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RENATIONALISATION: BACK TO THE FUTURE?

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Summary

- Actual and perceived problems associated with privatised utilities have led to some public disenchantment with these businesses. Polls suggest that there is a popular majority for renationalising them, and there is some cross-party support for this.
- Examination of these industries suggests grounds for concern over aspects of their recent operation. However, other criticisms are not substantiated, and there have been significant gains from privatisation which should not be ignored.
- Many of the problems of these sectors are not intrinsic to private ownership but are the consequence of continued government intervention and regulatory failure. Some problems – such as the conflict between prices to consumers and cost to the taxpayer - would persist even in the event of renationalisation, and could get worse.
- The record of post-war nationalisations was for the most part unhappy. The clamour for taking businesses back into state ownership ignores important lessons from that period, such as the instability of investment when nationalised industries have to compete against other government priorities.
- The cost of renationalisation would be considerable. The issue of compensation to private shareholders is being treated superficially: wider UK share ownership and the increased involvement of foreign investors would make it be much more difficult than in the past.
- Foreign nationals would be in a strong position to challenge attempts to acquire assets at less than market value. Such attempts would damage the UK's reputation for upholding property rights and could also lead to retaliatory measures against the UK's own large stock of overseas investments.

- Proposed new organisational arrangements for renationalised businesses are untested and may lead to continual politicisation, adversely affecting future performance.
- It could be more sensible, where necessary, to strengthen the regulation of these businesses with a focus on reinforcing market mechanisms. The aim should be to reduce political interference and reduce disruption to business operations.
- Notwithstanding political support for renationalisation from several parties, it seems unlikely that there will ever be complete consensus. Future governments might re-privatise, or threaten to re-privatise. The instability created by this sort of ping-pong would damage these industries' performance, with consequent adverse effects for customers and taxpayers.

Introduction

There is considerable public disquiet about the recent performance of some privatised utilities. A May 2017 YouGov poll[1] found that 65 per cent of respondents wanted to renationalise Royal Mail, 60 per cent the railways, 59 per cent the water companies and 53 per cent the energy companies. More recent polls have broadly confirmed this picture.

The Shadow Chancellor, John McDonnell, confirmed at the 2018 Labour Party Conference that his party intended to bring each of these four industries back into public ownership.[2] But Labour is not alone in support for nationalisation. The Scottish National Party has pressed for and won the right for all Scottish rail franchise competitions to ensure a public sector bid; its water supply is already not-for-profit and it plans to develop public sector bus and ferry services.[3] Plaid Cymru supports rail nationalisation,[4] as does the Green Party,[5] which also wants to see Royal Mail back in public hands.[6] So a coalition involving these smaller parties would be likely to support Labour's plans.

And it is not as if the Conservative Party has in recent years been 'hands off' in relation to the privatised utilities. It has acquiesced in the poorly-

1 'Nationalisation vs privatisation: the public view', You Gov, 19 May 2017 (https://yougov.co.uk/topics/politics/articles-reports/2017/05/19/nationalisation-vs-privatisation-public-view).
2 'John McDonnell's full speech to Labour Conference 2018', Labour Party, 24 September 2018 (https://labour.org.uk/press/john-mcdonnells-full-speech-labour-conference-2018/).
3 'Does the SNP support public ownership?', SNP (https://www.snp.org/policies/pb-does-the-snp-support-public-ownership/).
4 'Wales rail franchise should be state run, trade unions say', BBC News (https://www.bbc.co.uk/news/44224359).
5 https://twitter.com/TheGreenParty/status/948134019174141953
6 'Policy: Economy', Green Party (https://policy.greenparty.org.uk/ec.html).

performing Network Rail remaining in the public sector, has imposed badly-designed passenger franchises and then scrapped them, and interfered in energy pricing.

So partial or complete renationalisation of utilities is no longer fringe politics. But is it sensible? Our paper explores the case for restoring utilities to the public sector.

It begins by reviewing the past experience of nationalisation in the UK, and why the Thatcher and Major governments were attracted to privatisation.

We then look at the performance of the four industries currently in question. While there are significant achievements to be credited, there are clearly problems which have made these businesses unpopular with the public.

Some of the renationalisation proposals are lacking in detail, but there have been hints about both the process of renationalisation and the organisational structures which might be imposed. We examine problems likely to be faced in implementing these plans and we question whether the gains are likely to exceed the costs involved.

We also consider other possible reforms of the structures and regulation of these industries, which might be feasible while keeping them within the private sector. We conclude that reforms such as these are more likely to bring the benefits which the public seeks than outright nationalisation.

Nationalisation and privatisation in the UK

Public ownership goes back a long way: the origins of the Royal Mail lie in the sixteenth century, some components of the energy industries were taken into municipal ownership in the nineteenth century, and the same is true of much of the water industry. Pragmatic nationalisations took place in the early decades of the twentieth century – including British Petroleum, originally nationalised by Winston Churchill before the Great War for security reasons, the Port of London in 1908, the BBC from 1927, and the London Passenger Transport Board from 1933.

Some economists have argued for nationalisation in sectors where there are said to be 'market failures' such as natural monopolies (where economies of scale, possibly the result of 'network effects', mean that the market becomes dominated by one supplier), externalities (where a business has an impact elsewhere in the economy, whether for good or ill, which it doesn't take into account), or information problems.

But past nationalisations rarely took place as a result of dispassionate textbook analysis. Before World War II, nationalisations were carried out by different political parties for a variety of pragmatic reasons. Even when Clement Attlee's government carried out the comprehensive nationalisation of 'the commanding heights'[7] of the economy in the 1940s, it was argued by non-partisans that nationalisation could increase efficiency by cutting out duplication (for example of railway routes) and could improve wages and working conditions of employees.

7 A phrase apparently first used by Lenin in a speech in 1922: ('Notes for a Report "Five Years of the Russian Revolution and the Prospects of the World Revolution" at the Fourth Congress of the Comintern', V.I. Lenin, 13 November 1922 (https://www.marxists.org/archive/lenin/works/1922/nov/13b.html)).

For many socialists, however, there was a fundamental belief, embodied in the Labour Party's 1918 constitution, that common ownership of the means of production was just a good thing in itself.

Nationalisation in the 1940s: 'Common ownership of the means of production'

The 1940s wave of state ownership was widely seen as the first opportunity for a Labour government with a big majority to fulfil the demands of Clause 4 [8] of the party's constitution:

> To secure for the workers by hand or by brain the full fruits of their industry and the most equitable distribution thereof that may be possible upon the basis of the common ownership of the means of production, distribution and exchange, and the best obtainable system of popular administration and control of each industry or service.

In a hectic six years, the government nationalised the coal, gas and electrical supply industries, the railways, road haulage, buses, docks and inland waterways, airlines, iron and steel, the Bank of England, and a variety of smaller businesses including raw cotton importing. The major nationalisations created state monopolies in these industries, although a by-product of some of the acquisitions also involved the state operating in otherwise competitive fields: hotels owned by the former railway companies, for example.

Given that there had been considerable wartime government control in all these areas, nationalisation seemed less radical and controversial than it might otherwise have been. Compensation, based on the market price of shares, was paid to previous owners in the form of government bonds. The returns on these 'risk-free' bonds were less than dividends on the shares might have been, but in the circumstances of the time this is conjecture. The terms do not generally seem to have been seen as confiscatory (Myddelton 2014).

The disparate industries and organisations taken under state control in this period were organised in different ways, but there were some basic principles in common amongst the better-known nationalised industries

8 Repealed at a Special Conference of the Labour party in 1995.

(Box 1). This was ‘Morrisonian’ nationalisation: Herbert Morrison, Deputy Prime Minister, had overall responsibility for the nationalisation programme. He had a clear vision, based on his experience with the London Passenger Transport Board between the wars, as to the ‘best available system of administration’ (Schmitthoff 1951: 562-563).

Box 1: Characteristics of post-war nationalised industries

- Faced little or no domestic commercial competition in their sector.
- Managed by boards appointed by the relevant minister, who could give general direction in areas defined by legislation.
- The Treasury was responsible for the finances of the industry. Boards could issue bonds guaranteed by the Treasury.
- Boards set conditions of employment in consultation with the minister and negotiated with trade unions.
- Boards were accountable to Parliament through the relevant minister.
- A ‘break-even’ objective was set.

One element was that day-to-day management of the industries was vested in a board, rather than part of a government department under the direct control of a minister. Boards were, however, normally appointed by ministers: there would be a Chair, often well-remunerated[9], and a mix of managers and part-time members drawn from retired trade union officials, former civil servants, businesspeople and industry experts (Robson 1950).

Another common feature was that boards operated on a ‘top-down’ basis: the industries were usually centralised, although later developments allowed for a degree of decentralisation.

9 In the late 1940s, for example, the Chairman of the British Electricity Authority was on £8,500 per annum, around £300,000 in today’s money.

Importantly, there was never any question of nationalised industries being operated on a syndicalist or 'guild socialist'[10] basis, by the workers directly, or by their trade union representatives. State industries were 'owned' by the public as a whole, and were to be operated on its behalf, not for employees who happened to work in them at the time.

