Briefing Paper

PRIVATISATION

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With the appointment of a new Secretary of State for Trade and Industry the government have announced that they intend to proceed "briskly" with a programme of privatisation. This word has many different meanings, but it broadly corresponds to what twenty years ago would have been called de-nationalisation. In pursuit of this programme, the government have already sold off their majority shareholdings in Amersham, Britoil, Cable & Wireless, and Associated British Ports.

The timetable for the disposal of other major public enterprises is as follows. This year, the government hope to pass legislation enabling the sale of their shareholdings in British Telecom and British Airways, the oilfields of British Gas, the Sealink services of British Rail, the repair yards of British Shipbuilders, and the Royal Ordnance Factories. Next year, it is intended to sell the Jaguar, Land Rover, and Unipart divisions of BL, the National Bus Company (the fate of the Scottish Transport Group remains unknown), the British Airports Authority, and the warship yards of British Shipbuilders. (The sale of Scott Lithgow seems to have been as unplanned as the nationalisation of Rolls Royce in 1974.) Some time (unspecified) it is intended to dispose of British Steel, British Rail, British Gas, Rolls Royce, and the rest of BL. The other major publicly-owned enterprises i.e. the National Coal Board, the Post Office and the CEGB are not mentioned at all in the goverment's programme, and therefore their place in the timetable may be presumed to fall under the heading of "never".

It is difficult to discover any rationale in the order of priority which the government have set themselves for the process of privatisation. For example, Beesley & Littlechild (Lloyds Bank Review No. 149 July 1983) who are sympathetic to the idea of privatisation (indeed both authors were separately commissioned by the government to carry out independent studies of the future of the telecommunications industry) conclude that "the bulk of the consumer benefits that can be expected to follow from privatisation could be achieved by appropriately designed policies for .... five industries alone". These five industries are the CEGB, British Telecom, the National Coal Board, British Rail and the Post Office". Of these five, British Telecom appears on this year's list, British Rail appears in the government's "sometime" list, while the other three industries apparently fall into the "never" category.

The largest single source of the confusion which has plagued the debate about privatisation so far both in the press and in parliament is that the government apparently cannot, and many academic commentators such as Beesley & Littlechild are unwilling to, distinguish between two wholly different concepts: **the form of ownership** on the one hand (i.e. whether an enterprise is publicly or privately owned), and the **form of market organisation** on the other,(i.e. whether an enterprise operates in a competitive or monopolistic environment). People confused about this distinction are therefore unable to distinguish between the "privatisation" of an organisation (that is the transfer of the ownership of the enterprise from public to private hands) and the "liberalisation" of an enterprise or organisation, (that is the breaking or eroding of a monopoly whether it be publicly or privately owned) to enable a greater degree of competition in the supply of the goods and/or services that it produces. The possibility that an organisation might remain in public ownership while being fully exposed to the vagaries of market forces, without any more protection or regulation than that accorded its privately-owned competitors is either ignored or dismissed out of hand.

State owned enterprises in Britain vary considerably in the degree of competition which they face, or to put the matter another way in the form of the organisation of the market within which they operate. To the extent that the publicly owned enterprises which the government intends to privatise are at the competitive end of the market organisational spectrum (such as British Airways) there seems to be no particular reason, from the point of view of the public interest, why their ownership should be transferred into private hands. If retained in public ownership they should not be treated as British Airways have been in the past, with their losses being made up by the Treasury, and their profits (if any) going back into the Treasury's maw. They must be treated at arm's length, as are BP, and allowed to go bankrupt if necessary.

For those state-owned enterprises which are at the monopolistic end of the spectrum, such as British Gas or British Telecom, then traditional economic theory suggests that the public interest will be best served not by changing their form of ownership, but by changing the form of organisation of the market in which they operate, so that they are fully exposed to competition. In other words, they should not be privatised, but liberalised. If the rhetoric of this government was to be believed, it would be supposed that they had understood the benefits and advantages of competition. However it appears that they are opposed not just to bad economic theory but to any economic theory at all.

It may be argued that treating publicly-owned enterprises on the same basis as privately-owned ones will not work, because politicians will not be able to resist the temptation of intervening in the affairs of these companies in order to gain some political advantage. So long as there is a clearly understood arms-length policy, such as operates in the case of BP, this need not happen. But if there should be any worries on this score they could be diminished by the establishment of a state industrial holding company which would operate like any other conglomerate on strictly commercial lines. It may be asked, why bother to retain such enterprises in public ownership at all? Why not just sell them off for whatever the market price will fetch? There are several reasons why the state should retain ownership of a substantial number of enterprises (particularly large enterprises) in a modern advanced economy. There is in particular the argument, first advanced by Walras, that profits are composed largely of rents, and that the benefits should therefore accrue to the community as a whole. In the present age, where technical change, market size and government regulation bring windfall profits as well as political influence to large corporations, large concentrations of power are increasingly unacceptable. Those who are familiar with the behaviour of large publicly- owned corporations in the advanced countries will be aware of the practice of such corporations of putting the interests of their staff - especially their senior staff - ahead of the interests of their customers. It is important to understand, however, that this practice arises not because the enterprise in question is publicly-owned, but because it is a monopoly protected by the state. Once again, one must not confuse the principle of ownership with the principle of organisation.

