

# Privatisation: A UK success story

Thomas O'Malley

This *Monograph* is a joint publication of the Free Market Foundation of Southern Africa and the Conservative Research Department of London, England.

It was first drafted by Thomas O'Malley of the Conservative Research Department during his visit to the Free Market Foundation in September 1996 and up-dated in the Spring of 1998. The 1996 visit was supported by the Westminster Foundation for Democracy.

First published in **1998** by **The Free Market Foundation**  
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FMF Monograph No. 21

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ISBN: 1-874930-25-2

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# Foreword

The purpose of FMF *Monographs* is to use the analytic method of political economy to shed light on how best the promotion of free markets will improve the workings of the South African economy. In particular, authors are urged to apply the microeconomic approach of studying how individuals, firms and households behave in response to either naturally occurring or regulatory induced incentives. This requires that they display a sound, institutional knowledge and understanding of their theme. Where macroeconomic aggregates are introduced into the discussion, FMF authors analyse them from the market perspective, namely from the foundation stones of economics itself, supply and demand, the interactions of countless individuals with differing preferences and intentions. This approach also requires that authors pursue their analysis in a logical fashion to policy proposals unencumbered by preoccupations as to what is or is not politically practicable at any given time. They should not be tailored simply to gain the approval of pre-existing (but from a historical perspective transient and ephemeral) vested interests or political groupings.

The author of this *Monograph* writes explicitly within this framework but confesses more than once that the policy success he describes (UK privatisation) was stumbled upon by successive UK governments rather than designed. Thomas O'Malley has carefully studied the UK history and provides a well-documented microeconomic explanation of why it succeeded, and why consequently, it has been imitated throughout the world from Australia to Venezuela. But not in South Africa.

The sluggishness of South Africa in moving down the privatisation route, even with a specially designated Minister in charge of the process, is globally notorious – yet perhaps it is understandable. The South African government shares many intellectual roots with the UK Labour Party – a longstanding (until recently) opponent of privatisation. If an understanding of the UK Labour Party's conversion can be gained then perhaps the not dissimilar opposition of organised labour and of government in South Africa can also be constructively transformed.

Privatisation affects not only income distribution but also wealth distribution and it has the potential to alter the total to be distributed in the first place. John Maynard Keynes thought it did not. In 1924, he said:

[T]here is for instance no so-called important political question so really unimportant, so irrelevant to the reorganisation of the economic life of Great Britain, as the nationalisation of the railways.<sup>1</sup>

Keynes was wrong. As the father of aggregate-demand management, he held the view that control of investment and/or government spending could stabilise economic fluctuations and/or induce managed economic growth. In the 1960s and 1970s, British nationalised industries became one of the principle tools used to implement demand management. But both the timing and the size of the incremental investments proved unsuited to either the marginal adjustments or predictable lead times in spending or investment upon which successful demand management depended. If Keynes had had access to the writings of James Buchanan and other public-choice theorists, which point out that politicians act in their own self-interest, an interest that only occasionally coincides with the interests of consumers, he would not have dismissed nationalisation so lightly.

The misguided use of nationalised industries in the UK distorted supply and demand in the capital markets, which reduced their efficiency and, hence, overall welfare. In South Africa, state-owned industries went one stage further and moved deliberately into the labour market, distorting the demand for and supply of white and non-white labour.

Privatisation is a recent phenomenon. But so, too – except in the UK and South Africa – is nationalisation.

As recently as 1970, not a single manufacturing industry in which state-owned firms held an important share ... could be found in Western Europe. That has now changed radically ... [S]tate-owned firms have gained a dominant position in ... aerospace, steel, aluminium, shipbuilding and automobiles... Each year more firms are drawn into the state-owned sector.<sup>2</sup>

Other than its obvious obsolescence, the statement emphasises that you can privatise only what has first been nationalised. Why did the British nationalise so much in the late 1940s?

As O'Malley points out, the British Labour Party was committed to nationalisation in Clause 4 of its constitution. In 1956, Labour leader, Hugh Gaitskell, spelt out the four objectives of Clause 4. These were:

- a. to encourage social equality;
- b. to ensure that the means of production are fully used to the best advantage;
- c. to promote industrial democracy through community ownership of capital and the power that goes with it; and
- d. to encourage cooperation in society.<sup>3</sup>

Gaitskell, however, did not believe that nationalisation had achieved any of these four objectives. He argued that giving shareholders government bonds in exchange for their share certificates hardly leads to equality in wealth if most members of society start with no share certificates. Like Keynes, Gaitskell thought the demand-management argument for nationalisation was irrelevant. He felt other instruments (for example, fiscal and monetary policy) would be more effective than ownership change. Gaitskell, of course, wrote before the worst demand-management errors by UK governments were made using investment increments (positive or negative) in the state-owned industries. The third point Gaitskell skated over. He agreed that decision-taking should be diffused, but wondered "if the decision so taken would always be better". He had not made the step William H Hutt<sup>4</sup> made 20 years earlier, in 1936, when he argued that the most diffuse decision-making of all is a consumer democracy when consumers, as individual sovereigns, are allowed to make their own free, unimpeded choices as to which suppliers they buy from or refrain from buying from; which goods they buy or do not; and to whom they sell goods or labour or from whom they freely refrain from selling.

Possibly Gaitskell's difficulty was explained by his honest despair in the fourth point: "no very noticeable general change among employees to a less materialistic outlook" has yet emerged. Indeed lack of cooperation, industrial unrest, and strife have been greatest in the state-owned industries, not in the private ones. This continues today, 50 years after the nationalisation wave. The longest-drawn-out, most bitter UK strikes occur in the nationalised rump such as coal mining, railways and health services.

Revisionist socialists such as Hugh Gaitskell had their visions confirmed by empirical fact. O'Malley lists many in Chapter 2. These are now well accepted. Richard Pryke<sup>5</sup> examined the economic performance of each in individual nationalised industry in the UK, and found it wanting. For example, none met consumer wants where an alternative supplier existed. Every UK nationalised industry that faced competition in the 1960s and 1970s consistently lost market share.

Pryke then asked whether they at least used the least-possible quantity of resources to produce what they did sell. Pryke found that changes in labour productivity in all nationalised industries (monopoly or not) were generally below those of the manufacturing-industry average. And, in turn, as a consequence of low and declining efficiency, the nationalised industries all raised their prices more rapidly than did private industry.

While labour productivity declined, earnings per person rose more rapidly than in the private sector. Union militancy was most especially felt in the nationalised industries. As Pryke puts it: "The extent to which the [state] sector has contributed to wage and price inflation requires detailed investigation, but there is little doubt it was significant." Less-exhaustive evidence is available for

South Africa, but a study by Geert de Wet produced similar results. The major South African state-owned industries have consistently increased prices ahead of the general inflation rate.<sup>6</sup>

Boardman and Vining in a multi-study, multi-national review make a similar point. They show that privately-owned firms outperform state-owned ones. Furthermore, mixed ownership enterprises “performed no better (and sometimes worse) than state-owned firms”. This last finding is especially interesting for advocates of privatisation. It suggests that partial privatisation might be less satisfactory than no privatisation at all. Why? Possibly managers in mixed enterprises experience a muddling of objectives that those in a fully private or fully nationalised firm do not. The South African route of privatising only part of Telkom, or leaving a large part of many firms in the hands of the quasi-state Industrial Development Corporation might, therefore, prove to be very unsatisfactory. Such arrangements prevent markets in corporate control from working.

As O’Malley emphasises, governments privatise for two main reasons, other than raising revenue: improving economic performance and redistributing wealth through wider share ownership.

But why will privatisation improve industry’s performance? The men, machines, and management remain the same. Any difference in performance must come from changes in the constraints, opportunities, and incentives that privatised firms face. Management autonomy is increased when statutory controls are removed. When politicians are kept at a distance, managers are better able to follow their own commercial judgements in investing and planning.

