

PRIVATISATION

The British Experience

An Australian Perspective

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EXECUTIVE SUMMARY

The concept and its origins

In the British experience of privatisation there was no green paper, no white paper, no definitive piece of legislation, no second reading speech, and the concept was not even contained in the Conservative Party manifesto for the 1979 election when the Tories came to office. It was not really an issue in the 1983 election. Even today there is no distinct policy document from either the British government or the Conservative Party defining privatisation, justifying it, outlining its objectives or spelling out its future applications. It is consequently necessary to identify these aspects in order to analyse both the public and the hidden agendas of British privatisation practice. This has to be accomplished by sifting through ministerial speeches, legislation, prospectuses, reports, and the like as well as the observations of supporters and critics of the policy.

In its most comprehensive sense, the term 'privatisation', as it is used in the UK, embraces four elements. There is the privatisation of financing a service that continues to be produced by the public sector (as in the 'user pays' principle). There is the privatisation of the production of a service that continues to be financed by the public sector (as in contracting out). Third are denationalisation and load-shedding, meaning respectively selling of public enterprises and transfer of what were state functions to the private sector. The last element is liberalisation, meaning relaxation of any statutory monopolies or licensing arrangements that prevent private sector firms from entering markets previously exclusively supplied by the public sector. This study focuses on the 'selling off' and 'contracting out' elements.

The origins of the British privatisation experience are many and varied. One very prominent element has been the perceived failure of many of the public enterprises, including their failure to live up to the theory and aspirations of their architects, to satisfy the needs of the public, to maintain the welfare of their employees, and to achieve efficient levels of economic performance, with resultant drains on public finances. There is widespread agreement in Britain that much of this can be attributed to constant political interference with the activity of these enterprises, worsened by a perennially haphazard formal and informal

relationship between them and the government of the day. This continues despite attempts through various white papers to clarify the relationship.

Other substantial influences on the origin and snowballing effect of privatisation in the UK include the ideology of the new right, the driving force behind the programme. Some of this is based on ideas and concepts flown in from the United States but given a British application. The targets of the new right ideologues have been the size and scope of the public sector, and the influence of the trade unions. The basic drive is said to be the replacement of the decision-making of politicians and public servants by market mechanisms, and the injection of private sector management philosophy and practice into the remaining public sector to ensure maximum efficiency.

But it is important to realise that privatisation is only one component of new right economic and political strategy, whose basic objective is to bring about a fundamental and not easily reversed change in the power balance in society. That strategy in Britain has included reduction of the size of the public sector so that taxes can be reduced, and control and reduction of the level of public sector borrowing to leave room for unfettered private sector borrowing. It has also entailed reduction of spending on welfare to promote a return to family-based responsibility, and encouragement of popular capitalism through maximising share ownership in the community as well as ownership of land and housing. Trade union activity has been restricted, or even eliminated, to prevent union power interfering with the market and forcing up the scale of the public sector.

An interesting aspect of the British experience has been the influence of City financial institutions on the government's privatisation programme. Another is the gradual building up of enthusiasm among influential public sector officials in Treasury, the civil service, and the enterprises themselves, as the privatisation programme has gathered momentum. These are both new phenomena in British politics.

Aims and objectives

The official case for privatisation (to the extent that it can be identified) has a number of specific objectives. They have changed over time, however, and so has the emphasis on them. The basic aims are claimed to be the promotion of competition and the increasing of efficiency. Other derived objectives include the

promotion of wider share ownership by both employees and the public, ostensibly to increase competitiveness, enhance technical innovation, and break down barriers between employees and management. Ownership of shares breaks down barriers between owners and earners, and contracting out introduces more specialised expertise, more flexible work practices, and deployment of manpower.

At times the government has claimed that privatisation aims to prevent politicians meddling in the affairs of business enterprises, and also to distinguish between the economic and social objectives of these enterprises. To that extent privatisation is claimed to produce transparency of decision-making. Because capital markets are likely to be a surer source of funds than the political capital market over a period of time, privatised companies should be able to raise funds to finance efficiency or expansion in a more flexible manner to meet their special needs. The financial markets, in turn, bring their own scrutiny by analysts and bankers, which is a kind of scrutiny and discipline not available within government.

Apart from the official case, a large number of writers identify many other objectives of privatisation. The kinder critics of the government say it has been out to clarify government and industry relationships in strategic parts of the economy, and the company prospectuses for the privatised bodies certainly achieve that objective. A considerable array of harsher critics claims that the government has been out to smash the power of trade unions, reduce the public sector borrowing requirement (not just for its own sake but also because this statistic has become a key indicator of government macro-economic performance), and generate revenue (some say to finance tax cuts before the next general election). There is some supporting evidence for each of these contentions.

The process of privatisation

The Minister responsible for the bulk of the public enterprise sales has explained that the sales process can take two to three years and typically has three phases. First, candidates are identified, the necessary parliamentary authority obtained, regulatory structures developed if needed, and national objectives secured. Secondly, companies must be financially restructured until they are in a position to survive and flourish in the private sector. Thirdly, when the market and the company are ready, the enter-

prise is sold at a price that should fairly reflect the Treasury's interest (which can involve a compromise between best price and optimum spread of ownership).

This study has revealed that the sale process is heavily driven by the expectations of the market. The factors important to the share market in appraising a government body being offered for sale include its debt to equity ratio, the nature of the business, the quality of its management, the capacity of the market to take the float, the simplicity and clarity of the prospectus, few negative government controls, the impact of any regulatory system, and above all the certainty of government policy towards the industry.

