

The PRIVATE Paradox

Britain was the laboratory of the world's most sustained privatisation program. But the lessons are more than a little surprising. Grahame Thompson concludes that, for the Australian Left, regulation, not ownership, should be the key issue.

The pressures to privatise various public sector activities are growing on a global scale, and these pressures are expressed nowhere more strongly than in Australia at present. The UK can claim the somewhat dubious distinction of having pioneered this movement, and it has probably pushed the process further than most countries because of the head start it gained when a radical 'new Right' Conservative government was elected in 1979 bent on 'transforming' Britain's admittedly creaking economy.

The main privatisations so far achieved in the UK are detailed in the adjacent table. This shows the formidable extent of the sale of publicly-owned business to date. If the UK Conservatives have their way and win the next general election, more sales can be expected — British Rail, British Coal and the prison service being the most likely targets.

Privatisation programs are usually discussed in terms of the increased resort to the market mechanism for organising and regulating the economic activity involved. Here I want to use the UK example to show that this characterisation is too simple. In practice, things are far more complicated than generally recognised, particularly by

The UK Privatisation Program — Main Companies Sold

Name of Company	Year
Cable and Wireless	1981
British Aerospace	1981
Amersham International	1982
Britoil	1982
Associated British Ports	1983
Enterprise Oil	1984
British Telecom	1984
British Gas	1986
British Airways	1987
Rolls Royce	1987
British Airports Authority	1987
British Petroleum (31.5%)	1987
Water Authorities	1990
Electricity generation and distribution	1990

(Source: Various reports of the Comptroller and Auditor General.)

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PRIVATISATION

Cartoonist's signature

Graphic: Mark Cornwall

those on the Left. The process of 'marketisation' has been accompanied by a process of deep regulation in the UK which has meant a closer public scrutiny of many of the post-privatised companies than they received while in public ownership.

The main point to drive home is that there has been a change in the form of intervention in the UK, rather than a simple withdrawal from intervention. This poses very important issues for the precise regulation of post-privatised companies in other countries now facing the full force of privatisation. The Left in the UK was totally unprepared for this issue and, as a result, it was the Right and traditional economic arguments that drove the discussion about the post-public ownership regulatory regime.

I begin with an obvious point but one that seems to have escaped many of those on the 'new Right' as well as on the 'new Left'. It is impossible not to regulate industrially advanced, financially sophisticated, and internationally interdependent economies like those of Western Europe, North America and Australia.

Such economies demand an extensive regulatory and interventionary framework as a condition of their existence. Thus, despite calls for a withdrawal from intervention and a rhetoric that claims to produce this, the actual picture is considerably more complex. The general point here is that the usual way of conceptualising these issues — along a dimension of 'more or less' intervention — is neither a satisfactory nor a useful one. What is at stake is a change

in the forms of intervention and regulation. The quantitative dimension of 'more or less' is simply one aspect of the qualitative 'change in forms' dimension; it is not totally unimportant, but rather secondary.

The challenge is to specify the change in the forms of intervention over the period of the 'conservative turn', to assess the consequences of these, and to ask what the appropriate response might be from the Left.

Over much of the post-Second World War period three fairly distinct mechanisms of micro-economic intervention were legitimised within liberal democracies of the European, Australian and even North American type. These were subsidisation, regulation and nationalisation. Broadly speaking, it is these types of intervention that have

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been ideologically sanctioned by the 'legacy of liberalism'. I list them deliberately in the above order to indicate the degree to which the implied intervention challenges the established status quo of free market organisation.

Subsidisation challenges this the least in that the subject of this form of intervention need not necessarily respond positively to the offer of subsidisation, nor will it attract a penalty as a result (other than not receiving the subsidy, of course). This form of intervention is an indirect form because it encourages a particular type of response without directing it. On the other hand, regulation, as usually understood, is a direct form of intervention inasmuch as there is a penalty for non-compliance. For instance, policing is involved and legal or semi-legal sanctions can be brought to bear if the regulated activity does not conform to requirements. This mounts a greater challenge to the private decision-making of market agents. Finally, nationalisation represents the most serious and direct challenge to the established order since it transfers ownership of resources to a public body. Notice, however, that this remains a legitimate and sanctioned aspect of liberal social democracies in my schema. While this is clearly a controversial claim, the way nationalisation was carried out and has functioned within mixed economies of the liberal type in the post-Second World War period tends, I would submit, to bear it out.

One important common characteristic that further justifies the combination of the above three forms of intervention, despite the differences between them, is that they all presume existing economic activity. The object of any of these interventionary mechanisms is already established prior to the attempt to subsidise, regulate, or nationalise it. Contrast this with a different form of intervention, one directed mainly at the industrial field — one that tries to establish new economic activity from the outset. Robust mechanisms to carry out this kind of 'intervention' within liberal democracies are very difficult to come by. Attempts at identifying gaps in the productive structure and seeking to fill them with publicly-controlled institutions have usually ended in failure. Such attempts are politically sensitive because they contain the seeds of a type of economic practice that could exceed the legitimate bounds of the liberal and social democratic tradition.