But again, why will this increased discretion be used to benefit society rather than the managers? The answer lies in the increased spur to efficiency that will now exist in the product market they operate in, or the capital market, or both. Firms will be disciplined to meet consumer wishes by the threat of transfer of custom to other firms. Meanwhile, the capital market imposes the threat of bankruptcy or takeover if resources are applied to relatively less valued uses.

What if newly privatised firms tend still to be dominant or near-dominant sellers? A monopoly in the product market is not cause for concern provided entry is easy. Furthermore, if private firms – monopolists or not – fail to operate efficiently, their share prices weaken. This in turn makes it likely that controlling interest in the firm will be transferred. A less-quiescent group of shareholders will demand that managers boost their performance or lose their jobs. So privatisation provides incentives both for productive efficiency (the achievement of profits) and allocative efficiency (keeping prices in line with consumer valuations).

O’Malley writes in his own capacity. His views are not those of the FMF (which has no corporate view), nor of its Council Members or Directors. But his understanding of the UK experience of privatisation over nearly two decades is profound. As such, the FMF believes this *Monograph* is an important contribution to the current debate.

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## Notes

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4. WH Hutt, 1936, *Economists and the Public*, Jonathon Cape, London.
5. R Pryke "Public Enterprise in Practice" in WJ Baumol (ed) *Public and Private Enterprise in a Mixed Economy*. International Association, 1981.
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"[Ons sien] dat elektrisiteitstariewe, spoorwegtariewe (goedere) en die staalprys sedert 1970 op enkele uitsonderings na, elke jaar gestyg het. Verder het hierdie tariewe in 'n hele aantal jare met baie meer as die verbruikers-prysindeks gestyg... [Dit blyk dat daar] sedert 1971 ... nie 'n enkele jaar was waarin daar nie ten minste een van hierdie sleutel geadministreerde pryse was wat met meer as die inflasiekoers gestyg het nie. In meeste van die jare het meer as een van die pryse met meer as die inflasiekoers gestyg ... Wat (die data) vir ons duidelik toon, is dat hierdie grootliks *eksogene* pryse oor anderhalfdekade voortdurend opwaarts geneig het, soms met baie sterk krag. Gevolglik het dit deurgaans 'n inflasionere invloed uitgeoefen."
7. Boardman and Vining, *op cit.*

## The author

Thomas O'Malley is an Assistant Director of the Conservative Research Department. He was born in 1969 and educated at Ampleforth College School, Yorkshire and New College, Oxford, where he read history. He joined the Conservative Research Department in 1991. As Trade & Industry Desk Officer, he was responsible for providing information on the Conservative Party's privatisation programme. As Transport Desk Officer, he worked on the passage through Parliament of the Railways Act 1993 under which UK railways were privatised. As Head of the Political Section in the run-up to the unsuccessful 1997 General Election, he was in overall charge of monitoring Labour Party policies for the Conservative Party political machine.



# 1

## Introduction

The huge defeat of the Conservative Government in the UK's 1997 General Election should not diminish the achievements of that Government during eighteen years in office. One of the most significant of these was the privatisation of many state-owned industries and assets.

From a few sentences in the Party's 1979 election manifesto developed an economic movement that has changed the face of public enterprise across five continents. Methods, structures and speed of change have varied in different countries, but no serious politician can now stand against the tide and defend widespread public ownership as a long term response to the challenges of today.

Even the British Labour Party – once privatisation's fiercest critic – had formally to ditch its commitments (i.e. Clause IV of the Party's Constitution) to wholesale renationalisation before it could be regarded as an acceptable alternative government. Over the years, pledges to renationalise privatised industries were dropped by Labour. During the 1997 election, one newspaper even reported changes in the Party's attitude under the headline, 'Blair: we'll privatise everything'. As on other occasions, the actual speech delivered by Tony Blair did not live up to its advance billing and in their first months of government, Labour have shied away from new privatisations. But the Labour Government is not expected to re-assert state control over Britain's privatised industries.

Privatisation has come to be seen as an important part of a country's response to the challenge of tough world markets. Inefficient and over-priced utilities and services are a drag on a nation's competitiveness. Every extra cent wasted by every domestic company on burdensome electricity or telephone charges has to be passed on to customers. Every unnecessary labour cost is a free gift to foreign competitors.

The success of privatisation does not mean that its introduction is easy, even today. The forces that make state-owned enterprises inefficient and uncompetitive – vested interests resistant to change – often fight against privatisation at every stage. The general public – who have long ago given up expecting from public utilities the same standards they demand from private business – are vulnerable to scare stories and merchants of doom. Often, entrenched perceptions of what can be achieved have to be broken down.

For these reasons, a policy of privatisation is not for the faint-hearted. It cannot be undertaken without resolute political commitment. There are always set-backs and storms along the way. The forces of the past cling to their citadels with a tenacious grip. Politicians must be prepared to conciliate and cajole, as well as to risk unpopularity and discontent. And they must be prepared to challenge their own preconceptions and prejudices.

For a nation that stays the course, the rewards are considerable. Corporations that had been condemned as third-rate can become world-leaders. Burdens and delays to which entrepreneurs had resigned themselves melt away. Through share flotations, employees and customers are given the opportunity to hold a stake in the nation's vital industries.

For politicians the rewards are often bittersweet. Instead of past arguments about the size of utility price rises, they now often face criticism when price cuts are deemed too small. As usual, it is they who take the blame when things go wrong, and others who enjoy the benefits when things go right.

In the UK, a lot of things have gone right – falling prices have been secured alongside a transformation of public service culture. Losses have been turned into profits and share ownership has been widely extended.

In the following pages we expand on and explain why this phenomenon has occurred. Chapter 2 details the main reasons why state ownership of industry has been such a dismal failure. Chapter 3 looks at the consequential objections of privatisation as a means of overcoming the elements of

failure. Chapter 4 then examines the record with especial emphasis on the public utilities (water, telecommunications, gas, electricity). Chapter 5 examines some smaller scale privatisations (which have had similar records of success), while Chapters 6 to 9 look at wider implications such as the spread of share ownership, competition, employment and net revenue gains or losses to the fiscus. Chapter 10 examines more recent privatisations under post-Thatcher governments (in particular the Railways, concluded under the Labour Government of Mr Blair).

### **Table 1: Key successes**

- Well over 50 major businesses have been privatised in the UK since 1979.
- Privatisation proceeds now total £70 billion (R560 billion at R8 to the pound).
- Subsidies for state-owned industries cost the taxpayer £50 million (in current cash terms) a week in 1979. Restored to profitability in the private sector, the former nationalised industries contributed to the Exchequer in corporation tax on their profits – £60 million (also in current pounds) a week by 1996.
- One company, British Telecom (BT), has contributed £11.3 billion (R90 billion) to the Exchequer in taxes since it was privatised in 1984 – enough to fund the UK's entire school building programme during that period.
- Along with the sale of council houses to their tenants, privatisation has played an important part in the creation of a property- and share-owning democracy. The number of shareholders had risen from 3 million in 1979 to 10 million by the end of 1996 -almost one in four adults – with some flotations many times over-subscribed.
- Privatisation has delivered lower prices for utility customers:
  - BT call charges are down by 59 per cent in real terms;
  - the real cost of domestic gas has fallen by at least 32 per cent; and
  - domestic electricity charges have been cut by 18 per cent in real terms.
- Privatised firms have also been able to make up for years of under-investment by successive governments. Many thousands of jobs have been created through massive infrastructure renewal programmes:
  - BT has invested £32 billion (R256 billion) since 1984; and
  - English regional water companies are engaged in a ten-year, £32 billion (R256 billion) investment programme.
- Standards of service have also risen:
  - there are 50 per cent more phone boxes, with over 95 per cent working at any time (74 per cent worked before privatisation);
  - new phone lines are installed within days (even hours). In the early 1980s, up to 250,000 people would have to wait more than 2 months. Customers receive rebates if installation is delayed; and
  - British Airways once came below Aeroflot in a customer poll. It now carries more international passengers than any airline and scores highly in consumer surveys.