To repeat, publicly-owned enterprises should be treated no differently from privately-owned enterprises. The government should intervene to ensure that the market mechanism operates in accordance with the classical principles of competition: it should in other words be the function of government to ensure that in every sector of economic activity there should exist sufficient diversity of thought and decision that innovation is encouraged and change is accepted. Government intervention should be actively, principally and continuously directed to the operation of this principle, entirely irrespective of questions of ownership.

That this distinction between the form of ownership and form of market organisation is of more than academic importance may be seen by examining the case of British Telecom. At the present time this is the second largest of all the publicly-owned undertakings in this country, with an annual turnover of almost £6,000m, and employing a workforce of 246,000 people. The 1981 Telecommunications Act permitted a small degree of liberalisation of the BT monopoly without touching the question of ownership. The idea of a change of ownership (i.e."privatisation") did not appear to be envisaged when the 1981 Act was being passed, and therefore it was something of a surprise when the decision to privatise was announced in the House of Commons on 19 July 1982. The case for privatising was then argued almost solely on the grounds that the current method then being used by British Telecom to finance its investment programme was unacceptable. Government restrictions on public sector borrowing forced BT to finance investment from revenues, and, the then Secretary for Industry, Mr Patrick Jenkin argued, BT found investment capital not by increasing efficiency and cutting costs but by increasing charges to its customers. Selling 51% of BT, he concluded, would allow it to borrow in the market place without public sector borrowing restrictions. Subjecting BT to "proper market discipline" also obliged the corporation to improve its internal efficiency and cost effectiveness.

In fact, the amount of market discipline actually envisaged in the future regulated private monopoly is really quite small. The 1983 bill enabling the privatisation of British Telecom does not envisage the restructuring of the organisation is any significant way, so that in the words of the **Financial Times** "there is the risk that British Telecom will simply be transformed from a public into a private monopoly with an inadequate regulatory system." While doing little to encourage competition, the 1983 bill does provide for tighter regulation on the forthcoming private monopoly as compared to the existing public monopoly. This is the more ironic in view of another repeated justification for privatisation which is offered by government ministers, namely that it will reduce political interference in the enterprise concerned as well as improving the quality of management. Once the government goes down the road of increased regulation rather than that of increased competition, then the disciplines of the market will be modified, while those of the public sector will no longer apply. It seems likely that the customer, particularly the domestic consumer, will in many cases pay more for reduced services, while losing all influence over the behaviour and policies of the continuing monopoly. There are therefore significant risks that the future privately-owned British Telecom, as organised in the manner outlined by the 1983 bill, will produce the worst of both worlds.

While the word "privatisation" really has the industrial connotation of the transfer of ownership, in the case of the service sectors it has come to mean different things, especially in the rhetoric of government ministers. In the case of health services, it appears to mean the encouragement of a greater number of privately-owned hospitals and clinics, as well as the possibility of switching all or part of NHS funding to an insurance principle. It is not easy to fit the National Health Service into a monopoly-competition spectrum, since the picture is completely distorted by subsidy. Since most NHS services are provided free of charge, it is remarkable that a competive service, which does charge full costs for its services, can co-exist. This suggests that competition cannot be measured in a single dimension like price, but that there are important dimensions of quality as well. In education and housing, "privatisation" has come to stand for the replacement of student grants by loans, the encouragement of voucher schemes, and the sale of council houses. Again, in both these sectors, the question of subsidies complicates the picture. In education, despite the fact that publicly owned services are provided free, there seems to be no lessening of demand for competing privately-owned services which again are charged at a price sufficient to cover their costs. It may be significant that, in this sector, the costs of provision of publicly owned services, are apparently higher than comparable privately-owned ones.

Publicly owned housing services are not provided free of charge, but at a subsidised rate. The market for the provision of privately owned housing services (the rental market) has virtually ceased to exist, thanks to government regulations, but owner-occupation (also subsidised) appears to be on an increasing trend as incomes rise.

It is sometime argued that railways and electricity supply must always remain in public ownership since they are "natural monopolies". In fact, there is no reason why competition should not be restored by a policy of franchising, such as is already applied to the supply of commercial television and commercial aviation services. The introduction of competition in these sectors would not only produce an agreeable improvement in the responsiveness of the supplier to consumer wishes (and anyone who has ever had to deal with an electricity board or gas board will understand what this means) but it should also lead to future improvements in technical innovations and cost-cutting. It would also diminish the tendency of the staff of such monopolies to make investment decisions which enhance their prestige (such as the building of large but unnecessary power stations) which is in evidence in this country, but has reached its apogee in France.

To recapitulate, the argument of this article could be summarised in the following way:

(1) Except in very special cases, such as defence, there is no need for legislation on the subject of the form of ownership of particular organsations of production. Therefore the existing and proposed privatisation measures as they apply to industry are redundant from the point of view of the public interest.

(2) There is a very considerable need for a much stricter policy on the promotion of competition, which should apply equally to all organisations, whether they be privately or publicly owned. This would include the removal of artificial restrictions on entry, various forms of tariff and non-tariff protection, and also subsidies except for those directed to specific, temporary and well-defined objectives.

(3) In particular, protection from all monopolies should be withdrawn. This means that publicly owned enterprises should neither have their profits confiscated by the Treasury, nor should they be bailed out when they go bankrupt.

In other words there is a strong case in the public interest for the government to pursue a programme of liberalisation, rather than privatisation. Unfortunately, the present government seems to have confused the two things, which both in theory and in practice are quite distinct.