A further key element was the requirement for businesses to aim to at least break even (Schmitthoff 1951: 569). Nationalisation statutes laid down that revenues 'taking one year with another' had to cover running costs and 'proper provision' for interest, depreciation, redemption of capital and reserves. It was only later that nationalised industries began to acquire wider social and economic responsibilities.

The nationalised industries in the 1950s, 1960s and 1970s

Conservative administrations from 1951 to 1964 returned road haulage and steel to the private sector. For the most part, however, the Conservatives accepted nationalisation, although they tried to make state industries more efficient. A 1961 White Paper, *Financial Objectives of the Nationalised Industries,* set 5-year financial targets which involved making a reasonable rate of return on the capital employed in these industries, wherever possible (Brittan 1964: 95). The 1963 Beeching Report, *The Reshaping of British Railways,* analysed the pattern of losses across the railways and made a serious attempt to impose a degree of economic rationality on one important nationalised industry.

Labour's return to power from 1964 to 1970 saw 70 per cent of the steel industry being taken back into the public sector, but otherwise no further major nationalisations took place. Harold Wilson's government continued the attempt to set targets for the nationalised industries: another White Paper, *Nationalised Industries: Review of Economic and Financial Objectives,* was published in 1967. It recognised new commitments related to prices and incomes policy and various social objectives, but is best remembered by economists for two other innovations. First was the injunction to set price equal to marginal cost – an apparent triumph for textbook welfare economics – though this principle was rarely observed

10 Guild socialism stood for workers' control of state-owned industries by guilds of workers in particular trades or industries rather than by government-appointed management. It was popularised by the socialist academic G. D. H. Cole (1920), and its influence survived into the 1970s. Tony Benn, both as Secretary of State for Industry and subsequently, supported a version of workers' control.

in practice. Second, the White Paper set a standard test discount rate for nationalised industry investment appraisal, later applied across the public sector (Spackman 2013).

Labour also established the Industrial Reorganisation Corporation,[11] a new way of intervening in the economy with the purpose of encouraging mergers to make British industries more efficient. It facilitated the mergers of GEC, AEI and English Electric to form an electronics conglomerate, and that of the British Motor Corporation with Leyland Motors to form the ill-fated British Leyland.

The 1970s initially saw some modest privatisations under the Heath Government (notably the travel firm Thomas Cook, and pubs in Carlisle[12]), but the Conservatives also nationalised the failing luxury car and aero engine manufacturer Rolls-Royce to save it from imminent collapse. For similar reasons, the drift to further state ownership continued under the 1974-79 Labour government, with the nationalisation of British Leyland in 1975 and British Shipbuilding in 1977. Labour's National Enterprise Board, formed in 1975, took shares in many individual firms to help them 'restructure'.[13] Some state investment was more forward-looking, though not necessarily more effective, with the government investing in emerging microelectronics and biotechnology companies. And the hope of gaining natural resource rents for the public sector led to the formation of the British National Oil Corporation in 1976.

By the end of the decade the nationalised industries employed over two million people, producing about 11 per cent of GDP and accounting for 16 per cent of Gross Fixed Capital Formation (Ricketts 2019: 490). Opinion amongst economists, however, was shifting against nationalisation. One prominent critic, Richard Pryke, wrote two influential books a decade apart (Pryke 1971, 1981). In the first he was sympathetic to the nationalised industries; by the second he took a much less favourable view of their

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11 The Industrial Reorganisation Corporation and the 1968 reorganisation of British manufacturing', History of Government blog, 17 June 2019 (https://history.blog.gov.uk/2019/06/17/the-industrial-reorganisation-corporation-and-the-1968-reorganisation-of-british-manufacturing/).

12 Taken into public ownership in 1916 in a bid to control excessive drinking amongst munition workers. The same policy was introduced in other parts of the country, but it was only in Carlisle that this wartime arrangement continued for over half a century. (https://historicengland.org.uk/whats-new/first-world-war-home-front/what-we-already-know/land/state-control-of-pubs/).

13 95 per cent of the funds the NEB disbursed are said to have gone on 'lame ducks' (Wickham-Jones 1996: 141).

performance. Over the 1970s their record compared unfavourably with the private sector on key measures including labour productivity, output growth and rate of return on capital.

Why was this? Partly it was because the nationalised businesses were concentrated in slower-growing or declining sectors of the economy. Restricted as they were by statute, it was difficult to shift into new and growing areas. But there were also many problems intrinsic to the relationship between business and political imperatives.

At different times, political pressures forced nationalised industries to hold down prices to support incomes policy, or to raise them to reduce the public sector deficit. Investment was sporadic, and industries had to compete for finance on political rather than strictly economic grounds. At times of financial crisis, new investment would dry up completely, as this was less immediately painful than cuts in jobs or welfare benefits. At other times, investment would be directed to areas of high unemployment rather than to where it was most productive or remunerative. It was always difficult to close plants or coal mines, particularly where unions were strong - as they were in most of the public sector. Faced with union obduracy, managers may have tended to opt for a quiet life. They had little incentive to innovate if politics made it difficult to follow through: this contributed to inefficiency and overstaffing.

Privatisation

The UK's privatisation programme[14] was undertaken for many different reasons, and the rationale evolved as time went on. Partly it was an ideological shift against state interference, partly a pragmatic response to the failure of attempts to reform nationalised industries, and partly a reaction against the power of militant trade unions. In many fields it was a way of introducing and/or increasing competition, reducing prices and improving consumer choice. Some saw it as a way of popularising capitalism by spreading share ownership.

The first privatisation of a major nationalised industry (British Telecom) was linked to innovation – it was felt that a state-owned company would not be able to harness new communications technology as well as one or more commercial companies.

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14 The story of UK privatisation is set out in full detail in David Parker's authoritative two-volume account (Parker 2009, 2012). A useful summary of the businesses privatised is provided in Rhodes et al. (2014).

Money was also an issue, but not just because of the obvious revenues raised by asset sales. Privatisation was also a means of accessing the private capital market to enable investment that would otherwise not have been possible given constraints on government borrowing (as with the water industry).

The programme began modestly under Mrs Thatcher's government. In its first year (1979-80), a few shares were sold in government-owned companies, bringing in less than £400 million. The disposal of smaller public assets continued for a few years, until by the mid-1980s much larger sales were raising billions of pounds annually.

The first major step was the decision to privatise British Telecom. Once that had been announced, it was clear that, in principle, any business could be privatised. And there was soon evidence that this was politically popular, not least because of the opportunities for small investors.

Privatisation of gas was next, as it was relatively straightforward, followed by water and then electricity, which required more substantial restructuring to facilitate competition. Rail was a low priority because it was more complicated, and because of the need for continued subsidies. Rail was also regarded at the time as a declining industry, and therefore less attractive to investors.

Receipts to the Treasury peaked in 1991, when sales of tranches of shares in BT, National Power/Powergen and regional electricity companies raised nearly £12 billion (£25 billion in today's terms). Over the whole period of the Thatcher and Major governments, virtually all the nationalisations of the post-war period were reversed.

People tend to remember the big share sales to the general public - at a discount to encourage the growth of small shareholder capitalism - such as the famous 'Tell Sid' campaign to promote sales of British Gas shares.[15] However, privatisation took a variety of forms. In addition to stock market flotations, there were management buyouts, such as British Steel and the component parts of the National Bus Company, and direct asset sales to the private sector, for example the sale of Sealink (British Rail's ferry

15 British Gas shares: Thousands "told Sid" 25 years ago', *BBC News*, 21 November 2011 (https://www.bbc.co.uk/news/business-15792873).

service) to Sea Containers, and Rover Group to British Aerospace.[16] On the railways, part of the privatisation took the form of disposing of assets and then franchising routes to private companies.

As Britain's privatisation programme grew in scale and scope, it was increasingly copied in other countries. By the turn of the century, privatisation had become the new orthodoxy amongst economists as well as politicians.[17] For classical liberals and all those believing in free enterprise, this was a welcome development for its own sake. But how successful was privatisation in improving economic performance?

As Ricketts (2019: 519) has pointed out, 'the question is more complex than it looks, and the empirical work required to provide an answer encounters substantial methodological problems.' The Conservative governments were pursuing multiple objectives, so there is no single measure of success. Many other changes were occurring at virtually the same time, including a new regulatory structure, considerable technological change (notably in telecoms), and growing capital mobility and international competition. Controlling for these factors is difficult. Another issue is that the performance of nationalised businesses had often improved considerably as they were restructured in preparation for sale, making simple 'before' and 'after' comparisons difficult.

Various approaches have been used to examine the impact of privatisation. There have been comparisons of the performance of publicly-owned enterprises with privately-owned ones in the same or similar countries, detailed case studies of firms' performance before and after privatisation, and econometric analysis using data from a large number of businesses operating in different environments. An example of the latter is D'Souza and Megginson's (1999) paper comparing pre- and post-privatisation financial and operating performance of 85 companies, from 28 industrialised countries, privatised between 1990 and 1996. They found statistically significant increases in profitability, output, operating efficiency and (perhaps unsurprisingly) dividend payments. Employment fell slightly, but not significantly, while capital expenditure rose. They concluded that their findings 'strongly suggest' privatisation had yielded significant performance improvements.