These aspects have led to a number of interesting features of the process itself. The British government decided to handle each sale separately, so there is no omnibus legislation. The average time for all phases of each sale has been two years. 'Dressing up' some of the enterprises has involved substantial injections of government capital. There has been a quite remarkable degree of reliance on City expertise in the privatisation programme, and numerous merchant banks and financial institutions have been engaged as consultants, underwriters, stockbrokers, and advisers. There has probably never in British history been such contact between the civil service and the private financial institutions.

Measures have had to be devised to protect the 'public interest', particularly with public utilities. These arrangements have thus far included creation of a separate regulatory body for the industry; introduction of social objectives into the new legal mandate of the privatised company; and special arrangements in the voting structure of the privatised body, including golden shares and government-nominated directors. Sunset clauses have been built into licensing arrangements. Some obligations have been imposed on the new entity to privatise, as much as possible, the delivery of social obligations. Subsidies from elsewhere in government administration have been used to meet some of the former social obligations of the enterprise. Occasional reporting mechanisms to the minister concerned have been established, and some kind of new competitive framework created.

Most of the sales of public enterprises have been by fixed price offer, and this has generated a great deal of controversy, especially as share prices have often escalated. Encouragement of widespread shareholding and employee shareholding has been common. The government has also adopted a number of innovative methods of promoting share sales, and parcels of shares have been earmarked for sale abroad.

Money from the sale goes into consolidated revenue after netting off expenses connected with the dressing up and sale. The administrative arrangements for the sale and its after-effects in particular are quite complex and involve close monitoring of the results.

Criticisms of privatisation

There can be no doubt that the early phases of privatisation caught most of the opponents of the Conservative government off guard. There is now, however, a body of criticism of the programme from political quarters, the media, and the academic literature. Criticisms of the government's motivation and the premise on which its reasoning is based, are abundant, and the debate is very familiar to an Australian audience. In many ways it is a return to the great political economy debates of the 1920s and 1930s about the role of public and market forces.

Criticisms of the methods of privatisation are less well known. They include arguments that the assets of enterprises are undervalued because of government fears that sales will not be finalised. Potential is seen for conflict of interest on the part of consultants in the programme, some of whom are reported to be donors to the Conservative Party. Share sale methods that result in a lower return to the exchequer from the sales than should be the case (an item of repeated concern to the Public Accounts Committee) are criticised. Employees are seen as being induced to obtain shares through a variety of generous mechanisms solely to break trade union influence. Critics say there is a danger of crowding out the stockmarket through such massive public flotations (British Telecom and British Gas have been the largest floats in world history), especially at a time when the 'big bang' of stock-market deregulation has been in preparation.

The fiercest criticisms of the British privatisation programme have been in five major spheres: (a) the failure of the government to ensure competition in industries where privatisation occurs, thereby appearing to convert public monopolies into private monopolies; (b) the creation of inadequate regulatory frameworks in such monopolistic or oligopolistic industries, especially in relation to the fulfilment of social obligations on the part of privatised industries (it is feared that the regulators will be captivated by the industry); (c) failure on the part of the government adequately to safeguard national interests from foreign influences in the privatisation drive; (d) 'selling the family silver'—the argument that revenue from sales of public assets

should not be apportioned to consolidated revenue but should be earmarked for future generations and future public uses; (e) the standard of services after sale or contracting out.

The main concern this study expresses about the British privatisation process is its apparent lack of public accountability. There have been very few checks on the programme through traditional democratic avenues to ensure that the public interest is not sacrificed to benefit private interests, and the new regulatory regimes that have been created seem inadequate for this purpose.

Conclusion

Taken at face value, the results of the British experiment have been impressive. More than eighteen major enterprises and more than three-quarters of a million houses sold, a doubling of share ownership in Britain, a projected revenue of some £20 billion from the programme by 1988–89, and instances of contracting-out at central and local government level running into the thousands. The trade unions are on the run, the opposition parties are shredding their manifestos, and it seems that an army of little capitalists will soon be walking and stalking the British Isles. The top echelons of the civil service have been converted to a policy that rewards them for dismantling their own empires. This is a remarkable change of circumstances and values, and the fact that it has been achieved in only two terms of office reveals rare political consistency and a combination of ideological fervour with disciplined action.

The same laudatory remarks cannot be made of the process of the privatisation programme, which gives the appearance of being extremely incremental, potentially draconian in its capacity to redistribute wealth from the many to the few, and very low on accountability. For this and other reasons it is doubtful whether the British system could be applied in Australia without severe modifications, despite the fact that many of the premises and motivations behind the programme would be identical. Not least would be the popular capitalism theme. This would sit easily with the new right thinking in Australia, where less than a twentieth of the population are shareholders. What has appeared to be missing in Australia is rabid ideological fervour in a mainstream political party, which has driven British experience to the point where conservative forces want to produce a fundamental, irreversible redistribution of power and voting intention.

The two questions most often asked in Australia about the British privatisation experience are the simplistic 'Is it good or bad?'

and 'Would it work here?' As in most areas of public policy, simplistic answers cannot be given. The objectives of privatisation in Britain have been numerous and both overt and covert, so evaluation by traditional methods of comparing performance against objectives is not easy. The clearest answer this study can provide is that it appears to have been strong and consistent on content, dubious on process, and would require some fairly significant remodelling before it could be implemented in Australia.