# 2

## Failure of state ownership

Nationalised industries failed in their objectives of serving the community for a range of reasons. For example, their management was inevitably subject to political interference. This often resulted in sub-optimal pricing and investment decisions, whilst simultaneously demoralising managers and encouraging confrontational rather than co-operative industrial relations.

### **Political interference**

State ownership distances public enterprises from their customers. Commercial decisions are second-guessed by politicians and civil servants unfamiliar with the disciplines of the market. Nationalised utilities are often monopolies, with customers unable to turn to another supplier if prices rise too fast or service standards fall.

An example of political interference going wrong in the UK occurred in the early 1970s. Following the oil crisis, the British Gas Corporation was required by the Government to hold down domestic prices so as to soften the blow of increased fuel prices for consumers. But cheap gas undercut coal-fired electricity, adding to problems of excess capacity in the electricity and coal industries. Unable to meet the artificially stimulated demand, the Gas Corporation was forced to turn away new industrial business. In the end, gas prices were forced back up to their market level, leaving consumers, who had switched to gas when the prices were low, blaming the very politicians that had earlier tried to help them by keeping costs down.

Too often, the strategic plans of a state-owned industry were focused on meeting Treasury targets, rather than customers' needs. Finding an unexpected shortfall in their budgets, ministers would often require those state corporations that were not making a loss to produce more revenue, leading to higher prices. Alternatively, they would delay investment programmes.

### **Higher prices**

State monopolies, divorced from genuine customer accountability, are inclined to push prices beyond a level which customers would otherwise accept. In addition to price rises brought about by unexpected Treasury demands, opportunities for cost savings are often not pursued with vigour.

- In many cases, UK nationalised industry prices rise faster than inflation. Between 1971 and 1982, while retail prices rose by 310 per cent, the prices charged by state corporations rose by 380 per cent.
- Under the last Labour Government, between 1974 and 1979, UK domestic electricity prices rose by an average of 2 per cent every six weeks (cash terms).

### **Misdirected investment**

Under state control, the balance sheets of all state corporations become part of the state budget. All major spending has to be approved by government. Any borrowing is ultimately underwritten by the taxpayer and counted as part of a government's borrowing. As such, it has to be authorised by ministers.

In the UK, this reliance upon government prevented the management of state corporations from taking long-term strategic decisions. Key investment programmes were often postponed or cancelled at the last minute.

Purely political considerations had as much damaging impact as budgetary ones. Investment, which was often cut back early in the course of a Parliament, picked up as an election approached. High profile spending on schools or hospitals would invariably take priority over less exciting, longer term maintenance. Recent increases in water charges in the UK can be explained largely by

the need to make up for years of under-investment in maintaining water pipelines and sewers. Contracts would invariably be awarded to deprived or politically marginal areas, largely disregarding cost or other considerations.

Any resources allocated by the Treasury which a state corporation had left unspent by the end of the financial year would be lost by that corporation and usually subtracted from the following year's budget as well. Since the amount of money which a corporation could extract from government was seen almost as a test of its virility, new schemes would be dreamt up to increase a corporation's bid for its slice of the public spending cake. In order to ensure that spending did not undershoot the budget, the final months of the year would often see high levels of wasteful and disparate spending.

It is for economic historians to judge how much stronger would have been the economic performance of the UK in the 1950s to 1970s had the huge amounts of taxpayers money invested in nationalised industries been invested according more to the needs of the customer, rather than politicians or trade unions.

### **Emasculated management**

Such a high degree of political interference was bound to have an impact on the management of state corporations. Unable to act independently and forever subject to the whim of politicians, many of the disciplines of management were lost. Management had little control over the key decisions that affected their industries and, as a result, took little responsibility for them. There was little or no incentive to innovate or to improve efficiency.

Although many managers were of high quality, others held their posts because of political affiliation or the need to satisfy some unwritten quota.

### **Demotivated workforce**

As well as imposing price increases, state corporations with a captive market paid less attention to customer service. What did it matter to the fuel supply corporations if customers could never get through to them on the telephone? They could simply cut off the customer if a bill was not paid. Why should the telecoms board care if it took up to six months to get a phone installed? Customers would still need a phone from them two months later, unless a customer's business had folded in the meantime. Why should staff at a railway station bother to help carry passengers' luggage, when it was not in their job description?

Such acceptance of mediocrity had a desperate impact upon the morale of a corporation's workforce. Over-staffing meant that staff had little to do, and it did not matter if they did it badly. Attendance rates in nationalised industries were poor, as bored staff found something better to do with their time.

### **Politicised industrial relations**

Under state ownership, the relations between management and workforce became an issue for high politics. Pay negotiations were conducted not on the basis of what productivity had been achieved, but what the unions thought the Government could afford. If the Government had a policy for desirable pay norms across the whole country, these would have to be imposed upon a state corporation, irrespective of that industry's performance.

Every new innovation or practice was an excuse for new pay and conditions. Privileges, once gained, would never be given up.

- Until the time of privatisation, British Rail signalmen were paid for the time it took them to walk to their signal boxes (usually from the nearest station), dating from a time before widespread ownership of the motor car. No doubt many other workers today would welcome being paid for the time it takes them to travel to work.

Unions would often strike to achieve some political objective. They would take advantage of a period of political uncertainty to extract the maximum advantage for their workforce.

In the UK, strikes in nationalised industries were largely responsible for the electoral defeat of two successive governments. In 1974, following more than a year of industrial unrest, the Conservative Government sought a new mandate on the question 'who governs Britain?' The electorate was not prepared to back the Conservatives against the unions, and chose a Labour Government instead.

By 1979, Labour's inability to face up to union power was a key factor in the motivation and success of the Conservative Party under Mrs Thatcher. Strikes across the public sector had brought the country to a standstill in the 1978-9 'winter of discontent', as the Government's pay policy fell apart. 29 million working days were lost to strike action in the course of the year, giving the new Government a clear mandate to tackle the abuse of trade union power and to liberate industry from state control.

With these failures in mind, what then were the tactical objectives of those in favour of privatisation? Chapter 3 examines these goals.

# 3

## Objectives of privatisation

The Conservative Government elected in 1979 pursued a policy of privatisation as a means of reducing the size of the state. It believed that nationalisation undermined economic freedom. Extending employee share ownership was an objective set out in the 1979 election manifesto. Although they are now common cause some other potential benefits were not fully appreciated from the outset. These are discussed below.

### **Encourage competition**

It is only when consumers can withdraw their custom from a supplier of goods or services that the supplier will become dedicated to meeting consumers' needs. One of the greatest barriers to success for state corporations is their monopoly or near monopoly position in the market.

The extension of consumer choice was a key objective for Conservative privatisation policy. Competition was introduced wherever possible. The widespread assumption that certain utilities constituted 'natural' monopolies was overturned. Material benefits for customers were most rapid where the newly privatised firm was exposed to competition.

### **Spread ownership**

State ownership was supposed to mean that the industrial or other assets of a nation were 'held in trust' for its citizens and managed for their benefit. In practice, citizens got a pretty poor deal. As taxpayers, they had to subsidise inefficiency and, as customers, they were largely ignored and faced inflationary price increases.

Extending share ownership has a beneficial effect on the whole economy. Individuals holding shares understand the need for profitable private industry.

A key objective of privatisation in the UK was to spread ownership of the nation's once great industries in a truly meaningful fashion. In almost all cases, great importance was attached to giving employees the opportunity to hold a stake in their own company. With the larger privatisations, mass popular ownership was achieved through the public flotation of shares in the companies. With smaller companies, management and employee buy-out schemes were usually favoured.