16 Although not discussed here, one of the largest privatisations was that of the UK's local authority housing stock.

17 Labour governments from 1997-2010 did not reverse Conservative policy, and indeed continued with some low-key privatisations of their own, such as defence technology company Qinetiq and British Nuclear Fuels Ltd (BNFL).

A similar conclusion was reached in a major survey by Megginson and Netter (2001) reviewing many studies in a variety of contexts. The authors concluded that privately-owned firms were more efficient and profitable than otherwise-comparable state-owned firms.

But there are caveats to these favourable views of the effects of privatisation. As Parker (2004: 21) has noted:

> Competition and in the absence of competition effective state regulation are important if privatisation is to lead to performance improvements … ownership change of its own does not appear to have a significant effect… where there is market dominance, especially in terms of welfare gains to consumers.

Most of these studies relate to the period immediately following privatisation. As time has passed, most of the UK's privatised firms have changed their identity, merged or demerged, disappeared entirely or altered their purpose. Many are now part of multinational conglomerates. Over the last twenty years, major changes in the economy make it difficult to trace their progress since privatisation, or to imagine a counterfactual – what would have happened if coal, or telecommunications, or British Airways had remained in public hands.

However, the four sectors which the public supports returning to public ownership (water, railways, energy and Royal Mail) are still recognisable descendants of nationalised industries of the past: in many other countries, these sectors have never been privatised. We now turn to look at each in detail, starting with water.

Water

If there is one industry where it should be possible to make a decent case for renationalisation, it is surely water. The water and sewerage utilities provide an essential service, have many features of a natural monopoly, and need high levels of investment that could, in principle, currently be financed more cheaply by government. It has been claimed that 'water bills have increased 40 per cent since privatisation' and we need to 'replace our dysfunctional water system with a network of regional publicly-owned water companies'.[18] But there are also strong arguments in favour of keeping the current ownership structure and focusing instead on better regulation.

Background

Some parts of Britain had piped water supplies as early as the 15th century, but only in the late 18th century was piped water available to virtually the whole urban population. The widespread construction of sewers followed later.

At the beginning of the 19th century, most UK water works were privately built and operated. In the course of the century, however, growing public health concerns led to increasing government regulation and control. By the early 20th century, most water and sewerage systems had become the responsibility of local government. There were a large number of authorities and water boards: as late as 1945 more than 1,000 organisations were involved in the supply of water and around 1,400 responsible for sewage disposal. The costs of the services provided were met through water rates (based on property values) and central government subsidies.

18 'For the many, not the few', *Labour Party Manifesto*, 2017 (https://labour.org.uk/wp-content/uploads/2017/10/labour-manifesto-2017.pdf).

In 1973, the Heath Government's Water Act brought some order to this fragmented sector by creating ten Regional Water Authorities (RWAs) in England and Wales. These authorities, and later Scottish equivalents, were based around river basins or watersheds. They combined water treatment and supply, sewage treatment, land drainage, river pollution and fishing. This rationalisation created significant efficiency gains, but by the early 1980s the RWAs were suffering badly from insufficient investment. The authorities were prevented from borrowing money directly, but Mrs Thatcher's government was trying to control public spending and central government funding dried up. Underinvestment, combined with high levels of industrial pollution, led to a decline in river and drinking water quality. New EU legislation from 1975 onwards set river, bathing and drinking water standards which the UK was unable to meet, leading to embarrassing prosecutions by the EU. The capital expenditure required to modernise infrastructure and meet EU standards was considerable - £25-30 billion at that time (around £120 billion in today's prices) - and the government began to think seriously about privatisation. The idea was first discussed in 1984 but public opposition led to postponement until after the 1987 election.

The privatised water sector

The newly created, privately owned, water and sewerage companies (WSCs) paid £7.6 billion for the RWAs. The government assumed responsibility for the sector's total debts (amounting to £5 billion) and granted the WSCs an additional £1.5 billion to help with environmental improvements. In 1989 England and Wales thus became the only countries in the world to have a fully privatised water and sewage disposal system.[19] In Scotland and Northern Ireland, however, these services remained in public ownership.

Jumping forward to today, three of the nine regional water and sewerage companies in England are still listed on the stock market. The rest have been bought out by other businesses, including consortia of private equity

19 However, having run into financial problems, Dŵr Cymru Welsh Water, the outfit supplying drinking water and wastewater services to most of Wales and parts of western England, was reconstructed in 2001 as a single-purpose, not-for-profit company with no shareholders - effectively the same set-up as in Scotland and Northern Ireland.

and infrastructure funds, pension funds, sovereign wealth funds and foreign utility companies.[20]

The upshot is that most households in England are now served by what are, in effect, regional privately-owned monopolies, replacing the publicly-owned monopolies that existed before privatisation. But they do not have a free hand: each is licensed and regulated by Ofwat, a non-ministerial government department (see Box 2). Its main regulatory tool is a price review, which takes place every five years. Currently Ofwat is completing PR19, which will cover the period from April 2020 to March 2025. This is expected to impose price cuts averaging around 5 per cent in real terms, as well as further quality improvements. There are also consumer committees, which are an improvement on the old nationalised industries too. Last but not least, there is increasing competition in the supply of water to industrial customers.

20 This is not unusual: many companies involved in energy supply and distribution are now foreign-owned too.

Box 2: The privatised water industry

There are currently 32 privately-owned suppliers of water in England and Wales, most of which are water-suppliers only. The bulk of the water and sewerage business is in the hands of the WSCs, which still possess virtual regional monopolies.

In Scotland and Northern Ireland, publicly-owned Scottish Water and Northern Ireland Water occupy a similar monopoly position, although there are around 25 companies which hold water supply licences in Scotland and can compete to retail water which Scottish Water supplies on a wholesale basis.

In England and Wales, the Department for Environment Food and Rural Affairs (Defra) has overall responsibility for the water industry, but privatisation led to the creation of three specific regulatory bodies:

- The environmental regulator: the National Rivers Authority took over the remaining functions, assets and staff of the water authorities in relation to issues such as flooding and environmental sustainability. These responsibilities were later switched to the Environment Agency.
- The regulator of drinking water quality is the Drinking Water Inspectorate.
- The economic regulator (such matters as competition and pricing) is the Water Services Regulation Authority, more commonly known as the Office of Water Services (Ofwat).

For at least as long as the UK remains in the EU or in transitional arrangements following its departure, it is subject to European legislation on water and related environmental issues. Other UK bodies such as the Consumer Council for Water and Natural England also play a role.

The case for renationalisation

Before considering the achievements of the privatised water companies, we start by looking at seven arguments often made in favour of taking the industry back into public ownership.[21]

First, water is one of life's necessities, making price, quality and security of supply particularly critical and leading to demands that 'water companies work for people not profit'. But the same argument could presumably be made about food, shelter or anything else essential to life. However, few would argue that only the state can trusted to provide these vital goods and services.

Second, the supply of water has some features of a 'natural monopoly', where high fixed costs and other barriers to entry make it harder for private companies to compete against each other to offer customers better service or lower prices. However, this problem is not insurmountable. For example, energy companies can compete without having to run multiple gas pipes and electricity lines into a single building. There already is competition by different private water companies to supply industrial customers, using network common carriage arrangements similar to those in energy. On the whole, this seems to be working well.

What is more, even in the case of monopolies, regulators have many tools to enable or simulate competition, incentivise producers and promote consumer interests. The water sector is already heavily regulated to prevent abuse of monopoly power. Ofwat focuses mainly on economic and financial issues, including pricing. The record financial penalties[22] recently imposed on Southern Water show that Ofwat has teeth, while it is reported that the regulator is setting new investment credit rating requirements and planning cuts in consumer bills from next April.[23]

21 The Labour Party is not alone in arguing for renationalisating water. The GMB trade union, 2019 (https://www.gmb.org.uk/campaign/water-campaign) and the Green Party, 2017 Manifesto (https://www.greenparty.org.uk/assets/files/gp2017/greenguaranteepdf.pdf) have also pressed the case.

22 'Southern Water punished over 'shocking' wastewater spills', BBC News, 25 June 2019 (https://www.bbc.co.uk/news/business-48755329).

23 'Ofwat ready to turn off water firms' dividend tap', *The Times*, 10 July 2019 (https://www.thetimes.co.uk/article/ofwat-ready-to-turn-off-water-firms-dividend-tap-cdqq7s386).

In addition, English water companies have to meet quality and environmental standards set by Defra and (for now) the EU, and by other bodies such as the Environment Agency and the Drinking Water Inspectorate.

