Nationalisation or privatisation?

What role should the public sector play in the economy? This has been a point of contention between the Conservative and Labour parties over many years. **Catherine Youds** examines the economic issues involved

The debate around nationalisation or privatisation exercises both sides of the political divide. How much should the government intervene in the market? Is it necessary to intervene in the presence of market failure or is there an underperforming, inefficient service that needs selling to the private sector?

Traditionally the Labour Party have favoured the nationalisation of key service providers in the UK, whereas the Conservative Party have favoured privatisation. The public perception of privatisation and nationalisation has changed back and forth over the past century. However, the key question that needs to be addressed is whether something is best provided by the free market or by the public sector.

Over the last few years, this debate has resurfaced in the UK. The country that was once the leader of privatisation is now reconsidering how public services should be run.

Nationalisation

Nationalisation is the process of taking an industry or asset into public ownership by government. This extreme form of intervention in the market is one solution to fixing market failures, e.g. inequality, monopolies and externalities. If the private sector fails to provide in the interest of the public, then the government can take ownership of the industry through nationalisation or renationalisation. As the government takes control of such industries, it can address any concerns and run them in the public interest rather than for private gains. The political left predominantly advocates nationalisation, as they believe public-spirited officials can replace private greed.

Historic nationalisation

The majority of nationalisation in the UK took place between 1945–51. The Labour government led by Clement Atlee planned to nationalise weak sectors of the economy in order to correct market failures. They also saw this as something that was morally desirable by society at the time. Following the Second World War, the public were in favour of policy that moved towards a fairer society based on common ownership.

The Bank of England was the first organisation to come under public ownership by the Labour Party. During 1945–51, Atlee's government nationalised coal, gas, steel and the railways. They also owned airlines, travel agents and a removal company.

Should the government have nationalised Carillion in 2018?

Specification links

nationalisation, privatisation, natural monopoly

Recent examples of nationalisation have happened in response to the financial crisis in 2008, where a number of UK banks at risk of going bankrupt became fully or partially nationalised. In February 2008, Northern Rock was the first bank to become nationalised, and by March 2009, the Treasury had taken a 65% stake in the Lloyds Banking Group and a 68% stake in the Royal Bank of Scotland.

Privatisation

Privatisation is the transfer of assets from the public sector to the private sector. Those on the political right advocate little or no government intervention, putting more reliance on market forces with an aim of increasing competition. A government could transfer the ownership of a public service over to the private sector if they deemed it inefficient or a source of industrial unrest.

Privatisation was one of a number of policies to encourage and reward individual enterprise and initiative. It was also a way of reducing trade-union power, widening share ownership and increasing investment. In the UK, the process of privatisation has led to a substantial reduction in the size of the public sector. State-owned enterprises now contribute less than 2% of GDP and less than 1.5% of total employment.

Historic privatisation

Despite the focus of nationalisation in politics from the 1940s, by the 1970s there was a major shift in favour of privatisation politically and socially. It was clear by the mid-1970s that many of the nationalised industries were operating inefficiently. After the 1979 election, the Conservative Thatcher government introduced a policy of change and engaged in an extensive process of privatisation. Throughout the 1980s and 1990s, successive Conservative governments sold back nearly all of the nationalised industries to the private sector.

Initially, the introduction of privatisation was to reduce the size of the public sector by selling already profitable public entities. The Thatcher administration was successful in selling large companies such as British Aerospace and Cable & Wireless. However, after the recession of the early 1980s, privatisation became the solution and a way to discipline the market. It was intended to make the large utilities more efficient, productive and encourage competition.

Case study: Royal Mail

Royal Mail was privatised in 2014 and is argued to be the most ambitious privatisation since the railways in 1994. The floating on the stock exchange allowed retail investors to buy shares and ended nearly 500 years of state control. However, the government did retain 30% of shares and 10% were given to Royal Mail employees.

Advantages

One of the main arguments for this privatisation was the increasing competition from the private sector and the ability of the public sector to compete successfully in this market. By allowing Royal Mail to be sold, it would be in a better position to raise any necessary funds to invest in new technology and compete more effectively for a share in the growing market.

Disadvantages

There were concerns that the nature of its infrastructure made Royal Mail a **natural monopoly**. This may mean it could face a breakdown of its current infrastructure in the future, which could lose its economies of scale. There were also concerns from trade-union leaders who feared that the privatisation could lead to a loss of jobs. Since it has been privatised, 11,000 jobs have been lost, a fifth of mail centres have closed and 5% of delivery offices shut down.

Total proceeds of the sale were £1.9 billion, which is a large source of income for the government. The initial offer price was 330p, which closed at 455p. This then rose to 615p before falling back to £5 per share. This would suggest that the government sold off Royal Mail too cheaply. However, despite this, at the beginning of March 2018, Royal Mail reclaimed a place in the FTSE 100. It has concentrated on introducing technology and revenues are increasing in parcel deliveries.

It is not clear-cut whether the privatisation of the 500-year-old service can be called an outright success or failure.