### **Separate ownership from regulation**

Another reason for poor service under state ownership was the conflict between government's role as owner and its role as regulator. As owner of the state enterprises, government was most keen to extract the maximum return from its holding, or to limit the amount of investment it had to fund. This role almost always took precedence over government's role as regulator and defender of consumer interests.

As well as ending government's role as owner of state corporations – even this role was rarely exercised satisfactorily – privatisation in the UK limited government's role as regulator. In the case of all of the utilities, and for some other industries as well, independent regulators were established at the time of privatisation.

Where privatised firms retained a monopoly – usually in the supply of utility services to domestic customers – regulators were given extensive powers to set prices and service standards (see 'prices' below). As competition developed a reduced role for regulators was envisaged.

### **Improve access to private capital**

As long as public corporations remain under state ownership, any borrowing which they undertake is ultimately underwritten by the taxpayer. Because it is one of the first duties of government to ensure that public finances are in good order, ministers have rightly insisted on maintaining control

over spending and borrowing by these enterprises. For reasons set out above, this control has often had a detrimental effect on the ability of state-owned corporations to plan and invest for the future.

Privatised firms in the UK have made extensive use of the freedom they have to borrow on the capital markets. Utilities and other public service companies tend to offer financiers the guaranteed long-term returns which they prefer. Although many enterprises had been nationalised so that a long-term view could be taken of their investment needs, short-termism was predominant. Ironically, privatisation has enabled many companies to take a longer-term, commercially-driven view of their investment programmes (see 'investment' below).

### **Release state assets**

The state has never been good at managing a nation's assets. By 'protecting' large parts of the economy from the disciplines of the market, the state was condemning the whole economy to perpetual under-performance. Taxpayers' resources were tied up in enterprises which had little incentive to improve their efficiency. Too often, the taxpayer was forced to pick up the tab for losses resulting from poor management decisions or market developments for which inadequate preparation had been made.

In the UK, privatisation reduced the proportion of the whole economy controlled by the state. The policy also raised considerable proceeds, which the Treasury was able to use to reduce government debts and to fund capital spending on other public services, such as schools and hospitals. Huge taxpayer subsidies for loss-making businesses were ended as corporations became profitable and began to pay corporation tax on their profits.

### **Utilise outside expertise**

In many cases, new developments in technology and business practice were missed by state corporations. Where new expertise was applied, it was often on a haphazard and inconsistent basis.

Privatised firms have the freedom to respond to new developments in the market and on the part of their competitors. Managers are not subject to the whims of politicians and can operate internal structures which allow their companies to respond quickly to new developments. They have more freedom to draw upon outside expertise, whether in marketing, technology or management, and to pay the market rate for any staff that have to be brought in.

### **Motivate workforce**

Too many state-owned companies are over-staffed with badly motivated and bored employees. Poorer attendance records and higher levels of staff sickness than in the private sector indicate low morale. Staff interest in entrenched perks and privileges seems to outweigh other considerations. Many state corporations give the impression of being run for the benefit of the workforce rather than the customers.

Privatisation brought with it a change of internal corporate culture. Flexible structures meant that employees have had the chance to contribute their ideas, whilst effort and ability were rewarded more quickly. Responding to customers' needs gave employees greater job satisfaction. The opportunity to hold shares in their company incentivised staff, breaking down barriers between employers and employed.

Chapters 4 to 9 examine whether these (and other) objectives were achieved.

# 4

## Utility privatisations – achievements

### **Prices**

Competition will almost always act to keep prices down. Where the development of full competition was not possible from the first day of privatisation, independent utility regulators were established to mimic the exercise of consumer choice in an open market. Regulation protects the consumer for as long as the utility company retains a near monopoly in the provision of services.

A dominant factor in most consumer purchase decisions is price. In order to replicate this reality of the market, the main instrument of utility regulation in the UK was the imposition of price formulae. In each industry, a domestic price formula was set by the regulator for a time-limited period, taking into account the potential for efficiency gains within that period. The formula usually took the form of ‘Retail Price Index (RPI) minus X’, where X was the regulator’s estimation of the extent to which cost savings could be achieved within the privatised industry.

Over the years, the price formulae have usually been tightened for as long as the regulated utility has retained a near monopoly, and relaxed where competition has developed or where the regulator has required corporate restructuring which would otherwise have had a negative impact on shareholder value.

- For example, BT was subject to an RPI minus 7.5 per cent formula from 1993 to 1997. In each of these years, the low rate of inflation meant that BT had to deliver cash term price cuts.
- This formula was relaxed in 1997 (all previous changes have seen it tightened) to RPI minus 4.5 per cent, taking account of the fact that BT is now subject to significant competition in some of its key markets. If inflation remains around the Government’s 2.5 per cent target, further cash terms price cuts will follow year by year.

The regulators have also taken into account the investment required for the continued delivery of high standards of service. In the case of the water industry, exceptional investment needs – to make up for years of under investment and to meet new environmental standards – led to the regulator permitting price rises above the rate of inflation.

The advantage of regulation with price formulae rather than with permitted rates of return – as in countries such as the United States – is that the utility has an incentive to improve its performance above and beyond what the regulator believes to be reasonable progress. Where there is a target rate of return, companies plan to hit that and do not strive for further gains. With a price formula, a company knows that the benefit of any efficiency gain over and above that envisaged by the regulator can be passed directly to shareholders.

### **Telecoms**

- Call charges are down by 59 per cent in real terms since BT was privatised in 1984.
- The UK has led the way in the reduction of call charges by European telecom providers. A three-minute weekday morning call from London to Manchester costs less than half the price of a similar call in Germany.
- The cost of a five minute call to the United States has been cut by around 80 per cent in real terms.
- The cost of having a domestic phone line installed by BT has fallen by 22 per cent in real terms.
- Even with greatly increased phone use, the average residential phone bill has fallen by almost 20 per cent over the past five years.
- Over the past five years, businesses have saved a total of £920 million a year (£7.4 billion), and domestic customers have saved £872 million a year (£7 billion) through price reductions and



simplifications such as the abolition of the morning peak rate and the introduction of a single low-cost weekend rate.

- A major consumer survey conducted in 1995 ranked BT amongst the UK's top ten companies offering value for money – alongside such famous names as Boots, Tesco, Sainsbury, the BBC, Virgin, the Body Shop and Cadbury's.

### ***Gas***

- The cost of domestic gas has been cut by at least 32 per cent in real terms since British Gas was privatised in 1986.
- Over ten years, the typical domestic gas bill has fallen by around £100 (R800) in real terms.

### ***Electricity***

- Domestic electricity charges have been cut by 19 per cent in real terms since the industry was privatised in 1990. In April 1997, the typical household paid £58 less (R464), in real terms and excluding VAT, for electricity than in 1990.
- Domestic prices are lower in real terms than at any time in the past 20 years, and are lower than in France, Germany and Spain.
- The cost of industrial electricity has fallen by up to 30 per cent in real terms.
- Industrial electricity prices are lower than at any time since records began in 1970.
- UK industrial electricity prices are lower than in the Germany, France, Spain and Italy.

### ***Water***

- Water charges have risen since the industry was privatised in 1989. Increased charges have been necessary to make up for under-investment by successive governments and to help meet new environmental standards.
- Under price limits set in 1994, water charges across the board have not been increased since then by more than 1 per cent a year.

### **Quality of service**

In many cases, UK regulators have required privatised utilities to meet targets for standards of service. These have typically related to issues such as the amount of time taken to connect a customer or repair a fault. Breaks in service have also been penalised.

Service standards have been enforced in two ways. The utility has been required to compensate individual customers for failures to meet published standards – sums of between £10 (R80) and £50 (R400) are paid direct to customers for breaks in service, etc. Utilities have marketed these standards as a new contract between them and their customers.

The regulator has also set tough targets for the proportion of cases in which set standards have to be delivered. Failure to meet service standards has resulted in a tougher price formula being imposed at the next review.

