Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Harvey Morris

Failing privatisations add to the woes of Broken Britain

British households will be paying more for their water from the start of this month, adding insult to injury amid a crisis in a privately-owned sector blighted by decades of excessive profit-taking and underinvestment.

The issue came to a head at the end of March when the institutional owners of Thames Water, the biggest UK regional supplier, reversed a pledge to provide £500m in emergency funding to cover short-term cashflow.

Their decision was linked to a stand-off with the water regulator, Ofwat, which had baulked at the company's proposals to push bills even higher.

The dispute has exposed a wider phenomenon whereby investors in the UK's most basic utilities and infrastructure have for years been cashing in on their monopoly positions, using complex ownership structures almost as murky as the nation's sewage-polluted waterways.

Somewhat confusingly, Thames Water's harshest critics include some of the most enthusiastic partisans of a privatisation drive that saw state-run utilities sold off in the first place.

Monopoly status

As free market commentators were busy denouncing the unacceptable face of rentier capitalism, Conservative minister Michael Gove was branding Thames' management as "a disgrace" for having prioritised profits over the interests of consumers.

Perhaps the apparent ideological volte face should not be so surprising. The supposed merit of the privatisation revolution initiated by Margaret Thatcher in the 1980s was that it would expand consumer choice while creating a share-owning democracy.

One problem with that scenario is that Thames Water and its other regional counterparts have retained their monopoly status. Its 16 million customers across London and southern England have no choice over who supplies the product emerging from their taps.

Additionally, they cannot buy shares in the supplier. Its retail shares stopped being traded in 2001, 12 years after privatisation, when Germany's RWE utility group became the first of a series of institutional investors to buy it.

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That trajectory has not been unique to Thames, or indeed to the water industry. Since the Thatcher years, and particularly since the 2008 international financial crisis, large-scale investors worldwide have been ploughing funds into direct ownership of basic infrastructure rather than relying on the traditional currency of stocks and bonds.

Investors such as pension funds and insurance companies were assisted by increasingly powerful asset managers, who raised mountains of debt to finance complex structures, often involving offshore tax havens, and to pay their own generous fees and bonuses.

The Australian asset manager Macquarie aquired Thames in 2006 and sold out a decade later by which time it had increased the utility's debt pile fourfold to more than £10 billion.

In the final two years of Macquarie's tenure, it paid out £239 million in dividends, depite having been previously heavily fined for extensive sewage pollution, the result of what a presiding judge described as "inadequate investment, diabolical maintenance and poor management".

Light-touch regulation

Over the years, interest from institutional investors and asset managers has extended beyond utilities to include infrastructure such as housing, transportation and even public facilities such as schools and care homes.

This worldwide trend was enthusiastically embraced by successive UK governments, as it facilitated the financing of vital public services while keeping the borrowing costs off the Treasury books.

That enthusiasm was matched with a preference for light-touch regulation, seen as a necessary bait to encourage such inward investment. In the process, politicians may have overlooked warnings about the inherent vulnerabilities of the system, particularly in periods of higher interest rates.

> "They've actually prioritised financial engineering...and none of them have done the housekeeping" - Dieter Helm

Even before the 2008 financial crisis, Oxford economist Dieter Helm was warning that the financial structure of privately owned but regulated utilities, such as the water companies, would lead to excess profits and underinvestment.

In a recent update at the end of December, he listed Thames Water, alongside Royal Mail and government-funded Network Rail, as having failed the promise of privatisation. "They've actually prioritised financial engineering...and none of them have done the housekeeping, the day job, of delivering the services," Professor Helm said in a podcast.

He stressed that they were not alone among companies across the utilities sector that had failed customers by poorly maintaining their assets.

How to guarantee essential services?

There is no way for politicians any longer to avoid the long-building crisis, now that Thames Water's nine investors are threatening to walk away.

In terms of the size of their stakes, they are led by the eminently respectable Ontario Municipal Employees Retirement System and Britain's equally worthy Universities Superannuation Scheme, with the Chinese and Abu Dhabi sovereign wealth funds and a range of investment managers bringing up the rear.

If they fail to strike a deal with the regulator, the most likely outcome is that Thames would go into special administration, nationalisation in all but name.

A comparison with the defunct rail infrastructure company, Railtrack Plc, that was put into administration in 2001, is less than encouraging. Its functions were taken over by Network Rail which, as Professor Helm pointed out, is yet to make the trains run on time.

Polling indicates that a comfortable majority would like to see the rail network renationalised, while most people would like to see other utilities and services, such as energy and care home provision return to the state sector

Given the dissatisfaction among voters, Conservatives included, about the state of the nation's public services, it might be time for the government to bite the bullet and simply acknowledge that some sectors are just not suited to the privatisation model.

Polling consistently indicates that a comfortable majority would like to see the rail network renationalised, while most people would like to see other utilities and services, such as energy and care home provision return to the state sector.

The chances of such a drastic government U-turn so close to an election are close to zero. What might appear as common sense to most voters would amount to a Conservative admission of defeat.

The ultra-cautious Labour Party is meanwhile is desperate not to be seen as the party of state control. At its 2023 conference, trade unions and the rank and file voted to reaffirm support for nationalisation of the rail and energy industries in a motion opposed by the party leadership.

Whoever forms the next government will be under intense public pressure to solve this latest chapter in the saga of Broken Britain, with a comprehensive plan on how to guarantee essential services.

In the meantime, rail travellers should continue to check for cancellations before they head to the station and bathers should lookout for sewage before they take a dip.