Ofwat is also strengthening its own oversight. For example, since 2010 the regulator has run a service incentive mechanism (SIM),[24] which monitors customer service performance and applies rewards and penalties as part of its price review. This will be replaced as part of PR19 by a strengthened 'customer measure of experience (C-MeX)', effective from April 2020.[25]

The terminology borders on the impenetrable, but these are the areas on which a publicly-owned water industry would presumably have to focus too. The water industry itself has made a number of pledges[26] to work in the public interest, covering essentially the same ground.

A third argument is that big savings could be made by financing investment at the lower cost of government borrowing. But there are few goods and services that the government could not provide more cheaply if (a big if) borrowing costs were all that mattered. In any case, it was the lack of appetite for financing large-scale investment that led to the privatisation of the water companies in the first place.

It has been estimated that at least £100 billion needs to be invested in the industry in the coming decade; under nationalisation this investment would have to compete for limited public funds. In principle, public investment in water could be ring-fenced and protected under a sensible set of fiscal rules. In practice, there is a clear risk that it would be crowded out by other political priorities, whereas the private sector would continue to provide finance, given sensible regulation.

It is true that the large payments of dividends and debt interest that privatised water companies make to investors could be avoided if the water companies were brought back into public ownership. But government

24 'Overall service incentive mechanism scores 2018-19', Ofwat (https://www.ofwat.gov.uk/regulated-companies/company-obligations/customer-experience/service-incentive-mechanism/).

25 'Customer and developer services experience', Ofwat (https://www.ofwat.gov.uk/regulated-companies/company-obligations/customer-experience/).

26 'Water industry reaffirms pledge to work in the public interest', Water UK, 25 April 2019 (https://www.water.org.uk/news-item/water-industry-reaffirms-pledge-to-work-in-the-public-interest/).

debt and interest payments would increase, and future investment would still have to be financed in some way.

Furthermore, the cost of finance for private water companies is already relatively low compared to other industries, including other regulated industries.[27] This can be seen as the flipside of the arguments about water being an essential service, having some monopoly characteristics, and being capital-intensive with many tax reliefs: these factors have made it a relatively safe and attractive investment. The potential savings from replacing private with public borrowing might therefore be quite small, and need to be set against the efficiency advantages of private sector management.

This leads to the fourth argument – that privatised water companies have blown these advantages by taking on too much debt and paying excessive dividends. The points here are well made by Bayliss and Hall (2017) and Turner (2013).

However, to the extent that there is a problem of poor financial management (or financial management that has outsmarted the regulator), it is unclear that public ownership would provide a better solution than more effective regulation. For example, the former regulator Ian Byatt (in the foreword to Turner's paper) has suggested some form of dividend control. There is of course only so much a regulator can do to limit potential returns without reducing incentives for private sector managers to improve efficiency.

But companies are also still subject to market pressures. Here, Turner has suggested that the acquisition of some of the largest water firms by private equity funds has 'insulated them from the discipline of the equity market' and reduced accountability. In reality, though, it seems equally possible that tight control by a small number of private equity investors will exert *more* discipline than a stock market listing, and that bondholders will be at least as alert to potential financial risks as holders of equity. Indeed, several water companies (notably Thames Water) have run into difficulties with credit rating agencies.[28]

27 See the regular reviews published by the UK Regulators Network (https://www.ukrn.org.uk/publications/).

28 It was also financial problems at Welsh Water's previous parent company that forced its change of status.

It is still reasonable to ask whether the benefits of cost savings should sometimes have been shared more evenly with consumers. For example, the National Audit Office (2015) has estimated that water companies made net windfall gains of at least £800 million between 2010 and 2015 (£410 million from lower-than-expected corporation tax rates and £840 million from lower-than-expected interest rates, only partially offset by water bill discounts of £435 million).

However, it would be wrong to see this a 'rip-off'. Water companies had simply been on the right side of a change in financial conditions that the regulator (among others) had failed to anticipate. If conditions had instead deteriorated, shareholders would have borne the additional costs. Clawing back these gains in future price reviews, as some have suggested, could appear to be a form of expropriation.

Similarly, some water companies have been accused of forms of 'financial engineering' which deliver returns far greater than those justified by the ordinary business risks of investing in the water industry. There may be a case for regulators to monitor these practices more closely. But it could also be argued that investors should be free to take on additional risks and that this can be left to the discipline of the markets too.

The fifth argument questions the track record of the privatised water companies in delivering a good service at a reasonable price. Supporters of renationalisation have had some success in portraying private ownership as bad for consumers, taxpayers and the environment – citing large price increases since privatisation, alarming data on water leakages, and so on.

But these arguments are not convincing either. On price, the claim that water bills have risen by 40 per cent since privatisation is presumably taken from the 2015 NAO Report (National Audit Office 2015). But this report also noted that most of the increase happened before 1995, when prices were allowed to rise significantly to finance investment. The 40 per cent figure is also now out of date. Bills are roughly the same in real terms now as they were twenty years ago and have been flat or falling since 2015 on this basis, with plans to reduce them by another 5 per cent in real terms in PR19.

As for quality, the industry lobby group Water UK has claimed that:

> [L]eakage is down by a third since privatisation and is due to be cut by 16% by 2025 and by 50% by 2050. Water companies have spent around £25 billion on the environment since 1995, with 10,000 miles of rivers being protected and improved since then. Environmental work since privatisation has resulted in wildlife returning to rivers that had been biologically dead since the Industrial Revolution.[29]

Moreover, customers are now five times less likely to suffer from supply interruptions, eight times less likely to suffer from sewer flooding, and 100 times less likely to have low water pressure than they were when the industry was in the public sector.

Statements from an industry lobby group should, of course, be taken with a pinch of salt.[30] But the 2015 NAO report was also mostly positive about the performance of the privatised water companies, although it was rather more critical of the regulator.

The sixth argument concerns precedents from elsewhere in the UK and further afield. Water is run on a not-for-profit basis in Wales and Scotland, and in most of the rest of the world. International comparisons do suggest that water bills are sometimes lower when services are provided by public bodies. However, this partly reflects higher taxpayer subsidies: as we shall see, a similar issue arises with railway fares.

Advocates of nationalisation can also point to cases when performance has improved after a *failing* private provider has been taken over by a municipal authority. Paris and Berlin are often cited as examples here (Bauby et al. 2018). But this does not mean that similar improvements could not have been achieved by a better-managed private company.

The most relevant comparison might seem to be with the performance of the not-for-profit companies in Scotland or Wales. This evidence is inconclusive, however. The average combined water and sewerage bill

29 ‘Dramatic fall in support for water nationalisation after revelations on pension cuts’, Water UK (https://www.water.org.uk/news-item/dramatic-fall-in-support-for-water-nationalisation-after-revelations-on-pension-cuts/).

30 For instance, environmental quality claims, see ‘No river in the England is safe to swim in, results of pollution investigation reveals’, *The i Newspaper*, 3 August 2019 (https://inews.co.uk/news/environment/uk-rivers-pollution-wild-swimming-environment-agency/)

charged by Scottish Water[31] is expected to be £369 in 2019/20, which is below the average in England and Wales of £415. However, Welsh Water's average bill is relatively expensive, at £445.[32]

What is more, Welsh Water's customer service rating is not significantly different from those of the privatised English companies.[33] Scottish Water saw rapid improvements in the early years of public ownership, but this was flattered by efficiency gains following the merger of several smaller suppliers, and a policy of matching the performance of the newly privatised companies in England and Wales.

The final argument is about the cost of renationalisation. The Labour Party has suggested that this would be quite low: the starting point for compensation should be the original value of the companies when they were privatised, perhaps based on the 'book value' of shareholders' equity, or the 'regulated capital value' which includes the book value of debt. These two figures have recently been estimated by Moody's at £14.5 billion and £18.3 billion respectively.[34] Both would be much lower than the value of the financial investment in the companies, which is perhaps £40 billion for the equity,[35] based on an average of recent market prices.

Advocates of nationalisation tend to assume away the further cost of taking on the debt of the water companies (another £40 billion or so), on the basis that the existing borrowings would simply be transferred to the government and financed, as now, from customer bills. In other words, the increase in debt is offset by the acquisition of an asset. This approach is not unreasonable. Indeed, it is arguably misleading to include the entire value of the debt as a potential cost of renationalisation (as the Social Market Foundation did when arriving at its own estimate of £90 billion for the total price (Corfe 2018)). Nonetheless, the transfer to the government's books will still increase *gross* public debt, and there is no guarantee that

31 'About Your Charges 2019-20', Scottish Water (https://www.scottishwater.co.uk/en/Your-Home/Your-Charges/Your-Charges-2019-2020).
32 'Average annual water and sewerage charges across England and Wales households', Discover Water (https://www.discoverwater.co.uk/annual-bill).
33 'Service and delivery report', Ofwat (https://www.ofwat.gov.uk/wp-content/uploads/2019/01/Service-Delivery-Report-201718-25012019-Final.pdf).
34 'Water renationalisation to cost as little as £14.5bn', *Financial Times*, 25 April 2019 (https://www.ft.com/content/8ee5d48a-6103-11e9-a27a-fdd51850994c).
35 Labour spokespeople have sought to justify a substantial discount on two grounds: that the lower figure better reflects what private investors have actually put into the company, and that the higher figure assumes the continued payment of dividends, which will disappear after renationalisation. This argument is highly contentious.

the assets will maintain their value under public management. Moreover, if the government is going to continue to pay the same interest to holders of existing water company debt, this significantly reduces the scope to reduce bills by refinancing borrowing at lower rates.

