide TV services over its fixed lines which would have given it an incentive to invest in broadband services to the home – the absence of such an incentive is now plain to see. The facts are that the competitors supplying cable TV fixed line services have neither had the financial nor the engineering strength to provide fibre-optic connections on a national scale and have incurred huge losses.



In some newer technologies BT has been restrained from lowering prices because the regulator would deem it predatory. On the other hand, the formula that obliges BT to reduce access charges annually serves as a barrier to new entrants to the market.

With mobile telephony there is plenty of competition, so there is no need for a regulator at all. Nevertheless, the regulator has now started to meddle in this complex technical area. This is an industry which has grown from scratch with private sector capital in which two firms currently make a profit and two a loss, which clearly indicates a healthy level of competition.

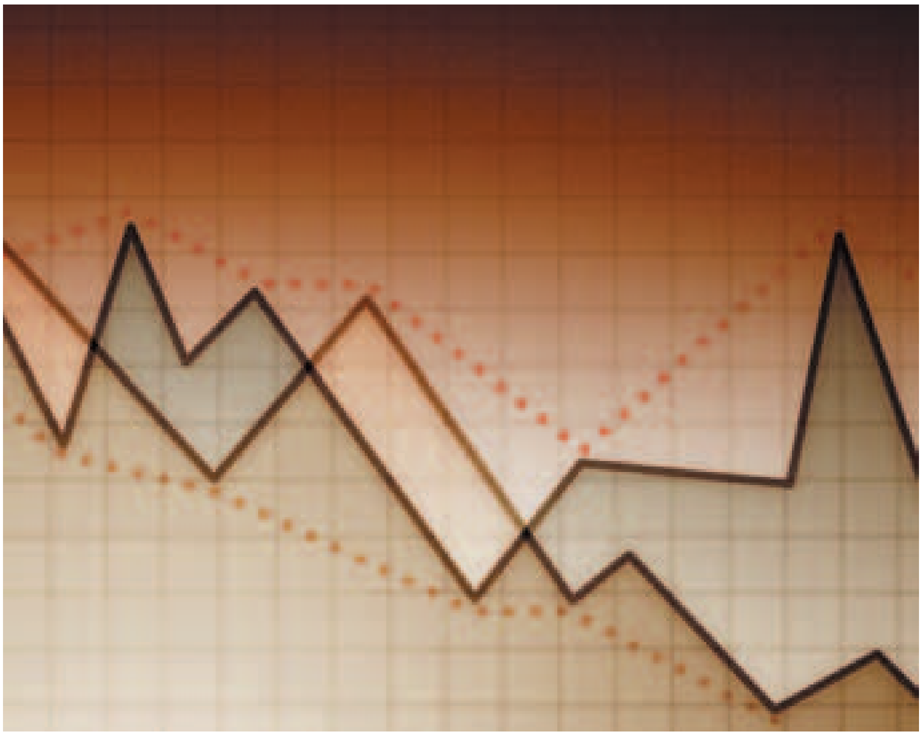
Electricity supply

The British electric supply industry was one of the best in the world but the activities of the regulator have provoked fragmentation which was never envisaged at the time of privatisation. Distortions have been introduced which caused companies to restructure to minimise the impact of the regulator on risk businesses. This has resulted in several companies being sold into overseas ownership, only for them to be resold in some cases after their purchasers have themselves become disillusioned. Was it ever the government's intention that London Electricity should be in the hands of the French nationalised electricity industry?

The regulator's concern with increasing competition and driving down prices conflicts with the need for policies to ensure a strategic mix of energy sources and reconsideration of nuclear power to meet the Government's environmental commitments.

The regulators

The regulators are independent of government. Ministers leave them alone and they have become laws unto themselves. Each one has been appointed from a different background and usually with no prior knowledge of their industry and none with the



technological training and experience to understand the issues affecting modernisation. As a result they go into the market and hire technical staff. For example, the Rail Regulator has 162 staff, Oftel 242, etc. In disciplines where there is an acute shortage of engineers, such as the railway industry, the regulator and the industry compete in the same personnel market. The companies have created departments to deal with the day-to-day demands of the regulators which seems to be an unproductive duplication. Certainly, the engineers involved would have been more productive working inside their industries.

The Post Office is the latest to have a regulator. In the space of a few months he has acquired about 50 staff and made plans for introducing competitors who will cream off the more lucrative traffic while expecting the Royal Mail to deliver letters to every house in the country, including the most remote areas. The Post Office, with its faults, is the best in the world and has made a profit every year from 1977 to 2000. The regulator will provide another example of harming an industry as Royal Mail earnings decrease and confusion for the customer develops.

The activities of the regulators follow no set pattern and depend to a large extent on the policy of the individual, but, looking back to the early eighties when serious privatisation was introduced, it is questionable that the way the regulators have been allowed to operate has been beneficial. The time has come for the Government to take stock of the regulatory regime and examine what needs to be done to bring constructive interaction between the industries and their regulators. It is now clear that the simplistic view that competition alone will produce an efficient strategic industry is insupportable.

One suggestion is that each regulator should have a non-executive board of senior individuals expert and experienced in the technologies and practices of their industries. The electricity regulator did this on a number of major price reviews and he and the industry benefited from well informed advice. The boards would meet, say, quarterly and the regulators would be expected to seek their opinions on major, technological matters and strategic issues. The Royal Academy of Engineering could help to identify suitable eminent engineers. ■