The intervention of the regulator in service standards has complimented and given substance to the transformation in attitudes to customer service brought about by privatisation. Companies have found that significant improvements in customer attitudes can be achieved through attention to parts of their business which have little impact on shareholder returns, but which affect customers.

- New technology has been installed to ensure that utility customer telephone enquiries can be answered quickly and can usually be dealt with by the first person to answer the phone, accessing customer details on screen in front of them.
- Companies have found that the early disconnection of defaulting customers is usually counter-productive, as well as being damaging their wider public relations. Instead, they have offered new methods to spread payments over time, so as to help customers budget to meet their utility payments.

- BT realised that telephone boxes, although accounting for only a small proportion of turnover, played an important part in customers' perception of their company. A lot of importance has been attached to ensuring that call boxes are kept clean and that the telephones in them work properly (see below).

New targets for standards of service and the publicity surrounding privatised firms has increased customer expectations. In many cases the number of complaints rose shortly after privatisation as customers put new systems to the test, but have fallen steadily since then as the culture of privatised firms has become increasingly customer orientated. The mere fact that customer complaints are monitored and details published regularly is a reflection of a cultural shift. Where there have been rising complaints these have usually coincided with periods of media interest in a company's profits or executive salaries.

### ***Telecoms***

- There are now 50 per cent more telephone boxes than in 1984 – 132,000 compared with under 80,000. More than 96 per cent of call boxes work at any one time, compared with 77 per cent ten years ago.
- There is now no waiting list for telephone installation. Before privatisation, 250,000 people had to wait two months for a phone line.
- New services have been provided for vulnerable groups: a low-user rate for those, such as the elderly, who need the phone in case they have to summon assistance; Braille telephone bills and other services for the blind; and a caller's number display service to protect against nuisance callers.
- BT now has 21.6 million residential customers and 6.8 million business lines, compared with 15.5 million and 3.6 million respectively in 1984.
- Some 94 per cent of households now have a telephone, compared with 78 per cent in 1978.
- Before privatisation, 1 in 30 calls failed to get through. Now it is 1 in 1,000
- The number of residential and business bill accuracy complaints is 1.2 in every 1,000, and many of these complaints are not upheld.
- 99 per cent of customers are connected to a modern, digital exchange.
- 37,000 customer interviews each month keep customer satisfaction under constant review. Satisfaction levels exceed 90 per cent for nearly all services.

### ***Gas***

- The number of gas disconnections has fallen by one third in the 11 years since privatisation. There are now about 30,000 disconnections for non-payment each year, out of around 18 million customers.
- When a fault has occurred British Gas now restores supply within 24 hours in 99.5 per cent of cases.

### ***Electricity***

- For 1996-7, disconnections were down by 99 per cent since before privatisation. Out of 24 million customers, there were only 471 disconnections, mostly for persistent non-payment.
- Across the 12 regional supply companies, the target of replying to all customer letters within ten days is being met between 98 and 100 per cent of the time.
- Complaints by customers to the electricity regulator have fallen by 50 per cent since 1990-1.
- Breaks in supply are restored within 24 hours in 99.8 per cent of cases.

### ***Water***

- The number of properties subject to unplanned interruptions in supply fell by 36 per cent in the five years after privatisation.

- Water quality has been improved significantly, with 99.3 per cent of 3.75 million samples meeting UK and European quality standards.
- 89 per cent of designated bathing waters now meet European quality standards, compared with 66 per cent before privatisation.
- Although 1995 was one of the hottest and driest summers in the UK for over 200 years, the number (60) of drought orders – powers to limit supply (not always exercised) – granted was well below the number (136 in 1976 and 104 in 1984) for other recent dry summers.

### **Efficiency**

The 1980s and early 1990s have seen a transformation in the productivity of British industry. Having languished at the bottom of the productivity league in the 1960s and 1970s, average annual improvements in UK productivity in the 1980s exceeded all other major industrialised nations.

Since 1984, productivity for the whole of manufacturing industry has increased by an average of 3.8 per cent per annum. Productivity improvements in many privatised firms have far exceeded those across industry as a whole.

- Since privatisation, BT has doubled its productivity, with improvements averaging 7 per cent a year.
- The electricity generators have also doubled productivity, with average annual improvements of around 20. per cent for National Power, and around 15 per cent for PowerGen.
- The 12 regional electricity supply companies have improved productivity by an annual average of 6 per cent.

### **Investment**

Privatisation has allowed the public utilities to undertake substantial investment. For the first time since they were nationalised, the utilities have been able to plan for the future with confidence. As well as reversing past under-investment in maintenance, companies have been able to invest in new technology or more environmentally-friendly processes.

The massive investment programmes undertaken by privatised utilities over the past ten years have generated many thousands of jobs. In many cases, investment has been in labour intensive fields: laying pipelines or new cables; building power stations; and up-grading pumping stations or sewage treatment plants.

### **Telecoms**

- BT has invested £32 billion (R256 billion) since privatisation, with further huge investment by its new competitors.
- BT has invested the equivalent of £1,300 (R10,400) for every household in Britain since privatisation.
- Last year, £291 million (R2.3 billion) is invested in research and development, placing BT at the cutting edge of telecommunications technology – giving Britain an expertise it can sell abroad.
- BT has established a nationwide fibre-optic network of 3.5 million kilometres. The company also has interests in telecommunications satellites and in undersea cables.

### **Gas**

- British Gas has invested £8 billion (R64 billion) over the past five years. Investment since privatisation exceeds £14 billion (R112 billion).
- Last year alone, British Gas invested £394 million (R3.1 billion) in exploration and development.

### **Electricity**

- Since privatisation in 1990-1, around £8 billion (R64 billion) has been invested by the regional electricity supply companies.

- The two privatised electricity generation companies have invested around £4 billion (R32 billion), with further investment by new independent generators.
- The National Grid Company has invested a further £1.5 billion (R12 billion) in the nationwide transmission network.

### ***Water***

- Annual investment in the water industry has doubled from around £1.5 billion (R12 billion) a year before privatisation to around £3 billion (R24 billion) today.
- A ten-year £32 billion (R256 billion) investment programme by the water companies is making up for under-investment in maintenance work on the pipeline network, as well as improving water quality.
- Investment already totals the equivalent of £700 (R5,600) for every household.
- Two thirds of water company profits are invested.

# 5

## Other privatisations

The remarkable transformations achieved through privatisation have not been limited to utility services. Many large companies, some with a less high public profile, have also seen huge improvements as a result of privatisation.

- **Cable & Wireless** was privatised in 1981. In the first ten years after privatisation, it made profits totalling £2.7 billion (R21.6 billion), compared with £329 million (R2.6 billion) in the decade prior to privatisation.
- **National Freight Corporation**, which had a long record of losses, was privatised in 1982. It increased profits from £4 million (R32 million) in 1982 to £90 million (R720 million) within eight years.
- **Enterprise Oil** was privatised in 1984. Since then it has become one of the largest private exploration and production companies in the world. The company's market capitalisation has increased from under £400 million (R3.2 billion) to £3 billion (R24 billion).
- In the years following privatisation in 1987, **Rolls Royce** increased its share of the world aero-engine market from 9 to 25 per cent.
- Since privatisation in 1987, **British Airways** has become 'the world's favourite airline', carrying more international passengers than any other airline – 26.6 million in 1996. In 1994, BA profits amounted to one third of all profits recorded by IATA registered airlines.
- **British Airports Authority (BAA)** was also privatised in 1987. Since then, it has dramatically improved the facilities at Britain's major airports and has established Stansted as London's third airport, with a £400 million (R3.2 billion) new terminal. BAA invested more than £3.2 billion (R25.6 billion) between 1987 and 1997, compared with £981 million (R7.8 billion) in the decade prior to privatisation, and is currently investing £1 million (R8 million) a day improving its airports. Charges for airlines have been cut by 20 per cent in real terms over the past five years alone. Retail revenue has increased by almost 50 per cent at the same time as guarantees have been given not to exceed high street prices in airport shops (less VAT and duty, in duty free).
- **British Steel** was privatised in 1988. It has become one of the most efficient steel producers in the world. It now takes around 4 man hours to produce a tonne of liquid steel, compared with 13 man hours in 1979. Losses of £1.7 billion (R13.6 billion) in that year had become profits of £733 million (R5.9 billion) ten years later.
- **British Coal** was privatised in 1994-5. In the years following 1979, the industry had received subsidies and grants totalling £20 billion (R160 billion). The corporation features in the *Guinness Book of Records*, for achieving the largest annual deficit in British corporate history. Within eighteen months as a privatised company, under the ownership of RJB mining, a profit was returned.

