The Return of Privatisation

Read through the article called 'The return of privatisation' and answer the following questions:

Q1. What is privatisation?

Q2. Under which Government and Prime Minister/s did the U.K. embark on an unprecedented sale of state assets?

Q3. What assets did this Government sell off?

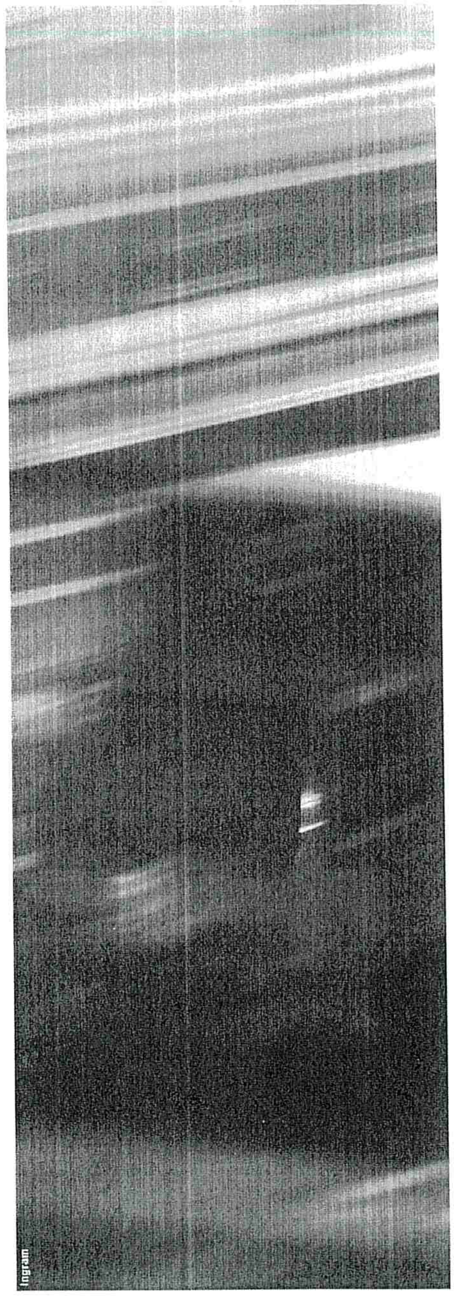
Q4. What was the UK Government's motives for selling off state assets?

Q5. Why did the newly privatised industries have to be subjected to regulations?

Q6. Which banks needed extensive recapitalisation?

The return of privatisation

With the Royal Mail set to go private, **Robert Nutter** looks at past privatisations and asks what the future could hold for state-owned UK companies



Following the death of Margaret Thatcher in April 2013 it seems rather appropriate to re-examine privatisation, one of the former prime minister's most significant policies. A new round of privatisations are in the offing, with Royal Mail at the top of the 'for sale' list. Also, with government borrowing and debt becoming such a major issue in recent years, the UK government has started to give private companies more freedom to operate in the public sector, even if outright privatisation is not possible or practical.

From public owned to plcs

Privatisation is the transfer of assets or economic activity from the public sector to the private sector. Privatisation is not merely the transfer of state-owned nationalised industries into shareholder-owned public limited companies, although that accounts for much of it. Privatisation also involves the contracting out to private companies of services previously run in-house by local authorities and the National Health Service (NHS), such as refuse collection and hospital cleaning and catering, as well as the running of prisons and prisoner transfers by companies such as G4S.

From 1979 until 1997 the Conservative governments of Thatcher and John Major embarked on an unprecedented sale of state assets, including gas, water, electricity, coal and rail. British Airways, British Steel and British Telecom also joined the private sector after years of state ownership. Most of these firms became public limited companies (plcs), with their shares traded on the stock market. Although the sales were controversial at the time, none of these privatised utilities were taken back into state ownership by Labour governments, with the possible exception of Railtrack.

Why privatise?

So what motivated the UK government to engage in such a massive realignment of ownership of key industries? There were many reasons:

- The sales of the nationalised firms raised money for the government, which helped to reduce the budget deficit.
- By placing these firms in the private sector it was felt that they would become more efficient, raising their productivity now that they were answerable to shareholders and faced increased competition. Privatisation was expected to lead to lower prices, greater choice and improved quality of service.
- The firms would no longer be able to rely on the state to protect them financially.
- Those that became plcs were able to raise finance more freely via banks and the stock exchange rather than being constrained by the Treasury and its borrowing limits.
- As shares in the companies were available to the general public there would be wider share ownership, with people able to own a stake in key industries.

Controversies

Many privatisations were controversial and meant that a state-run monopoly was replaced — initially at least — by a private monopoly. A lack of competition meant that the newly privatised industries had to be the subject of regulation to control prices and monitor the standard of service. The UK rail, water and energy industries have regulators, e.g. OFWAT regulates

The entry of private operators into the bulk mail market has hit Royal Mail hard

usehold water bills set by regional water monopolies such as Thames Water and Anglian Water.

For privatised firms that have monopoly power, effective regulation is needed in order to make sure that they operate in the interests of all their stakeholders. In the energy sector there is supposedly competition between the 'big six' gas and electricity suppliers, with OFGEM monitoring the extent to which these firms genuinely compete with one another. However, there is suspicion that some energy companies may be avoiding price competition through unspoken agreements called **tacit collusion**.

Many industry analysts feel that some activities are of such strategic importance to the economy that they should not be in private hands. Others believe that the way in which industries were privatised has caused serious problems in the long term for investment, performance and competition. The rail and energy industries spring to mind.