Inasmuch as regimes of regulation involving these types of interventionary mechanisms became robustly established in the post-war period, I would like to suggest they characterised a 'relatively extensive' system of intervention. By this I mean the scope of intervention was wide; the mechanisms were complementary. There was some overlap, of course, and it is not always possible to separate clearly where one type of intervention began and another ended. But, by and large, these three mechanisms were conceived as separate types, fulfilling separate functions and, in the main, operated separately. The question is: what has become of them?

Some mechanisms remain firmly in place. For instance, the tax-subsidy method — always at the heart of the liberal interventionist framework — continues, albeit in a redirected form. It is important to recognise the continuities between the old, pre-conservative turn system, and what I will argue in a moment is the newly emerging one.

The most obvious transformation occurs with the idea of nationalisation in the UK and elsewhere. It no longer represents an interventionary mechanism but, rather, the reverse; a classic case of the withdrawal from intervention, many would argue. This claim, however, needs to be approached with caution. Again, it is perhaps better described as a change in the form of intervention. The traditional UK nationalised industries are being transformed from large public monopolies into private ones, or sometimes into private duopolies, accompanied by a new extensive set of regulatory apparatuses. Even the water and electricity industries, which were not privatised as monopolies or duopolies, have attracted an extensive regulatory apparatus.

At this stage it may be useful to characterise these changes overall and then go on to justify this characterisation.

Above I suggested the post-1945 to mid-1970s regime of intervention was a 'relatively extensive' one. At present, I suggest, this is being replaced by a 'relatively intensive' one. This displays four main features. The first is a narrowing of the field of operation of intervention involving restrictions on its scope (though this is offset somewhat by

the growth of the new regulatory bodies outlined below). The second concerns a more intense 'gaze' directed at that economic activity under scrutiny from regulatory institutions (again, some of which are new). The third main feature involves the establishment of a deliberately 'layered' system of regulatory mechanisms. Finally, within a broad rule-driven regulatory structure, organisations have been given greater discretion to exercise autonomy in deciding the specific criteria for their individual assessments. In general, the effect of this emerging regime has been to deepen the regulatory experience. Clearly, quite a complex pattern is being suggested here which I will now try to unpack.

One of the central features driving the moves towards privatisation was the idea of increased competition. But the manner of its conception was not the form of the traditional neo-classical notion of competition, which stressed a static equilibrating market made up of a number of competing units. Rather, it was a more pragmatic notion of competition that informed the discussion. As long as the market was potentially contestable this would serve the objective of competition well enough. The regulatory apparatus was constructed, at least in major part, to serve this end. But given the size of the organisations involved and the lack of any serious attempt to break them up, any challenge to their monopoly or near-monopoly position has rather remained a sentiment only. Despite repeated attempts by the government and the regulatory bodies to 'clip off' activities existing around the edges of the privatised companies' core business and subject these to competition, the impact on the companies has so far been marginal.

Monopolists have an incentive to exploit the market and duopolists to collude to divide it up. This is why a new set of regulatory bodies was seen to be needed to supervise the post-privatised companies. For the newly duopolised telecommunications industry in Britain, an Office of Telecommunications (OFTEL) was set up. For the monopolised gas industry a similar organisation, OFGAS, has been created. For privatised British Airways (which is subject to international competition) and the British Airports Authority (which owns the major London airports and those in Scotland, and which is not subject to much competition), the already existing Civil Aviation Authority (CAA) has been revamped to provide the necessary regulatory apparatus. For the water companies, the National Rivers Authority was created to supervise their supply arrangements. As the electricity supply industry is primed to become a set of privatised companies it, too, is to be subject to a new regulatory body.

The UK has experienced then the demise of one traditional interventionary mechanism — nationalisation — as another — regulation — has been expanded in its place. This is not a simple case of withdrawal to allow the market a freer hand. The crucial feature is the operation of these newly emerging regulatory apparatuses.

The prevention of outright and obvious abuse of 'monopoly power' and the 'protection of the consumer interest' have remained the primary ostensible objectives of the regulatory bodies. OFTEL in particular has been surpris-

ingly diligent in pursuing the worse excesses of British Telecom. The general criteria by which these regulatory bodies are required to scrutinise involve the famous 'RPI-n%' formula. This sets the pricing framework within which the companies must operate. They are required to set their prices according to the formula 'retail price index - n%', where n% is some agreed figure for the company. Clearly, this is hardly the criterion of a non-interventionist; it goes to the heart of private sector decision-making. In addition, 'maintaining regulatory vigilance' has forced OFTEL to go further and inquire into rates of return on capital employed of British Telecom (BT), and its duopolist rival Mercury Communications. Quality control has now entered the

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regulator's vocabulary as well. And OFTEL has the power to consider any merger that either BT or MC might propose. Thus, in effect, OFTEL has at least a potential to influence all the central financial decisions either company is likely to make. The same goes for other the other regulatory bodies.

Another feature of the post-privatised regulatory regime is the way the government has retained a 'golden share' in a number of the companies, which allows the government wide powers to block certain shareholdings, to influence variations in voting rights, share issues, disposal of assets, and other matters.

