Economic Perspective 3

PRIVATISATION

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For many politicians and academic commentators privatisation has implications reaching far beyond the mere transfer of ownership. Conservative governments have in the past introduced denationalisation programmes although never on the present grand scale. As Simpson (1984) and others have pointed out, the Government and its supporters often fail to distinguish between the effects of denationalisation and the benefits of liberalisation.

It is a widely held view that nationalised industries are less efficient than private companies. Although Heald & Steel (1982) are doubtful about this proposition the essence of their argument can be summarised as follows: "public enterprises are intrinsically less efficient than private enterprises because they are insulated from the disciplines of the capital and product markets" (p.339). It is at this point that the distinction between liberalisation and denationalisation must be drawn.

Liberalisation involves the curtailment or abolition of statutory monopoly power with consequent increases in both allocative and productive efficiency. No such benefits derive from the transfer of ownership and the gains from liberalisation could be obtained without asset sales. In situations where a competitive environment cannot be guaranteed or where wider policy concerns dictate the need to intervene to alter the market outcome there is a view that efficiency gains accrue from a policy of denationalisation. It is argued that **actual or potential** interference in the affairs of business leads to **actual or potential** sources of economic inefficiency. Thus regulated and subsidised private concerns are to be preferred to state owned operations because government will interfere to a greater than necessary extent with the latter. Where the state is the owner it is asserted that inefficiency will be tolerated to avoid the political consequences of the business going bankrupt. Whilst the existence of this problem is pure conjecture, Steel (1984) points out that any such inefficiency from this source is unlikely to be eliminated via the present policy of creating part state-part private "hybrid companies".

The Government have decided to maintain large share holdings because strategic concerns dictate that certain eventualities must be effectively precluded. In addition they feel confident that they will be able to leave the "hybrid" to determine its own commercial policy in all but a few respects. If such restraint is possible for partially denationalised companies it ought to be equally possible for wholly owned state corporations. If state ownership **per se** is indeed a source of actual or potential inefficiency it is not an argument which the government should marshall to defend present policies.

It is suggested that, since denationalisation reduces the Public Sector Borrowing Requirement, it will help secure the Government's financial policy of encouraging lower interest rates and hence stimulating investment led growth. Asset sales provide a once and for all gain to the

Exchequer as well as a future stream of reductions in the PSBR consequent on removing nationalised industry borrowings. This latter effect is simply a transfer of demand and has no implications for interest rates. The gains from a sustained programme of denationalisation are likely to be small and temporary. Asset sales postpone the requirement for government to confront the fact that the British public simultaneously expect high public expenditure and lower tax burdens. This is a real danger that national assets will be sold off to finance public consumption and to temporarily perpetuate the myth that an efficient sophisticated welfare state can be sustained without sacrifices of personal disposable income. Thus, although asset sales **may** provide a modicum of short-run relief and benefit, the government cannot escape the implications of its underlying fiscal stance. The requirement to establish some concensus on public spending remains. A programme of denationalisation has limited short-run effects and virtually no long-run implications for the conduct of macro-economic policy.

It has been asserted that denationalisation will curtail the power of public sector unions and thus reduce the source of friction in labour markets and allow government macro-economic policy to operate more efficiently. Any rents accruing to organised labour do not emanate from public ownership but from X-inefficiency sustained by lack of competition in product markets. Liberalisation and not denationalisation provides the key to addressing such issues.

Wider share ownership is frequently cited as a reason for favouring denationalisation. Government spokesmen refer to vague notions of encouraging "real public ownership" and "ownership by the people". The government wishes to use asset sales to encourage the return of the small investor to the London Stock Exchange. Since the mid 1950s the personal sector has been a net seller of corporate securities. In 1981 the percentage of UK equities accounted for by private shareholders was 28.2% whilst financial institutions accounted for 57.9%. The reason for this decline rests with the UK fiscal system which restricts the ability of individuals to buy and hold shares and encourages indirect investment through pension schemes and insurance linked savings. The evidence from the flotations of British Aerospace and Amersham International suggests that the originally high number of individual shareholdings has fallen markedly implying that an overwhelming proportion of the stock has ended up in the hands of institutional investors. Renational-isation of state industries still does not make it efficient for small investors to participate directly in equity markets. The argument that asset sales **in themselves** promote wider share ownership is particularly unconvincing.

The benefits of privatisation derive largely, **if not exclusively**, from liberalisation. However, denationalisation imposes clear costs on the British taxpayer. The London new issue market is imperfect and there is a systematic tendency for mispricing. The Government have chosen the 'offer for sale' route in the majority of previous flotations. In this avenue, there is a clear source of pressure on the company and its advisors to set a low price. This heightens the possibility of the issue being oversubscribed which generates favourable publicity for all concerned, protects the underwriters and ensures an immediate capital gain for those successful in the ballots. Things can and do go wrong especially given unstable markets or the release of unfavourable news between drawing up the prospectus and receiving applications. The all-party Select Committee of Public Acounts has been extremely critical of this aspect of asset sales and has rightly pointed out the difficulties involved in securing a fair price using this approach. There is also considerable public concern about the fees and commissions accruing to those involved in the process of marketing the equity. The Treasury estimate that a handful of city institutions have received £22.7 million for services rendered during six of the early flotations. Given high transactions costs and a significant probability of under pricing there are grounds for questioning whether the taxpaying public has received a fair price from the sale of its assets so far.

Asset sales provide little clear economic benefits to the government although **political** advantage may well accrue.

Public enterprise is unpopular with a broad cross-section of the public and promises to "roll back the frontiers of the State" consequently attract considerable electoral support. In addition, denationalisation affords the Conservatives the prospect of offering their natural supporters both income and investment opportunities. A policy of liberalisation is a different matter. Liberalisation will eliminate the monopoly rents accruing to the business and the agents within the business. These will be redistributed in favour of consumers. If a significant proportion of the expected earnings of a company consists of monopoly rents then liberalisation will substantially reduce the receipts from any subsequent sale. A policy of liberalisation is in direct conflict with a policy of reducing the borrowing requirement through asset sales.

With regard to British Telecom and British Airways, these are more than esoteric points. There has already been criticism of the government owing to the limited extent of the competition which has been sanctioned in the telecommunications industry and the undue haste with which the regulatory arrangements have been designed. Airlines operate in a highly regulated environment where monopoly rents are high and over which the UK government has very little control. The sale of BA as presently structured would be the transfer of a monopoly from the public to the private sector. There is concern that these measures will yield insufficient relief to consumers but generate handsome receipts to satisfy the so-called 'PSBR imperative'.

It is clear that there has been a conscious government decision to emphasise the gains from liberalisation as a justification for privatisation. Government spokesmen now argue that the revenue implications and other side effects are of secondary importance. The experience of the BT exercise provides ground for doubting this. It appears that the prospects of introducing competition into the air transport industry are limited in the medium term. An early denationalisation of British Airways in its present form would therefore leave the government's credibility and commitment to a competitive market economy in tatters.

References

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