The contracting out of hospital catering and cleaning, prison security, refuse collection and care services for the elderly to private sector firms has always been seen as a way of providing these services at a lower cost and at a higher quality. Competitive tendering for contracts to perform these services should mean that competition drives costs down and quality up.

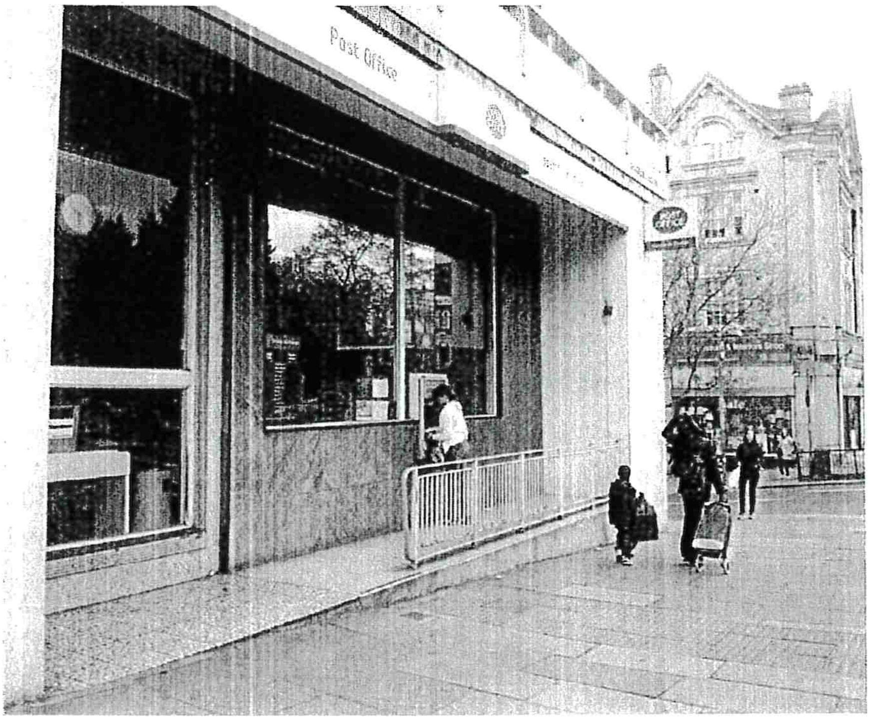
However, the competitiveness of the private firms relates significantly to labour costs. In-house public sector provision of these services meant employing workers on employment contracts that provided generous final salary pensions, sick pay and adherence to national pay scales. Private sector firms carrying out the same services do not employ workers on such favourable terms, resulting in a significantly lower cost base in activities that are very labour intensive anyway.

Labour and privatisation

The election of a Labour government in 1997 did not lead to any reversal of the privatisations carried out by the Conservatives, apart from the enforced state takeover of the railway infrastructure company Railtrack after a series of safety scares. In 2002 Railtrack was replaced by Network Rail, which is a state-owned limited liability company able to raise its own finance.

In 2001 National Air Traffic Services (NATS) was part privatised, with 51% of the company being sold. This freed it from Treasury control of its finances.

The recent credit crunch meant that some UK banks needed extensive recapitalisation by the government. As a result of these bank bailouts the government currently owns 83% of RBS and 40% of Lloyds. The UK Finance Investments company was set up to manage the government's shareholding in the banks. When the share prices of the banks have risen significantly the



government-owned shares will be sold to private investors.

Private post?

Of the state-owned UK companies, Royal Mail is set to be the next candidate for privatisation. Postal services have faced huge challenges in recent years due to increased competition and the decline of the letter as a means of communication.

European Union directives opened up UK postal services to private operators such as UK Mail and TNT. These companies have taken significant shares of the bulk mail market in the UK. For example, credit card companies such as Barclaycard send out vast quantities of mail to customers every day and private operators such as TNT collect and sort these bulk mailings before giving them to Royal Mail for delivery via its postal workers.

Royal Mail is estimated to be worth between £2.5 billion and £3 billion. The privatisation will almost certainly go ahead, although Post Office Counters Ltd, which owns the Post Office branches and is responsible for selling stamps and banking services, will remain in state ownership.

The Communication Workers Union (CWU), the trade union representing postal workers, is opposed to privatisation and wants any future Labour government to commit to renationalising the business within 3 years of coming to power. The union is more interested in pay, conditions of work and pensions than shares in the business. Frances O'Grady, the Trades Union Congress general secretary, backs the CWU and says that the Royal Mail is now modernised and stable and does not need to be privatised.

Private but not plc?

Privatisation is being extended within state-owned assets such as health, probation and social services. NHS reforms will allow clinical commissioning groups (of GP practices) to purchase services for their patients from either NHS hospital trusts or private health providers.

In the years ahead it is possible that we will see further privatisations, although not all privatised companies will become plcs. Nonetheless, with the stock market reaching pre-recession levels it is now becoming more attractive to sell off commercial state activities through the issuing of shares. The government's main aims are to give state-owned assets more commercial freedom and free them from the financial restrictions of the Treasury, particularly on how and where they can raise finance.

Much will depend on who wins the 2015 general election, as anything other than an outright Conservative victory is likely to slow down the privatisation process. However, business models are changing in the public sector and any government will have to deal with the huge national debt, which could reach 90% of GDP. Selling assets and commercialising other activities may be unavoidable if the UK cannot fund its public sector through tax revenues.

Robert Nutter is head of economics and business studies at Watford Grammar School for Girls.