All in all, these measures trawl in most of the major financial decisions that the privatised companies are likely to make. To exercise their powers, the regulatory bodies have initiated very detailed analyses of the companies' cost and revenues structures, their investment programs and their general business strategies. They have devised elaborate contracting arrangements to protect customers. Thus, they have been forced to install a very deep regulatory structure, with wide powers of investigation.

With respect to those industries where a number of separate companies were already in existence (the water industry), or where they could be easily created out of the existing industry structure (electricity supply), a different form of regulation has arisen. This is known as 'yardstick' regulation, and it involves comparisons between the various component companies within the industry. Although these do not extensively compete between each other, their regulatory targets can be set according to best practice comparisons between them, thus in theory allow-

ing a more hands-off approach to development. The practical consequences of this form of regulation have, however, yet to emerge.

One very interesting feature of the privatisation of the electricity supply is the creation of an 'internal market' for electricity within the newly privatised operational structure, involving a complex set of contractual arrangements between the power generation arms of the industry and the distribution companies. Nobody is yet sure how, or whether, this 'market' will actually work. It is illustrative, however, of a number of trends within the UK public sector where 'internal markets' have been set up (in health and education services). But these are not markets in the usual sense of the term and should not be confused with a traditional 'marketisation' of economic activity. They are highly regulated; price is not used to determine where resources are located — budgets are set 'prior' to providing a supply so 'cost minimisation' becomes the main objective.

A final aspect of the new regime is what I would describe as its 'layered' character. Instead of just one level of interventionary mechanisms — where a complementary but largely non-overlapping system results — it now seems to be deliberate policy to foster overlapping and even overlaid mechanisms. What is more, such a system is emerging even though it is not official policy to foster it.

In part, this results from the struggles emerging between the privatised companies and their regulatory overseers. It also results from the way some of the de-nationalised companies have become increasingly predatory in terms of their competitors. The takeover by privatised British Petroleum of another privatised company, Britoil, and British Airways' takeover of its main domestic rival, British Caledonian Airways (both in 1987) caused some disquiet and confirmed that 'competition' was no longer a serious objective of the government.

In connection with these cases and as an example of the trend towards a layered regulatory regime, we can point to the dual nature of the monopoly and merger legislation that applies to the UK — in the domestic sphere and again in the European sphere. Thus British Airways' bid for British Caledonian was referred to the European Commission after the domestic UK bodies failed to act. Similarly, the takeover proposal for the Rover Group by British Aerospace — again involving a recently de-nationalised company — was also referred to the European Commission. Again, the UK monopolies and merger legislation has been extended to include the remaining nationalised industries, which were previously exempt from this legislation. Other examples could be quoted.

One of the reasons advanced for this new layered approach is that it makes the capture of regulatory bodies by their regulated companies much more difficult. Although thoroughly exasperated by American writers, this phenomenon of 'regulatory capture' has struck a chord with UK policy makers as the UK embarks upon an American-type odyssey with 'regulatory intervention' (instead of the now unfashionable nationalisation).

Rather paradoxically the 'new Right' Conservatives have presided over one of the most sustained and rapid interventionary initiatives in British history. In general, it is clear that an approach to economic issues stressing a totally free-market, non-interventionary stance is on the defensive. A new realistic Right has emerged to take the initiative in these matters, a Right which is more pragmatic and less doctrinaire.

Given the installation of extensive powers to determine the course of the post-privatised companies there seems no strong argument for re-nationalising any of them. With a strong regulatory body — which itself has control over pricing structure and which provides a proper accountability for their monopoly or near monopoly status — there is little need to embark on the politically hazardous course of re-nationalisation.

The better approach is to supplement and strengthen the now already existing structure. Very dramatic effects, for instance, could be had by increasing, or merely threatening to increase, the 'n' component of the 'RPI-n%' pricing formula discussed above. In addition, the government still holds a large part of many of the privatised company shares, and it could buy more on the open market if it wished. Given the well-known ability of consolidated shareholdings of 20% or so to secure effective control of private companies, it would be easy to secure such a shareholding to be invested in an independent trust company which could supervise a privatised company and which could be made up of a wide range of social interests. This would have the advantage of once and for all eliminating any residual element of state ownership from the post-privatised industries.

How important any of these suggestions is for the Australian example remains to be seen. If there are any lessons to be learned they are twofold. First, devising a suitable regulatory structure is paramount. One will emerge or be imposed, regardless of the explicit intentions of policy makers. Secondly, this apparatus will have to contend with the business strategies devised by the privatised companies. British Telecom has set out to become a major global communications company by pursuing an acquisitions strategy in the US and elsewhere. Although this put considerable strain on its financial position — recently it was thought to be technically insolvent as its investment commitments overwhelmed its cash-flow and credit lines — it is probably a large enough company to achieve its aim. Can the same be said of Australia's Telecom or will it be swept up itself by a stronger company? Similarly with Qantas, a small airline by world standards. A number of airline companies have eyed Qantas for possible acquisition, and its privatisation may present a golden opportunity for this unless watertight steps are taken in advance to prevent it.

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