Privatisation vs nationalisation

One of the main arguments in favour of privatisation is that it may be less costly and more efficient for the free market to provide the service. Such efficiency gains would potentially mean lower consumer costs, greater competition, improved quality and more innovation. There would also be no political involvement in a privatised company and no need for bureaucracy.

Northern Rock was nationalised in 2008 during the financial crisis

The sale of a public service would raise funds for the government. However, if it were profitable then there would be a potential dividend loss for the government. Those in favour of nationalisation would argue that private companies are likely to have short-term profit aims, whereas the government can provide long-term investment for services that may not be profitable but are in the public interest.

Such arguments do depend on what the industry or service provided is, what level of regulation is present, what the quality is and whether it is a competitive market. If privatisation simply involves the transfer of a natural monopoly to the private sector, there is very little scope for an increase in competition. In other words, a natural monopoly would simply become a private monopoly. However, if there is competition, privatisation can lead to increased efficiency, more consumer choice and lower prices.

Private-sector involvement

Privatisation and nationalisation are the two extremes of supply-side policies. However, a government does not necessarily need to choose to adopt them in isolation. Privatisation can involve the introduction of private services into the public sector. Private-sector involvement refers to the participation of the private sector in government projects. Successive governments have used private finance to deliver social and economic infrastructure. Privately run companies can compete for a franchise contract and provide a service in the public sector.

There has been increasing involvement of such privatisation in the public sector in the UK and throughout the EU. It is argued


British coal was nationalised in 1947 and privatised in the mid-nineties

that it increases investment opportunities, improves efficiency and the benefits are then passed on to the consumer. However, it could be argued that the goal of a private firm is to make as much money as possible for itself and its shareholders. Therefore, is their profit motive compatible with the goals of the public sector?

Case study: Carillion

After the 2018 collapse of the private contractor Carillion, the debate about whether private involvement in the public sector is successful has resurfaced. Carillion entered liquidation and ceased trading. On the surface, it may seem that this is just a construction company that has collapsed. However, this private failure is a big problem for the government.

The public sector has paid £1.4 billion to private-finance companies where Carillion has a stake, and predicted future payments are estimated to cost £6.3 billion. Carillion owned stakes in 17 private-finance contracts, primarily for hospitals, schools and roads. Supporters of outsourcing to private firms would argue that the public sector may not have been any better at providing these services and may have been a lot more expensive.

Governments have seen this as a way of transferring risk away from the public sector, i.e. it is worth the price, as if something goes wrong the company will have to deal with it. However, this is not the case when the company collapses. The liquidation of Carillion shows that such involvement of the private sector in the public sector has failed.

The government has been placed in a difficult position. Should it have bailed out Carillion to save the infrastructure projects it was involved in? If it had, it would have undermined any future bidding by private firms. Private firms may bid knowing that they could not afford to carry out such projects, safe in the knowledge that the government would not allow them to fail. The government will need to address the issues around private-sector contracts in future and be sure that it provides better value and lower risk than leaving it to the public sector.

Glossary

Natural monopoly An industry in which there are such substantial economies of scale that there is only room for one firm to operate.

Full circle: Corbyn's policies

Despite an increase in private-sector involvement in the public sector, over the past few years the UK has increasingly accepted renationalisation. Alongside the nationalisation of high-profile banks and transport services in the UK, nationalisation has also happened across western Europe. Although we have not seen a complete shift in how our services are currently run, Labour leader Jeremy Corbyn would like to change this. If the Labour Party were to be elected, Corbyn would like to see rail, energy, water and the postal service renationalised.

Previously nationalised coal, electricity and gas had a poor performance record and were underinvested. It is argued that it would cost at least £124 billion to nationalise just the UK's top six utility companies. A recent report warns that nationalisation on this scale could cause a sharp increase in the government's borrowing costs and crowd out private-sector investment. However, those in favour of Labour's plans believe these fears are exaggerated and the profits generated would cover such borrowing costs.

UK railways are already partly nationalised; current franchises are awarded to the highest bidders at competitive auctions. Out of 20 franchises, 14 are now state-owned, which suggests that they are at least efficient enough to compete and undercut private operators.

Key points

1 Privatisation and nationalisation are the two extremes of supply-side policies and focus on how much a government should intervene in the market.
2 Nationalisation is the process of taking an industry or asset into public ownership by government.
3 Privatisation is the transfer of assets from the public sector to the private sector.
4 Privatisation can also involve the introduction of private services into the public sector in order to gain from the advantages without adopting all of the risks.
5 The success or failure of either privatisation or nationalisation will depend on the level of competition present in the market and the availability of long-term investment.

Conclusion

There is no definitive answer as to whether we should have more privatisation or nationalisation. It depends on the amount of competition present in the market. Privatisation is not beneficial if there is simply a transfer of a natural monopoly into private hands. However, there are also cases where inefficient and poorly run public services can benefit from private involvement.

Therefore, what is needed is a thorough evaluation of whether an individual service or industry could benefit from privatisation or nationalisation. There needs to be a strong, long-term investment plan and clear regulation put in place irrespective of whether there is private or public ownership.

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