In summary, there might be a stronger case for public ownership of the water industry if England were setting one up from scratch. But given where we are, the choice is between continuing to strengthen the regulation of a privately-owned industry whose performance is already good and improving, or a potentially disruptive and costly renationalisation with few tangible benefits.

Railways

More than a quarter of a century ago, Stephen Glaister and Tony Travers (1993: 9) began an IEA paper with the words:

> The role of the government has been a major issue throughout the history of the railways in Britain. Nobody ever seems satisfied.

This remains true, as we shall see.

Background

Railways in Britain were, unusually in international context, almost entirely constructed by entrepreneurial initiative and funded by private shareholders. But the government always played some role. Parliamentary approval was required to set up a joint stock company to construct a railway and to determine a route. Within a few years of the first railway construction, government regulation began. The 1840 Act for Regulating Railways gave the Board of Trade powers to set up a Railway Inspectorate to examine the causes of accidents and make recommendations to improve safety: more than 175 years later these functions continue as an arm of the Office of Rail and Road. The Board of Trade also had powers to approve new lines, and within a few years, under the influence of the young W. E. Gladstone (as Vice-President and later President), it acquired greater powers (Bradley 2015: 61-65). The 1844 Railway Regulation Act was the first legislation to lay down rules about services and prices: it mandated ‘Parliamentary Trains’ running at least once a day with seated and covered accommodation, stopping at every station on a route and charging no more than one penny per mile. Gladstone also, interestingly, pushed a clause calling for eventual nationalisation of the railways.

Increasingly detailed regulation gradually took place over issues such as common carriage, fares and carriage prices, taxes on tickets and even occasional profit controls. As early as 1856, Robert Stephenson counted 186 separate pieces of legislation to which the London and North Western Railway was subject, although the railways remained clearly within the private sector (Hylton 2015: 92). A Royal Commission confirmed in 1867 that the construction and management of railways should be left to 'the free enterprise of the people' (ibid. 2015: 81).

During World War I, however, the railways came under the control of the wartime government's Railway Executive Committee. The advantages of coordination led some politicians to argue that the railways should be permanently nationalised at the end of the war, but this was resisted by Conservative members of Lloyd George's Coalition. Instead, the 1921 Railways Act led to the amalgamation of companies to produce the 'Big Four' - the LMS, LNER, GWR and the Southern Railway – which continued as private businesses until nationalisation under the Attlee Government in 1948.

Thereafter, British Railways suffered long-term decline as road haulage and the private car took over much of its business. Some modernisation took place from the mid-1950s: various lines were electrified, and diesel traction replaced steam elsewhere. The Beeching report claimed in 1963 that one-third of route mileage carried only 1 per cent of all passengers and recommended the closure of 6,000 miles of track and well over 2,000 stations, plus a drastic cutting back of its freight business (British Railways Board 1963). Many of Beeching's recommendations were carried out, but the railways continued to be heavy loss-makers,[36] and passenger numbers and freight tonnage continued their seemingly irreversible decline. Line closures continued through the 1970s.

A further report, commissioned by the Thatcher government from a committee chaired by Sir David Serpell, was submitted in late 1982 (Ministry of Transport 1983). It considered a range of possible options for the railways, one of which would have seen the network reduced to a handful of main lines plus the London commuter network. The controversy which this option created overshadowed the rest of the report, which was eventually shelved. Meanwhile, British Rail scrapped its regional organisation (loosely based on the pre-nationalisation 'Big Four') in favour of 'sectorisation'. The business

36 The 1962 deficit of £159 million had only fallen to £151 million by 1968 despite more than 5000 track miles being closed (Hylton 2015).

sectors identified were the express services of InterCity (the only profitable sector), the London commuter trains of Network Southeast, regional passenger services (Regional Railways), four freight sectors and British Rail Maintenance Limited. In metropolitan counties local services were managed by Passenger Transport Executives. These changes in a sense paved the way for privatisation in that they demonstrated that the system could be operated as a series of relatively independent components.[37]

Privatisation and its achievements

Mrs Thatcher's administrations discussed the privatisation of the railways, but it was viewed as relatively difficult and priority was given instead to other utilities. John Major's government proved more radical (Haigh 2018). Following the general election victory in which railway privatisation was in the Conservative manifesto, a White Paper was published in July 1992 (Department of Transport 1992).

The White Paper claimed to offer more competition, greater efficiency and wider choice for passengers and business users. The government envisaged greater involvement of the private sector in running the railways, notably through contracting out of the management of passenger services. Organisationally, this was to require separation of responsibilities for maintenance and development of the track from the operation of passenger and freight services. The idea, first proposed by the Adam Smith Institute, was based on the principle of substituting negotiated contractual agreements for top-down control (Wellings 2014: 256).

It still required heavy involvement from the government, however - in setting strategic directions, in awarding franchises and management contracts, in specifying key fares and detailed provision of services, in providing subsidies to uneconomic operations and major investment schemes. As time went on, the government increased its direct responsibility for rail operation by in effect 'renationalising' the infrastructure after the collapse of the privatised Railtrack,[38] and taking over the direct running of services when companies surrendered their franchises prematurely. The result is the untidy public-private mash-up described in Box 3.

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37 Other initiatives undertaken by the Conservatives prior to privatisation included the sale of non-core British Rail businesses such as hotels and ferries, and joint projects with the private sector. Subsidies had declined and productivity had risen (https://researchbriefings.files.parliament.uk/documents/SN01157/SN01157.pdf).

38 The regulator at the time argued that this was unnecessary, but was overruled.

Box 3: The 'Privatised' Railway

- The track and many stations and depots are the responsibility of Network Rail, a public sector body which took over from Railtrack in 2002.
- Passenger services operate mainly as government-awarded franchises for varying periods of time, although there are some 'open access' operators such as Heathrow Express and Grand Central.
- The Department for Transport (DfT) sets overall rail policy and strategic objectives. It lets and manages the 15 passenger rail franchises in England, pays subsidies to loss-making rail franchises and receives premium payments from profit-making franchises. The DFT is also the 'operator of last resort' should an operator fail. The franchising authority for the ScotRail and Caledonian Sleeper franchises is the Scottish Government and for the Wales & Borders franchise it is the Welsh Government.
- A few rail services are operated by the private sector on behalf of a public sector body, for a fixed payment. Most of these services are in London and are let as concession agreements by Transport for London (TfL). The other notable concession agreement is Merseyrail. The awarding body sets fares and markets the services, retaining revenue from ticket sales.
- Passenger franchises and concessions use rolling stock leased from rolling stock operating companies (ROSCOs).
- Freight is open access. There are currently seven main operators, running trains all over the network.
- The Office of Rail and Road (ORR) (originally the Office of Rail Regulation) regulates Network Rail/Health and Safety.
- Because some routes are natural monopolies, key fares (season tickets and 'anytime' fares) are regulated, usually linked to RPI, by the DfT or other relevant body. But franchise-holding companies are free to set other prices.

There have been substantial achievements since privatisation began in the mid-1990s. Most obviously, passenger journey numbers have more than doubled since the days of British Rail: in 2018-19 they reached a record high of 1.759 billion, as against 735 million in 1994-95. This is commonly attributed[39] to improved marketing by franchise-holders, including steep discounting of advance tickets. Rail use was expected to decline, so this growth was unexpected.

Rail freight has been a more mixed success. Although the volume of rail freight moved, at 17.4 billion net tonne km in 2018-19, is a third up on its 1994-95 level, it has fluctuated with business conditions and has fallen sharply from a record high of 22.7 billion net tonne km in 2013-14.[40]

Investment has risen, and averages about four times its level in the late 1980s. A large chunk of this comes from the private sector, mainly to pay for new rolling stock. Britain's railway is also now the safest in Europe.

Even some of the original critics of privatisation changed their mind. Lew Adams, who as General Secretary of train drivers' union ASLEF led opposition to privatisation, had changed his tune by 2004. Pointing to 1,700 more trains running per day, £4.2 billion spent on new trains and higher employment than under nationalisation, he confessed that by then 'I cannot argue against private entrepreneurs coming into the rail industry'.[41]

Privatisation's critics and alternative proposals

However, the public is unhappy with the railways' performance, and surveys continue to suggest that a clear majority would like to see them renationalised.[42]

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39 Although part of the increase is down to demographic factors, urban planning policies and to increased road congestion. Note also that London Overground – controlled by Transport for London – has also greatly increased its number of passenger journeys.

40 The steep drop in the last five years is largely attributable to the fall in coal carried (down from 36 per cent of all freight in 2013-14 to 7 per cent today) now that coal production and use in electricity generation are being phased out. In the circumstances the freight companies have done well to develop new markets to offset this.

