How successful has privatisation been?

Privatisation involves the transfer of assets or economic activity from the public to the private sector. This is the general definition. There are, however, three specific types of privatisation:

Denationalisation: The sale of public sector assets. Includes industries, companies and local authority council houses. This is the type of privatisation that most people recognise: the selling off of British Telecom and the gas, electricity and water industries.

Deregulation: The removal of legal barriers to entry in a previously protected market to allow private enterprise to compete. Hence, public sector provision (i.e. financing) and production are replaced by private sector provision and production (e.g. the bus services).

Franchising: The public sector continues financial provision but for private sector production. Competitive tenders are requested for a contract to be awarded for a stated period of time (e.g. hospital needs and the railways).

In the private sector, decisions are made on the grounds of efficiency and profit. Politicians may make decisions to further their own political ends and not those of the industry in question.

State monopolies tend to create inefficiency, are poor innovators and restrict consumer choice. The existences of consumer sovereignty in the private sector has the potential for widening consumer choice, increasing quality and, through increased competition, lower prices. Basically, the nation's resources will be used more efficiently. Allocative efficiency and productive efficiency will be striven for, and more likely to be achieved.

The small budget deficits and occasional surpluses of the late eighties were in no small part due to the revenues gained by the government from the sale of various industries (from 1979-99 the Treasury has gained £70bn from asset sales). It has also to be remembered that these industries, that were often loss makers, no longer needed to be subsidised by the taxpayer. Finally, if these more efficient privatised industries began to record a profit, the government would tax these profits, thereby helping to keep the PSNCR down.

Is this an argument for privatisation or an end in itself? It is certainly a nice idea that more members of the general public own shares and, therefore, has a direct say in the running of the private sector. But do any of these part-time shareholders bother to go to AGMs to vote on important issues, and how many of them sold their shares as soon as they had made their overnight profit? Almost all of the denationalisations involved under-valued share prices to encourage their sale. With hindsight, this encouragement was not really required as there were normally at least five times as many willing customers as there were shares. Obviously the shares rocketed in value as soon as they were issued, giving these new shareholders an instant profit of anything between 20% (British Gas) and 85% (British Telecom). Some cynics argued that wider share ownership was a Thatcher end in itself as these lucky new shareholders were likely to vote Conservative for the foreseeable future.

The first two advantages are the most important; the second two were significant but not on the same scale. After all, the whole economic point of privatisation was to reduce the influence of the state, which was felt to be inefficient, and to enhance the position of the free market and competition, the most efficient market structure.

The success of privatisation depends not on the transfer of ownership from the public to the private sector, but on the extent to which the resulting set up is truly competitive. Private sector monopolies can be as bad as those in the public sector. Public sector entities that are exposed to competition can be more efficient than private sector firms with little competition (e.g. the Royal Mail).

However, there are several negative aspects of privatisation:

Those who have opposed privatisation argue that the public utilities were nationalised in the first place in the public interest. The utilities are products and services that are essential to all members of the general public. A private company in charge of one of these industries, interested only in profit, is likely to close down or marginalize unprofitable elements of its operations (e.g. cutting expensive remote services like phone boxes in the Shetlands). As nationalised companies, unprofitable but essential services continue through cross-subsidisation; unprofitable services being subsidised by the profitable services. Why else do you think that a first class stamp costs 27p whether you send a letter to a friend living miles away or to a friend living locally? As it happens, phone boxes were not closed, but this was only due to the existence of regulators. There have, though, been some worrying developments in the railways, with poorer services and timekeeping following privatisation.

The government avoided the problem of natural monopolies wasting resources in most cases by selling off industries in one go to one company. Unfortunately, this meant that the government had simply transformed an inefficient state run monopoly into a slightly more efficient but privately run monopoly with no competitive pressures. The whole point of privatisation was to allow competition to occur. In most cases this was difficult precisely because the industries in question were natural monopolies. Hence, all the utilities have regulators who make sure these privatised monopolies do not take liberties with their customers. Having said all that, many of the very monopolistic utilities have had competition forced upon them in the late 90s (e.g. gas, electricity and even water to a certain extent).

Unexpectedly, all of the utilities create negative externalities (via pollution, spoiling the environment, etc.) It can be argued that as public sector companies, the government can regulate output and make sure that it is at the socially optimal level (i.e. allow for externalities). In the private sector, maximisation of profit is the only concern, so a socially damaging level of externalities will occur. It should be noted, though, that the government could still achieve a socially optimal output level by subsidising/taxing the privatised utilities until the desired outcome is achieved.

One can argue that the increasing inequality of the eighties was, in part, due to privatisation. The government was selling off state assets (owned by everyone) to a wealthier subset of the population, thereby increasing the gap between the rich and the poor. Although it can be argued that the poorer have gained through improved services (e.g. BT), this is not true of all utilities and those at the top end have got ridiculously wealthy.

One of the major advantages of nationalised industries is that their sheer size allows them to take advantage of economies of scale. Privatisation normally involves the break-up of a large entity into many smaller ones. This was particularly true with the railways.

These smaller units will not be able to take advantage of economies of scale in the way that British Rail could in the past.
Privatisation forces the new private companies to be efficient, or at least find some way of reducing their costs in order to make a profit given the strict pricing formulae used by the regulators. By far the most popular way of cutting costs for these firms was to shed labour in large quantities. Productivity definitely rose in these industries, but was it due to increased efficiency via improved management, etc., or just a similar output being produced by fewer workers?

In conclusion, we have seen arguments for and against privatisation, and whether or not it has worked. It is quite likely that by becoming a privatised company, you will benefit significantly, and reap financial rewards. However, by becoming privatised it begs the question as to whether state assets should e sold off the private sector? Nonetheless, for the companies themselves, privatisation has worked.