Ian Byatt on Water Regulation
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After 30 years as part of the private sector, the water industry of England and Wales is under attack from all sides. Jeremy Corbyn's opposition Labour party had proposed to renationalise it. Investors reacted angrily to those plans. Now, Ian Byatt, former head of the industry regulator, apostle of privatisation and pioneer of regulation, has added trenchant criticisms of his own.

In a book reflecting his more than four decades of experience of the utility sector, he writes: "Customers have been overcharged; dividends have been excessive; there is a bias towards capital expenditure." What has gone wrong?

First, he thinks that, however bad things may seem now, they were worse under nationalisation in the 1970s. He has inside knowledge, as the Treasury's former second permanent secretary in charge of the sector. The long trench war to impose economic disciplines on the nationalised industries is described in some detail in the first section of his book. This part of his account, dating from 34 years ago, has become topical once more, as nationalisation has lurched back on to the political agenda. This section makes an instructive contrast with his criticisms of the modern industry.

This book is a collection of papers and speeches that Sir Ian gave during his 10 years as the first director-general of Ofwat, and later as the regulator of Scotland's state-owned water company. It is not a historical account and the tone is that of an economist. However, Sir Ian writes clearly and his assessment is sharply pointed. His arguments should be considered carefully by anyone who wants to reform the sector.

Why does the water industry need reform? Sir Ian makes a convincing case that the early years of privatisation were a success. It is true that water prices rose steeply while company dividends were generous. But price controls forced companies to shed old inefficiencies much faster than was expected. Shareholders may have reaped the early harvest, but customers also shared the benefits after the first five-year price review. That is how price controls were supposed to work.

However this gain was masked by price rises caused by the government's decision to load heavy costs on to the industry for stricter water quality and effluent standards. Sir Ian argued strongly against those new standards that he thought were excessive. T

he rot set in with a frenzy of takeovers. He writes that this began with a "soft" price review in 2004. Private equity and sovereign wealth funds fell over each other to snap up rich pickings, as "dividends increased dramatically". The takeovers resulted in opaque and labyrinthine ownership structures, blurred lines of responsibility, subsidiaries in the Cayman Islands, a delisting of most companies and a sense that financial engineering had become more important than providing a service. It became clear that the companies were gaming the system. They put forward large and sometimes unnecessary investment programmes on which they could get a guaranteed return.

Sir Ian observes that they did not retain profits for investment. Instead they vastly increased their debt. The industry's total debt is now close to the £56bn that has been paid out in dividends since privatisation. Sir Ian had been in favour of increasing debt to lower the cost of capital. But in recent years shareholders benefited more than customers. In his words, the companies were making "high-risk returns on low risk investments". Sir Ian, among others, had argued that the water companies should be completely open to takeovers, except by each other. The idea was that this would encourage efficiency and innovation. It probably did, but the darker consequence was not foreseen.

So are there remedies? Sir Ian's recipe is tougher regulation and, above all, independence from detailed interference by the government. He also says that water companies should be listed on the stock exchange. And that, surely, ownership should be transparent, preferably not dominated by funds addicted to short-term financial gain.

This book shows clearly how mistakes were made, but it gives at least some pointers to putting them right.