41 Quoted in Devereux (2018). By this time the former union leader was working in a managerial role for Virgin Trains.

42 'Do the public want the railways renationalised?' *Full Fact*, 14 June 2018 (https://fullfact.org/economy/do-public-want-railways-renationalised/).

The complaints are several. The services provided, and the finance of the railways, seem no more secure than in the past, with several franchise failures, including the East Coast line where franchisees have twice had to hand back services to the government as ‘operator of last resort’. The complicated nature of the system has raised costs as extremely detailed contracts have to be made between Network Rail and service operators.[43] Despite the profits made by train operating companies, and the investment from the Rolling Stock Operating Companies, the annual contribution from the state has almost doubled in real terms in the last two decades. And yet fares have continued to outstrip inflation, with critics claiming that ticket prices are more than 25 per cent higher than they were in the mid-1990s and by some measures are higher per kilometre than anywhere else in Europe except Switzerland.

Passengers also cite excessive delays and cancellations, with overcrowding and standing on commuter trains. Much rolling stock is still of poor quality, and its average age has been rising as promised deliveries of new carriages have been delayed.[44] Track upgrades, electrification schemes and other infrastructure improvements have taken longer than anticipated, and meant that regular services have often been cancelled for long periods, particularly at weekends when poor quality replacement bus services have proved a poor substitute.

There is resentment that firms can pay dividends to shareholders when providing an inferior service: unions and others see this as taking resources out of the sector which could be put to better use as investment or as a means of lowering fares.

Some of these complaints may be unfair – or at least there is another side to the story. The profits of the operating companies average around two to three per cent of turnover,[45] so do not siphon off huge amounts that could be spent in improving services or cutting fares. And fare comparisons with other countries can be misleading as they tend to be based on ‘walk

43 These include complex arrangements for compensating for delays, with Network Rail having to pay out to train operating companies between £300 and £400 million annually for the last three years (Marsh 2019). Bizarrely, this compensation sometimes accounts for the bulk of operating company profits.

44 Media in 2017 were reporting that the current UK passenger fleet was the oldest since records began, but there is a huge backlog of orders. Average fleet age is projected to fall from 21 years in 2017 to just sixteen in 2021 (Cinnick 2018).

45 ‘Reality check: where does your train fare go?’, *BBC News*, 30 November 2018 (https://www.bbc.co.uk/news/business-46398947).

on' prices.[46] While it can be very expensive to turn up and buy a ticket for an immediate journey in peak hours, train operating companies have taken price discrimination and dynamic pricing to lengths rarely seen in other European countries; travelling outside peak hours and booking fares in advance, using a variety of concessions such as senior railcards, 16-25 or 26-30 railcards, can make dramatic savings.[47] Although some consumers complain about the bewildering variety of discounted fares, economists would argue that these sophisticated pricing strategies smooth travel peaks (which would otherwise involve even more overcrowding) and have greatly increased off-peak and leisure travelling.

In any case, lower fares across the board would only be possible, at least in the short run, by increasing taxpayer subsidies. As four out of ten people do not travel by train in the course of a year, and regular travellers have incomes well above average, this would have perverse distributional effects and might be unpopular with those who travel seldom by rail.

Many of the problems which the railways have faced in recent years have been caused by the poor performance of the one part of the complex set-up which is already back in the public sector already – Network Rail. The delays on the East Coast upgrade, for example, prevented the growth of passenger numbers which Virgin East Coast had anticipated when making their bid for the franchise. The consequent revenue shortfall was a key factor which led eventually to the franchise being surrendered.

Franchising has been poorly handled for some years. Over-ambitious bids, which were accepted as they appeared to offer a higher benefit to the taxpayer, turned out badly and ended up with the Department for Transport having to take back the franchise. It is not obvious what the remedy would have been here. Should the regulator be expected to second guess the bidders and accept a lower bid?

Increasingly onerous and over-prescriptive specifications have also made bidding for new franchises[48] less attractive. As a result, most bids are now coming, paradoxically for a 'privatised' railway, from consortia including overseas nationalised railways. We are also seeing the government, rather than franchisees, ordering new rolling stock.

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46 European Commission Directorate General for Mobility and Transport (2016)
47 'Are UK train fares the highest in Europe?', *BBC News*, 14 August 2019 (https://www.bbc.co.uk/news/uk-49346642).
48 A typical bid costs about £10 million to prepare, all lost if the bid fails.

The future

It is clear that the railways are in a mess. The original vision of the separation of infrastructure from operation, with the government staying clear, has become very confused. The DfT now exercises such tight control on the terms of passenger franchises and Network Rail policies that the opportunities for genuine private initiative are arguably no greater than in the latter days of nationalisation. The effectiveness of the ORR is also in question. The government has recognised this by setting up a review under former British Airways chief Keith Williams. This is considering future commercial models for the provision of rail services which will prove financially sustainable.

Plans for renationalisation have not been spelt out in detail. One option is that existing franchises will be allowed to run to completion before services are brought back in-house as has happened on the East Coast. This would be cheaper than having to buy out franchisees, but it may be that there will be a demand to speed up the process. It is hoped that savings will be made by cutting out dividends to shareholders and by reducing the need for complicated contracts between different parts of the railway. Ownership of the rolling stock is another aspect of renationalisation, and this would require the ROSCOs to be brought into public ownership or their assets purchased, which could be an expensive business. What is to be done about the freestanding freight companies,[49] or the open-access services of Grand Central and others, is unclear. While the UK is in the European Union, it is required to offer (subject to certain conditions) running rights to private companies, but that could lapse after Brexit.

As with other proposed renationalisations, the unions can be expected to be a strong influence. People who are opposed to renationalisation often list 'more strikes' as their biggest fear.[50] There have certainly been several long-running rail disputes in recent years, including that over driver-operated doors on Govia Thameslink and Merseyrail. Renationalisation would

49 The Labour party does not currently aim to take the freight companies into public ownership, although this remains the policy of the powerful RMT union. Other parties sympathetic to railway renationalisation do not seem to have said anything about this aspect of the sector. Having freight and open access passenger services trying to operate on a network dominated by nationalised operators may not be a stable situation in the long run.

50 'Why the public want to nationalise the railways', *YouGov*, 11 May 2014 (https://yougov.co.uk/topics/politics/articles-reports/2014/05/11/why-do-people-support-rail-nationalisation).

increase the scope for industrial action: at present staff can only strike against the company by which they are employed; a completely public-owned railway would be susceptible to national strikes. We might therefore see management under pressure to accede to union demands on staffing, pay and pensions, as happened in the past. This would probably result in lower productivity and higher costs to the taxpayer or reduced services, if higher fares are ruled out.

Other than renationalisation, what options are there for improving the railways? Two broad directions have been suggested for a structure with a continuing role for the private sector. The first is to bring the infrastructure back together with the operation of services. Such vertical integration has been seen by some as the natural form of railway operation, the system which emerged spontaneously in the early days of the railways after the failure of an attempt at a 'common carrier' model (Wellings 2014). This is something that former Transport Secretary Chris Grayling saw as the model to work towards on the East-West Rail project to link Oxford and South-West England with Cambridge and East Anglia. While this has some attractive features, it is unclear how large these combined infrastructure-service operation companies would be. If very large, they would essentially be regional monopolies.[51] If small, the issue of coordinating through-running operations, with all the contractual problems this involves, might be little different from the current situation.

Another possibility would be to maintain the separation of infrastructure from service operation, but to move to a radical extension of open access (Quine and Jarvis 2019). Currently franchised operations account for the vast majority of passenger services, but all freight and some passenger services, particular on the East Coast main line, are open access: they pay for available running slots ('diagrams') and operate independently.

In principle this idea could apply across the board: the franchise system would be scrapped, and all would-be service providers would compete to bid for running slots, in the same way as airlines compete for landing slots at airports, and to set their own prices. Rather than have the government deciding what services should be run, in this set-up this would be essentially left to the market (although it would be possible for the government to fund some loss-making services if there was felt to be a need, and to have a role in deciding which slots to offer).

51 Although on many routes they would be in competition with other transport modes.

Advocates of both these approaches are agreed that the Department for Transport needs to stand back from close involvement in the railways, a view shared by Keith Williams, who is said to envisage the appointment of an independent 'Fat Controller' to take strategic decisions.[52] But can the government ever hold back from involvement? The planned HS2 originated with the Labour government and was supported by the Coalition and the subsequent Conservative governments: it was never a private initiative even though the railways were ostensibly privatised. The projected costs of the scheme have ballooned, while the estimated benefits have fallen, a characteristic of many grandiose government schemes. While there is still a possibility that it may be scrapped by the Johnson administration, one of the first acts of the new Prime Minister was to announce a scheme to upgrade the link between Manchester and Leeds, which was seen by cynics simply as a political sweetener to the North.

It seems that governments just can't resist playing with trains. Nonetheless, some form of revised structure, or new form of regulation, could still be preferable to outright renationalisation. As Devereux (2018) has warned: 'Complaints about fares and services were particularly rife during the BR period … the present generation needs to be careful what it wishes for'.