# 6

## Wider share ownership

### **A genuine stake**

Giving people a genuine stake in the wealth of the nation has been a key objective of Conservative policy since 1979. Privatisation and the sale of council houses have together represented the largest ever transfer of wealth from government to citizen.

- The sale of council houses – a form of privatisation – has seen 1.8 million council tenants buy their homes. In total, there are now 4 million more home-owners than in 1979. 67 per cent of households own their own home, compared with 56 per cent in 1979.
- Largely as a result of privatisation, the number of shareholders in the UK rose from 3 million in 1979 to 10 million by the end of 1996. The number of shareholders was given a further significant boost to around 17 million with the ‘de-mutualisation’ of many building societies in 1997. Around one in three adults now owns shares, compared with one in fourteen in 1979.
- Share ownership is spread widely across society, with two thirds of share owners outside the ranks of professionals and managers. 60 per cent of shareholders live outside the prosperous South East of England.
- For many, privatisation has been an introduction to the ownership of shares in other companies. Only around 10 per cent of shareholders have shares in privatised businesses alone.

The first large increases in the number of shareholders were achieved through heavily promoted flotations of shares in utility and other nationalised companies.

### **Shares for workers and the man in the street**

Throughout the privatisation programme, great importance was attached to making shares available to employees, as well as the general public.

- When British Aerospace was privatised in 1981, 89 per cent of the workforce bought a stake in their company.
- British Telecom (BT) was the first mass privatisation. When 51 per cent of the company was offered for sale in December 1984, more than two million people applied for shares. 95 per cent of the workforce bought a stake in their company. Subsequent sales of the remainder of the Government’s holding in BT have also been extremely popular.
- When British Gas was privatised in December 1986, 85,000 employees – 99 per cent of the total – became shareholders. Small investors received vouchers for their gas bills or bonus shares if they held share continuously for three years. The offer was five times over-subscribed, with 5 million people applying for shares. Only applications for up to 400 shares could be met in full.
- The regional water and sewerage companies were offered for sale in November 1989. 2.7 million people applied for shares. 86 per cent of the companies’ employees – 37,500 across ten companies – became shareholders.
- The sale of the twelve regional electricity companies was most popular of all. Eight million people bought shares in one or more of the companies. Employee ownership was enhanced with free shares and lower prices for staff.

Although some people – employees and general public alike – sold their shares quickly, the vast majority have held onto them, as can be seen from continued high levels of share ownership. For staff, holding shares has given them a new stake in the continued success of their company.

- 90 per cent of employees of National Freight Consortium still hold shares in the company.

- One third of British Airways employees are shareholders in the company. Staff are able to save money on a monthly basis in a share option scheme. When their scheme matures, staff have the option to buy shares at a pre-determined price or have the money refunded with interest.

### **Management and employee buy-outs**

Buy-outs are the most direct method of extending employee ownership. As part of the privatisation process in the UK, buy-out teams, often backed by outside finance, have taken control of a number of smaller companies, including Unipart, ISG (part of the Government's export credit agency), and British Technology Group.

Management buy-outs accounted for some of the recent privatisation of British Coal. Although the bulk of the business was bought by one company, some open cast pits were bought by management teams. One deep mine in Wales – Tower Colliery – was bought by the workforce, investing their British Coal redundancy money.

Management buy-outs teams have also secured some of the franchises to run passenger services on the privatised rail network, where such bids were particularly encouraged.

# 7

## Competition

It is only through the extension of competition that the full benefits of privatisation can be secured. The disciplines of shareholder accountability can do much to improve the efficiency of a company, but they are as nothing to the disciplines provided by the danger of losing dissatisfied customers to a competitor. In a genuine free market, the sometimes conflicting loyalties to customers and shareholders are kept in balance and complement one another.

Introducing greater competition wherever and whenever possible was a key objective of UK privatisation. Where full competition was not possible from the outset, regulators have a duty to encourage the development of competition in their industries.

In the UK, privatisations which resulted in a greater degree of competition delivered benefits more rapidly. Those companies which already operated in a competitive market were quickest to respond to the freedoms which privatisation gave them. British Airways quickly overcame the (continuing) disadvantage of having to compete against subsidised state-owned airlines, with a transformation in corporate culture and performance. British Steel and the National Freight Consortium were also quick to learn the lesson that when government will not help you avoid the difficulties of the marketplace, you have to overcome them yourself.

### Telecommunications

In December 1984, British Telecom (BT) became the first major utility to be privatised. Many believe that the company's early exposure to competition from a new telecoms carrier – Mercury, in a duopoly situation – explains BT's almost undisputed success in the private sector. BT's improvements were most rapid for business customers and domestic users making frequent long-distance calls, whose business Mercury was most keen to capture. Following the review of the duopoly in 1991 and the opening up of telephone services to a large number of licensed providers, improvements in customer service and price reductions have accelerated.

Wide-ranging competition in telecommunications has brought enormous benefits to the United Kingdom.

- Around £6 billion (R48 billion) a year is now being invested by competing telecommunications companies. Mercury has invested £2.7 billion (R21.6 billion) in its new digital network. Cellular and digital mobile operators have already invested around £3 billion (R24 billion).
- There are now around 150 licensed telecoms providers in the UK.
- The UK's four mobile phone networks are amongst the largest in the world, with more than 8 million customers between them.
- BT operates the world's largest national paging network, with 450,000 subscribers.
- Cable TV companies are now installing new lines offering TV and telephone services at the rate of more than 90,000 every month. There were 3.4 million cable telephone lines in January 1998, compared with 2.3 million in January 1997 – an increase of 51 per cent.

### Electricity

When the electricity industry was privatised in 1990-1, competition was introduced in electricity generation. The Central Electricity Generating Board was split into three companies. National Power and PowerGen – with 60 and 40 per cent of non-nuclear capacity respectively – were both privatised in stock market flotations. Nuclear Electric remained under state ownership, with the more modern nuclear power stations privatised in 1996.

New entrants were allowed to generate and sell electricity. In the first instance, sales were limited to the excess capacity from large industrial companies with their own generating plants. A large number of companies and joint ventures have since invested in building new power stations.



Almost without exception, these have been gas-fired, a process which is much less damaging to the environment than coal-fired power generation. Gas-fired power stations now account for just over 20 per cent of UK electricity generation, compared with 1 per cent in 1990. If all planned new power stations go ahead, gas-fired power stations will account for 39 per cent of generating capacity by 2002.

Many of these new power stations are funded on the basis of medium-term supply contracts with one of the twelve regional supply companies. Many supply companies now have a stake in generating businesses – they are allowed to take up to 15 per cent of their electricity from companies in which they have a stake. Supply companies also have contracts with the main generating companies for baseload and other levels of supply.

In addition, there is a ‘spot’ market in electricity – the pool – where electricity supply can be purchased for time periods of as little as half an hour.

All contracts entered into by the supply companies are subject to an over-riding statutory obligation to achieve the best deal possible in the interest of customers.

