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If you think privatisation and outsourcing are sacred, read this

From G4S to Thames Water, the markets have failed us in multiple industries. Their relationship to the state has to change

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Soldiers at the London Olympic Park following G4S's faliure to recruit enough personnel. Photograph: Getty Images

As the government prepares for two more major privatisations – Royal Mail and Lloyds – there's an almost kneejerk reaction in our economic culture that markets are infallible while governments are so prone to error that they should just keep out.

After the banks' Libor-rigging scandal, EU investigations into similar price-fixing in oil markets, the continuing provocation of inordinate bank bonuses, several exposures of misselling of financial products, unlimited executive pay self-gratification, not to mention mishandling of exotic derivatives which nearly crashed the global economy, this view is ripe for re-assessment.

There is an assumption that private markets are more efficient. They often aren't. According to the McNulty report, Britain's privatised railway now has 40% higher costs, and though passenger fares have increased significantly in real terms, the public subsidy to the railways has more than doubled to £5.4bn a year. The main reasons for this are higher interest payments to keep Network Rail's debts off the government balance sheet, debt write-offs, the costs of a multiorganisation fragmentation of the rail system, profit margins of complex tiers of contractors and sub-contractors, and dividend payments to private investors.

Is rail an extreme example? Not really. The privatised water companies have a byzantine structure of private equity financing, are good at making profits and paying dividends, but fall back on taxpayer subsidies for essential projects like sewer modernisation. Last year, Thames Water paid no corporation tax last year, yet paid out £280m in dividends and the private equity stake grew 10-fold in value over the decade. Martin Blaiklock, a former director of utilities at the EBRD bank, calculated that if no dividend payments had been made and the cash used instead to build up reserves, Thames Water could have provided the £4bn to build the new London sewage tunnel, with no extra borrowing and no extra water charges, when households are expected to pay at least £100 per year more in water bills to fund the project.

A similar pattern can be seen in privatised gas. Centrica recently announced annual profits were up 14% and the chief executive got a pay and shares award of over £4m, while the average household bill rose 8% despite wholesale energy costs falling. Next year it is predicted that the average profit per household made by the "Big Six" suppliers will nearly quadruple to £110 compared to last year.

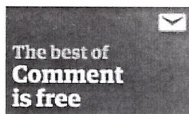
Nor is the record for outsourcing – the current government's fixation – any better. Everyone knows about the G4S Olympics security fiasco. Rather less publicised is the huge failure of the Work Programme, on which the government has so far spent £435m for private contractors. Though providers like A4E were paid £400 if they got someone started in a job and bonuses if they stayed in work, ministers were forced to announce that just one in 20 of the unemployed people pushed though this programme found work lasting 6 months, despite people who had already secured job offers still being encouraged to sign up for the scheme.

Similar examples abound. The outsourcing project to computerise NHS records was finally abandoned at a cost to taxpayers of £12bn. The £30bn public-private partnership for the London Tube network upgrading to two private consortia ended disastrously when one went bust with debts of £2bn and the other failed, leaving taxpayers with a £400m funding gap which even the Tory mayor described as "looting". Then there's the bailout of Southern Cross and the halting of prison outsourcing due to its poor value for money.

How should these across-the-spectrum privatisation and outsourcing let-downs be tackled? One obvious answer is tighter regulation. But the markets free-for-all and government-keep-out approach makes this hard to secure. The notorious light-touch regulation in the City paved the way for the 2009 financial crash. The Financial Services Authority, Ofgem and the Competition Commission have been ineffective. Most of the tough action, for example over tax avoidance, has emanated from US regulators rather than British ones.

A better solution lies in a much more nuanced approach to the balance between state and markets. The idea that the relationship is automatically adversarial should be discarded. Up to 40% of private sector activity is dependent on state investment, and many big new private sector advances have devolved from state-funded innovations such as, in the case of the iPad, communication technologies as well as GPS and touch-screen display. Economic growth has actually halved in the past 30 years under deregulated markets compared with the previous 30 years of managed markets. Other much more successful economies have not gone down the path of Anglo-Saxon market extremism. Unconstrained markets have not rebalanced the economy, but have badly exacerbated inequality.

Excessive concentration of market power in several sectors has led to abuses, weakened accountability, inhibited market entry for new competitors, and is often not aligned with the public interest. In all these areas there are strong grounds for redrawing the lines on the respective roles of markets and the state.



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