52 'Trains should be run by a 'Fat Controller' not the Government, says man tasked with reviewing railways', *Daily Telegraph*, 16 July 2019 (https://www.telegraph.co.uk/news/2019/07/16/trains-should-run-fat-controller-not-government-says-man-tasked/). This is journalistic hyperbole. This is what Williams has actually written: 'UK rail needs a new balance between public and private', *Financial Times*, 15 July 2019 (https://www.ft.com/content/987af2a2-a6f2-11e9-90e9-fc4b9d9528b4).

Energy

The Labour party wants to nationalise the energy transmission and distribution networks.[53] It claims these networks have been permitted by Ofgem to make excessive profits, have invested insufficiently in updated infrastructure, and have been slow to connect (and have overcharged) new renewable energy generating companies.

Others would go further. UNISON[54] has also called for the nationalisation of the retail arms of the Big Six energy firms. Despite the growing incursion of smaller suppliers, the Big Six (British Gas, SSE, E.ON, EDF Energy, Npower and Scottish Power) still account for about three-quarters of the domestic market.

However, British Gas's share of the gas market has fallen steadily from 100 per cent to below 30 per cent, while in electricity the market share of the five successor electricity companies is now down to about 55 per cent. Indeed, one of the larger new entrants, Ovo, is in talks to buy the UK energy businesses of SSE.[55]

53 Green Party policy, which you might expect to be clearer, is vague on this, simply talking about 'democratic controls' and 'central and local government energy plans' (https://policy.greenparty.org.uk/ey.html).

54 'Nationalise the big six…', Unison, 17 June 2019 (https://www.unison.org.uk/news/2019/06/nationalise-big-six-create-green-army-help-uk-hit-net-zero-says-unison/).

55 'SSE in talks with Ovo over sale of UK energy business', *BBC News*, 11 August 2019 (https://www.bbc.co.uk/news/business-49310574).

Background

The development of the gas and electricity industries was a product of the nineteenth century. Gas used in the UK was originally synthetic gas ('town gas') produced from coal. It was first used for lighting on Westminster Bridge in 1813. Over the next hundred years gas lighting became universal in towns and cities, and gas was also used from the 1860s for domestic heating and from the 1880s for cooking on gas stoves. Gas was generated locally, as there was no national network of pipelines until the twentieth century. Municipal authorities often ran their own production and distribution system, although small private firms were also active.

When gas was nationalised in 1949 over 1,000 separate municipal and private businesses were merged into twelve regional gas boards. The industry became a vertically integrated monopoly which was self-sufficient: there was no interconnection with mainland Europe at this time. Things started to change in the 1960s, when liquefied natural gas began to be imported from Algeria. Then the discovery of North Sea Oil led to the strategic decision to switch the UK to natural gas, which has certain technical advantages over coal- (or oil-) based gas. One in particular is that it can be pumped around the country and does not need large storage facilities in every town. The natural gas conversion programme, a huge investment, began in 1968. It was completed in 1976. Other changes were associated with the advent of natural gas, for instance the involvement of oil companies and the emergence of gas-based electricity generation. By 1980 this was a rapidly changing industry where 'natural monopoly' arguments seemed less convincing as a justification for overall government control, given the blurring of market boundaries and greater competition.

One of the most important factors from the early 1980s was the involvement of the oil companies. It was soon apparent that they could deliver gas to industrial companies, provided they could get access to it, but this was made difficult by the dominance of the British Gas Corporation.

The electricity industry grew from small beginnings in the late nineteenth century, with the first (financially unsuccessful) coal power generation station set up in 1882. The industry was regulated from the early part of the twentieth century: from 1919 until post-war nationalisation under the Attlee government, the Electricity Commission (a government department) laid down standards for key elements such as frequency and regulations for the construction of overhead lines. In 1926 the Central Electricity Board was set up to standardise supply across the country. This organisation

established the National Grid which, in stages from 1933 to 1938, connected regional grids.

Electricity was supplied by several hundred private businesses and local authority undertakings. The 1947 Electricity Act nationalised a total of 625 electricity companies, vested in twelve area electricity boards. The National Grid and electricity generation came under the British Electricity Authority, which in the 1950s was replaced by the Central Electricity Generation Board and the Electricity Council.

The electricity industry in the 1960s and 1970s was characterised by its critics as overstaffed, offering a poor quality of service and paying insufficient attention to consumers. Productivity growth was poor and government decisions locked the industry into reliance on polluting coal-fired generators on the one hand and grotesquely expensive nuclear power stations on the other.

Privatisation

As early as 1982, the Thatcher government flagged up its intention to allow private companies to provide electricity. Nigel Lawson, Energy Secretary at the time, said that ‘Our task is … to set a framework which will ensure that the market operates in the energy sector’ (Stagnaro 2015: 43).

The gas industry was privatised by the Gas Act 1986, initially still as a vertical monopoly, British Gas, to be regulated by the Office of Gas Supply (Ofgas). Ofgas used an ‘RPI-minus X’ (RPI-X) incentive pricing rule copied from the privatisation of telecommunications. This form of price cap regulation was first proposed for British Telecoms in 1983 by economist Stephen Littlechild, later Director General of Electricity Supply. It allows a company to adjust prices each year by the percentage rate of retail price inflation (RPI), less a specified number X set by the regulator to reflect, amongst other things, the expected percentage efficiency gain that the company could achieve over the time period for which the formula was set (typically five years).

In 1988 a White Paper announced that electricity privatisation would take place. It argued that competition would force down costs and prices, with ultimate gains mainly going to the consumer (Domah and Pollitt 2001). Electricity’s 1989 privatisation, unlike that of gas, involved a restructuring to produce competition. The Central Electricity Generating Board was split

into three generating companies and a transmission company. The transmission and distribution networks were required to service any generating or retail companies on a non-discriminatory basis. The networks, the only part of the industry which could be described as a natural monopoly, were again subject to an incentive pricing rule. The initial price caps were set by government for five years, for both gas and electricity, and reflected the need to sell the shares. Later price caps were set by the regulators.

British Gas was later encouraged to restructure itself on similar lines to the electricity industry, with three independently owned companies based on, respectively, upstream exploration, the networks, and retail supply. There was again provision for all producers and suppliers to have access to the networks, which continued to have price caps.

Wholesale competition developed as new suppliers entered the gas market and new generating companies entered the electricity market (Littlechild 2016: 119). The large incumbent generators were encouraged to sell off some existing generating stations, and there was cross-fertilisation between the two sectors as a result of British Gas entering the electricity market and most electricity companies entering the gas market. The similarity of forms of regulation and the increasing interconnectedness of the gas and electricity markets was reflected in the Utilities Act 2000, which, among other things, brought gas and electricity together under one regulator, the Office of Gas and Electricity Markets (Ofgem).

Retail competition was phased in gradually in both electricity and gas, beginning with the largest industrial consumers, then smaller industrial users, and finally the rest of the market, especially residential consumers. Competition proved successful. For the first twenty years or so of privatisation, investment and productivity rose, with consumers getting the benefit of lower prices[56] and a choice of suppliers offering different packages, while industrial consumers benefited from an even steeper fall in prices (Stagnaro 2015).

56 From 1990 to 1999 electricity charges fell by 26 per cent in real terms.

Box 4: The UK energy market

Getting energy to business and domestic customers involves many players.

- Electricity generation is primarily from large power stations, but there are many smaller generation businesses.
- Transporting gas and electricity across the country involves the National Grid (which transmits high voltage electricity for long distances) and regional distribution networks (six electric, four gas) which distribute lower voltage electricity and gas to homes and businesses. The National Grid has the task of balancing supply and demand across the country.
- Supply companies are consumer-facing. They buy energy wholesale and retail it to homes and businesses. The bulk of the market is in the hands of the 'Big Six', but there are over 60 active suppliers.

The market is regulated by the Gas and Electricity Markets Authority, operating through Ofgem. Ofgem's role is to:

- protect consumers, where appropriate by promoting competition
- issue and set terms of licenses to carry out activities in gas and electricity markets
- set tariff caps informed by expectations about the rate of return that can or should be achieved
- decide on changes to market rules from time to time.

Renewed interventionism

However, criticisms of the privatised energy market began to increase in the 2000s, driven not least by rising prices. This was partly a result of increases in international fuel costs, but another element was the growing awareness of the danger of climate change which led the European Commission and the UK government to take an increasingly interventionist role in the industry. Complex schemes were introduced to decarbonise

electricity through quotas for renewable energy sources (which were given huge subsidies), and this required expensive back-up capacity because of the unreliability of solar and wind energy. About 20 per cent of bills are now direct environmental costs (in addition to the indirect costs which arise from the prohibition of carbon-intensive fuels).