At the time of privatisation, the Government had retained a ‘golden share’ in each of the regional electricity companies in order to guarantee that strategic national interest was protected through the period following privatisation. This ‘special right redeemable preference share of £1’ reserved certain special rights, for example restricting any one shareholder from owning or controlling more than 15 per cent of that company’s shares. The expiry of the golden shares in March 1995 was followed by a number of takeovers, which altered the ownership structure of the industry. Some companies now offer a combined utility service, selling both electricity and gas to their customers.

The National Grid Company, which was jointly owned by the regional supply companies, was floated on the Stock Exchange in December 1995. A £50 (R400) one-off payment was made to all electricity consumers, in recognition of the benefit secured by the supply companies as a result of the sale.

### **No more ‘natural’ monopolies**

The agreement which allowed Mercury regulated access to BT’s telephone lines first demonstrated that ‘natural’ monopolies could be broken up.

- From the time of privatisation, there was competition in the supply of electricity to large industrial customers.
- Since 1992, the ceiling of the British Gas and regional electricity supply monopoly has been lowered in stages. Many medium-sized businesses like large shops were given a choice of gas supplier. Significant price savings have been achieved.
- There will be full competition in the supply to domestic users of gas in all parts of the UK from the end of May 1998 and of electricity from around the beginning of 1999. A gas competition trial throughout the South West region of England, with domestic customers having a choice of supplier, delivered price cuts of up to 20 per cent.
- In preparation for competition in the supply of gas through its pipelines, British Gas has split into two separate companies – one selling gas to end users, whilst the other managing the pipeline and storage network, as well as exploration and extraction.
- Studies are underway into the prospect of competition in the supply of water.

Effective regulation and accurate metering have achieved what many had dismissed as impossible – the supply of electricity, gas or telephone services by competing companies, down the same electricity cable, gas main or phone line.

# 8

## Employment issues

A major reason for the inefficiency of most state-owned industries in the UK was widespread over-manning. Having too many staff did not even result in an attentive service for customers. Instead, employees became increasingly demotivated as the normal disciplines of any genuine commercial organisation broke down, whilst customers were ignored. Progress was often thwarted by over-mighty unions, abusing their power to entrench uncompetitive practices, thereby damaging the long-term prospects of their members.

Substantial reductions in staff levels within privatised firms were an essential part of the return to competitiveness. But these job losses must be seen in the context of economic change.

A large corporation providing a service on which the whole economy depends – such as electricity or telecommunications – cannot also serve as a long-term government job creation scheme. The burden of unnecessary staff in key utilities is carried by the whole economy, for example in higher phone or fuel bills. The extra cost of utility services makes the whole economy uncompetitive. As one thousand jobs are ‘saved’ in a state corporation, thousands more are sacrificed across the country in contracts and orders lost through uncompetitive overheads.

The increased globalisation of the world economy means that even utility services cannot be shielded from the realities of the market. Already telephone and postal services exceed national boundaries with couriers and mobile telecommunications under-cutting some state suppliers.

The failure to respond to the forces of change is a betrayal of the workforce within a state corporation as much as it is a betrayal of the economy as a whole. The UK coal industry is a good example of this.

- Within the coal industry it had long been accepted that mines would shut down when the reserves they contained could no longer be extracted economically. Governments of both political parties presided over the closure of pits and helped the communities affected to restructure.
- After the 1970-4 Conservative Government had been plagued by miners’ strikes, misguided socialist interventionism led the Labour Government of 1974-9 into a policy of keeping mines open long after the end of their sensible economic lifespan. As a result, fewer than 50 mines were closed between 1974 and 1979 – compared with some 300 during the previous Labour Government of 1964 to 1970 – and costs in the industry rose.
- Industrial discord in the early and mid-1980s, with a twelve month miners’ strike in 1984-5, further distorted the economics of the coal industry. Instead of a steady restructuring of the industry and the regions in which it was based, rapid and painful changes could not be avoided. Sensible re-negotiation of working practices was not possible with extremist union leaders, and productivity stagnated. Even the brave establishment of a more moderate union to rival the National Union of Mineworkers came too late for the industry.
- By the time British Coal was privatised in 1994, it constituted 20 pits, employing fewer than 30,000 staff, compared with 220 pits and almost 300,000 staff in 1979. A total of £20 billion (R160 billion) had been invested by the taxpayer over seventeen years. Despite these huge resources, state ownership and union intransigence had prevented the industry from adapting for the future at a time when perhaps more jobs could have been saved.

Neither did state ownership guarantee stable employment levels, even in the short term.

- In the ten years to 1979, jobs were lost in the Royal Mail, British Leyland, British Rail, British Steel, and the National and Scottish Bus Groups.

- In the case of companies like British Steel and British Leyland, competing in more open markets, job losses could be largely attributed to the uncompetitiveness of state ownership in a market situation.
- One state-owned enterprise, the National Freight Consortium, almost halved its workforce in the 1970s – from 65,000 down to 35,000 – and still remained effectively bankrupt until privatisation turned it around.

Even very large reductions in the number of staff working for a privatised company can give a misleading impression of the true impact of privatisation on the labour market.

- The number of people employed in the electricity industry fell from around 200,000 in 1975 to 150,000 in 1990. It has since fallen to around 85,000.
- The ten water and sewerage companies of England and Wales employed 47,800 people at the time of privatisation. They now employ around 37,000.

The huge investment programmes embarked upon by firms after they were privatised have created many thousands of jobs. In particular, investment to upgrade the infrastructure of utility companies tends to be very labour intensive. In some cases, functions which were carried out within large public corporations have simply been contracted out and are now completed by specialist companies, which employ many of the staff that used to be employed by the corporations directly.

- At least £65 billion (R520 billion) has been invested in the UK economy by privatised firms over the past 15 years.

Many privatised firms have created jobs by competing in new markets abroad. British Gas and a number of UK electricity companies have been able to sell their expertise around the world. Other companies have simply increased the amount of staff they employ as their business has grown.

- British Airways now employs around 61,000 staff, compared with just over 40,000 before privatisation.

The most extensive new job opportunities resulting from privatisation have arisen where competition has been allowed to develop. In the case of telecommunications and electricity generation, whole new competitor industries have sprung up where there were none before. These new companies have employed many of those made redundant from privatised firms, as well as creating some completely new jobs.

- Although the number of staff employed by BT almost halved between 1984 and 1990, 80 per cent of those who lost their jobs found work in the same industry.
- The joint ventures formed to build new power stations to compete with existing generators have each had to invest well over £100 million (R800 million), creating many thousands of jobs.

There have also been spin-off benefits for employment. The deregulation of telecommunications included the manufacture and sale of telephones, now available in huge variety. The UK has also become a centre for expertise in the manufacture of gas turbines for power stations.

Privatisation has brought about huge changes in the distribution of employment within the UK economy; it could not have achieved such a fundamental improvement to the nation's economic potential without doing so. But these were only the changes which any company or country would have had to undergo in order to remain competitive within tough world markets. Often, the changes seemed traumatic, but that was only because state ownership had ducked the real issues facing a modern economy for so long. As the immediate effects of privatisation within the UK have settled down, it has become clear that the story was less one of job losses and more one of the re-allocation of labour within the economy. If that re-allocation is to prove lasting, then it must be for the market to achieve at its own pace. In a genuine free market, labour will be re-allocated more quickly. To deny that simple truth is only to prolong the suffering of a nation and its people.

# 9

## Treasury benefits

Nationalised industries were a huge burden upon the UK Exchequer. Protected from the disciplines of the market, the cost of increasing inefficiency was passed on to taxpayers and customers. Subsidies became the accepted norm in many industries. Capital investment was too often authorised for political rather than commercial reasons, and frequently failed to deliver a satisfactory return.

The sale of state enterprises has raised large amounts of money for the Exchequer, helping the Government to reduce the public borrowing it had inherited from Labour in 1979, and even to record a Budget surplus in the late 1980s.

- National Economic Research Associates have calculated that, over the past ten years, privatised industries have provided the Exchequer with an average of £8.8 billion (R70 billion) per annum in additional revenue.
- Of this, an average £4.8 billion (R38 billion) per annum has come from corporation tax, dividends, interest and debt repayments.

### **Burden of state enterprises**

- Nationalised industries cost the taxpayer £2.6 billion (R21 billion) – £50 million a week (R400 million) in cash terms – in 1979, which was equivalent to one third of that year's health budget.
- In current prices, this was equivalent to around £300 (R2,400) a year for every taxpayer in the country.

### **Privatisation proceeds**

- Privatisation has raised a total of £70 billion (R560 billion) for the Exchequer since 1979.
- Proceeds from three sales (1984, 1987 and 1993) of shares in BT total £14 billion (R112 billion).
- The sale of shares in British Gas raised over £7 billion (R56 billion).
- Water privatisation raised over £3 billion (R24 billion) for the Exchequer.
- The privatisation of the electricity industry raised a total of £16 billion (R128 billion).
- The Government has also been able to sell the right to receive future debt repayments from some privatised firms, which had been agreed at the time of privatisation as a way of clearing outstanding debts.

### **Increased tax revenues**

With losses reversed, privatised companies now contribute around £3 billion (R24 billion) a year in corporation tax on their profits. This is equivalent to over £100 (R800) for every taxpayer.

# 10

## Recent UK privatisations

The recent privatisations of British Coal and British Energy – comprising a large part of the nuclear industry – and of British Rail, were all achievements of the Government of John Major which had not been attempted under Margaret Thatcher.

**British Coal.** The remaining 20 economic mines of the UK coal industry were privatised in 1994. They were sold to a private company, RJB Mining. RJB made a loss from the mines in the first year after privatisation, but had managed to return a profit within eighteen months. One pit, Tower Colliery, deemed uneconomic by economists, was sold to a workforce buy-out team, which had pooled British Coal redundancy money to fund the purchase. In 1996, the pit made a £2 million (£16 million) profit.

**British Rail.** The 1994 Railways Act paved the way for the privatisation of British Rail. Existing business units were restructured into 90 separate businesses, bringing a greater degree of transparency to the different parts of the rail network than ever before. New methods of privatisation were necessary because the taxpayer would continue to subsidise socially necessary rail services. The ownership of track and signals was separated from service operators so as not to deter competitors from offering the same service along the same line in the future.

Railtrack, the company which now owns and operates the track and signalling network, was privatised through a share flotation in May 1996. Railtrack now charges passenger and freight operators for the use of the track. It has an important role, along with the Health and Safety Executive, in ensuring the safety of the whole network. Railtrack has overseen the sale of many British Rail property assets and the leasing to the private sector of some of the largest railway stations.

Railtrack has taken full advantage of the better access to capital markets which privatisation has brought. It has begun an £8 billion (£64 billion) investment programme.

Passenger services have been split between 26 operating companies businesses. Bids for the franchises to operate passenger services were decided by the Franchising Director on the basis on the largest amount a potential operator would pay for a franchise (between seven and fifteen years), or the smallest amount of subsidy for which he would continue to deliver the service. Certain levels of service are guaranteed in the franchise, although a degree of flexibility has been allowed. An estimated £6 billion (£48 billion) will be saved in taxpayer subsidy over the next fifteen years.

Passenger franchise operators lease trains from three rolling stock companies (ROSCOs). These companies, holding all British Rail rolling stock, have been privatised. So too has been all British Rail maintenance and most other functions.

Although private enterprise is expected to deliver an exciting range of new offers to encourage more people to travel by train, discount railcards for young people, senior citizens and the disabled were guaranteed at the time of privatisation. The continued availability of through-tickets and a national timetable was also ensured.

**British Energy.** At the time of electricity privatisation in 1990, the nuclear business of the Central Electricity Generating Board was retained under state control because of concern about future decommissioning liabilities. At the time they were built, no provision had been made for meeting the future decommissioning costs of nuclear privatisation.

Since the time of privatisation, a 'nuclear levy' of around 10 per cent has been added to all electricity bills in order to provide resources for the future decommissioning. Around £8 billion (£64 billion) is now available to meet future liabilities. The reduction of this levy from 10 per cent

to 3.7 per cent in 1996 and to 2.2 per cent in 1997 brought an annual reduction of more than £20 (R160) in domestic electricity bills.

Under the privatisation of a new company, British Energy, in July 1996, ownership of the UK's Advanced Gas Cooled Reactors and the Pressurised Water Reactor at Sizewell B was transferred into the private sector. The older Magnox stations were retained in the public sector as assets of another new company, Magnox Electric and will eventually be transferred to British Nuclear Fuels, who will de-commission them.

**Civil Service.** Large parts of the civil service have become 'Next Steps Agencies', which gives them greater independence in the delivery of clear policy objectives. Savings of around £700 million (R5.6 billion) a year have been secured under the market testing programme, which requires the existing state provider of a service to demonstrate that its costs do not exceed the cost for which the private sector could deliver the same service.

There are proposals for the privatisation of some civil service functions, such as the payment of state benefits. Local government services, such as refuse collection have effectively been privatised in many parts of the country under the compulsory competitive tendering programme. This requires the bulk of a local authority's own in-house service providers to compete with the private sector for tenders to continue to provide given services. Taxpayer savings of around £400 million (R3.2 billion) have been achieved in this way.

## Appendix: List of major UK privatisations

December 1979	ICL
June 1980	Fairey
July 1980	Ferranti
February 1981	British Aerospace PLC
October 1981	Cable & Wireless PLC
February 1982	Amersham International PLC
February 1982	National Freight Corporation
May 1982	Redpath Dorman Long
November 1982	Britoil PLC
February 1983	Assoc. British Ports Holdings PLC
March 1983	British Transport Hotels
March 1983	International Aeradio
March 1983	Victaulic
September 1983	British Petroleum PLC
May 1984	British Gas – Wytch Farm
June 1984	Enterprise Oil PLC
July 1984	Jaguar Cars
July 1984	Sealink UK Limited
August 1984	Inmos
November 1984	British Telecommunications PLC
May 1985	British Aerospace PLC
May 1985	Brook Marine Limited
June 1985	Yarrow Shipbuilders Limited
November 1985	Vosper Thornycroft Limited
January 1986	Swan Hunter Shipbuilders Limited
March 1986	Hall Russell Limited
March 1986	Vickers Shipbuilding and Engineering Ltd
September 1986	BA Helicopters
December 1986	British Gas PLC
1986-1988	National Bus Company
January 1987	Unipart
January 1987	Leyland Bus
February 1987	British Airways PLC
April 1987	Royal Ordnance
April 1987	British Leyland Trucks
May 1987	Rolls-Royce PLC
May 1987	DAB (Subsidiary of Rover Group)
June 1987	Istel
July 1987	BAA PLC
September 1987	National Seed Development
October 1987	Doncaster Wagon Works
August 1988	Rover Group
August 1988	Govan Shipyard
October 1988	Yorkshire Rider
December 1988	British Steel
December 1988	Travellers' Fare
December 1988	Clark Kincaid Ltd
January 1989	Appledore Shipbuilders Ltd
March 1989	General Practice Finance Corp.
April 1989	British Rail Engineering Ltd

May 1989	Busways
September 1989	Harland & Wolff
October 1989	Short Brothers
November 1989	Water PLCs
July 1990	Girobank
November 1990	Regional Electricity PLCs
March 1991	Electricity Generating PLCs
June 1991	Scottish Electricity Companies
December 1991	Insurance Services Group
March 1992	British Technology Group
June 1993	Northern Ireland Electricity
July 1994	Belfast International Airport
December 1994	British Coal
May 1996	Railtrack
September 1996	AEA Technology
September 1996	Her Majesty's Stationary Office
October 1996	Teacher Pensions Agency
December 1996	British Energy
March 1997	BBC Transmission