Even if prices overall were rising, competition between suppliers still offered consumers choice. But in early 2008 Ofgem began to criticise the form this choice took. Often, former regional incumbent electricity suppliers would charge different rates in different parts of the UK. They offered lower tariffs to new customers outside their former incumbent areas than to existing customers inside these areas. By switching between suppliers, households could save money. Millions did, and continue to do so. However, Ofgem argued that customers that did not switch were disadvantaged, and in 2009 introduced a non-discrimination condition. This led suppliers to raise lower prices rather than reduce higher prices. It also led to a reduction in the number of customers switching supplier, and to a greater variety of tariffs as suppliers looked for new ways to compete. Ofgem blamed the reduction in switching on confusion caused by the greater variety of tariffs, and began to intervene to narrow the number and range of tariffs which could be offered and by preventing companies from charging different prices in different parts of the country. Previously, this had enabled suppliers to move into areas dominated by one of the Big Six suppliers and capture its customers by offering special deals. The prohibition of this practice reduced competition, as did limiting the number of tariffs that energy suppliers could offer. The switching rate continued to decline, and within a few years was half the level achieved in early 2008.

In 2014 Ofgem referred the industry for investigation by the Competition and Markets Authority (CMA). Then the Labour party's 2015 manifesto proposed a two-year price freeze further to 'help' consumers. This was fiercely opposed by the Conservatives at the time. In 2016 the CMA found that the wholesale market was competitive, and that Ofgem's non-discrimination and simple tariffs policies had had an adverse effect on competition. However, it found that there was 'weak customer response' in the domestic retail market, which led to an aggregate customer detriment averaging over £1 billion (some £2 billion in 2015), as a result of inefficiency and price discrimination. It recommended Ofgem take measures to stimulate customer engagement. It also introduced a temporary cap on tariffs for customers with prepayment meters (PPMs), about sixteen per cent of all customers. A minority report recommended a broader price

control. Ofgem extended the PPM tariff cap to cover certain additional vulnerable customers. The CMA's £1 billion/£2 billion detriment calculations were cited by most parties in the 2017 election campaign, after which the Conservatives under Theresa May brought in a policy not dissimilar to the Labour party's 2015 proposal, involving a temporary cap on standard variable and default tariffs which is reviewed every six months, and covers about 60 per cent of all consumers.

The CMA's PPM cap, and to a lesser extent the Ofgem cap, have had predictably perverse effects, with some existing suppliers treating the price cap as a target rather than a ceiling, and some potential new suppliers being deterred from entering the market. All this activity gave credibility to the narrative of 'rip-off Britain' and may have strengthened support for renationalisation. It reflects little credit on the regulators nor the May government.

Renationalisation proposals and alternatives

Labour's nationalisation proposals[57] involve setting up a National Energy Agency, under a board including employee, consumer and community representatives, to oversee the development of a new plan to update the grid and speed up the decarbonisation of energy supply. There would be regional energy agencies to implement these developments at the level of the distribution networks (this seems to be echoed in the Green Party's ideas).[58]

But nationalisation in itself solves nothing, other than perhaps cutting executive pay and abolishing dividends. It is unclear how state-owned network monopolies would be run in the public sector in such a way as to promote efficiency rather than the objectives of pressure groups such as trade unions and advocates for renewable energy.

And extension of nationalisation plans to major energy suppliers, as suggested by UNISON, would not be in the interest of consumers. At the moment there is still a lively market, with over 60 companies to choose from, while developments in solar and battery technology offer the possibility that in future many businesses and some households could find it technically and economically feasible to disengage completely from the transmission

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57 Bringing Energy Home', Labour, 15 May 2019 (https://www.labour.org.uk/wp-content/uploads/2019/03/Bringing-Energy-Home-2019.pdf).

58 'Policy: Energy', Green Party (https://policy.greenparty.org.uk/ey.html).

and distribution networks. Renationalisation of major suppliers would undermine competition, and strong incumbents would have less incentive to invest in new technologies.

Consumer choice is not simply about price. Suppliers have a variety of commercial and social objectives, allowing consumers to choose suppliers which concentrate solely on renewable energy (e.g. Ecotricity, Green Energy UK) or suppliers which are are non-profit (e.g. Ebico, Bristol Energy, Robin Hood Energy). This is a neglected but important benefit of competition.

In contrast, it was political control and the influence of unions on fuel choice which led to polluting, unreliable and expensive energy in the 1970s. Government intervention in the last ten years has cost both the consumer and the taxpayer more than any obvious failings of the private sector and has committed us to expensive future energy via such arrangements as the Hinkley Point C plant (which guarantees a price for nuclear energy which far exceeds the price for other forms of energy).

While a strong case can be made for the need to lower carbon emissions, the UK is currently tied into arbitrary targets for specific forms of renewable energy and outright bans (such as the plan to end the use of gas for domestic heating and cooking) which make little economic sense. This is a drift back towards central planning and 1970s-style ‘picking winners’, and renationalisation of energy would facilitate this drift. Following Brexit, and potential freedom from EU regulation, it would be sensible to switch to simpler ways of incentivising decarbonisation, for example a carbon tax, which the Green Party favours, and allow more rather than less competition.

Royal Mail

The Royal Mail was privatised only very recently (the business was sold off under the Coalition government in three tranches between 2013 and 2015) and there is little evidence that customer satisfaction has changed much since. Nonetheless, Royal Mail continues to be the favourite candidate for renationalisation. This seems to reflect nostalgia for a long-established service which used to offer more frequent deliveries, perhaps influenced by the perception that something with a 'Royal' connection should not be in private hands - coupled with pressure from the Communication Workers Union. Resentment of the high pay of some executives may also play a part, although this is not an issue confined to privatised industries and shareholders could force changes here without the need for renationalisation.[59]

Background

The Royal Mail has existed in one form or another since 1516, but for the first 120 years of its life it was a service confined to the monarch and his or her functionaries. In the 1660s the General Post Office (GPO) was established by Charles II and the office of Postmaster-General was created. Originally the receiver of a letter (rather than the sender) had to pay the postage on their letter. The rate was based on the distance the letter had travelled. Private enterprise, however, set up a 'penny post' scheme within London, with rudimentary postal districts and sorting offices and frequent deliveries in the busiest parts of the city.[60]

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59 There was a major shareholder revolt over executive pay at Royal Mail in 2018.

60 Letters under one pound were collected from various offices hourly and were delivered in the most populated parts of the city ten or twelve times a day, making this service almost as useful (or as distracting) as modern-day email.

Following a court challenge,[61] though, post was declared to be a government monopoly as all post within the city had previously travelled by private messenger.

Beyond this, limited innovation continued for many years. In the eighteenth century, regular coach services were organised to assist in mail delivery, latterly in Royal Mail-liveried coaches with uniformed staff, and a network of post offices[62] grew up. In 1830 the movement of mail by rail began; over the rest of the nineteenth century this greatly increased the speed with which mail could be delivered, with next-day delivery across most of Britain. In 1840 the modern postal system arrived with the revolutionary idea of a single rate for delivery anywhere in the country, prepaid by the sender through the purchase of a stamp – a system which was to be copied throughout the world and remains the core of the universal service obligation of today's Royal Mail.

The GPO's monopoly of postal delivery in the UK was the basis for it later developing a monopoly of newer communications technologies. Thus, the introduction of the telegraph, which made it possible to send messages in minutes rather than hours or days, led to telegrams becoming a government monopoly in 1868. Post Office Telegrams were followed in 1912 by Post Office Telephones. In the twentieth century post offices became the major means by which people received state benefits, commencing with the first old age pensions before World War I and expanding considerably after the expansion of the welfare state following the Beveridge Report. This new role eventually led to the founding of the Post Office's own bank, National Girobank, in 1968.

The late sixties, however, were a time of great change which was reflected in the structure of communications technologies. In 1969 the GPO (a Department of State) was abolished and a statutory corporation, the Post Office Corporation, was set up. In 1980 the telecommunications parts of the business were split from the postal part. The new British Telecommunications became a publicly owned corporation, privatised as we have seen in 1984.

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61 Brought to protect the interests of the Duke of York, who had a right to revenue from the post.

62 Crown post offices grew up in most sizeable towns; later thousands of sub-post offices, privately-owned outlets which might be combined with a small general store, were developed.

Privatisation and after

A further restructuring occurred in 1986 when Post Office Counters Ltd was created as a wholly owned subsidiary of the Post Office,[63] with delivery hived off to the Royal Mail and, later, Parcelforce. It is the delivery side of the operation which was subsequently privatised. The loss-making counter operation – much weakened now that most benefits are paid by bank transfer and the purchase of many government services (TV licences for example) is mainly done online – remains in the public sector.

Privatisation of Royal Mail was seriously considered under the Conservatives in the early 1990s; Michael Heseltine at the Department of Trade and Industry was keen (Parker 2014: 79-81). However, although there was felt to be a need for greater commercial freedom, many Conservative Members of Parliament were reluctant to support full privatisation because of fears over the future of the universal service obligation and its implication for rural customers. The plan was dropped. So, too, was a proposal when Peter Mandelson was Secretary of State at the Department for Business, Enterprise and Regulatory Reform in 2009 (Parker 2014: 78). On this occasion strong opposition from the Communication Workers Union and the Parliamentary Labour Party made Gordon Brown apprehensive about trying to push a privatisation bill through.

The privatisation of the Royal Mail under the Coalition in 2013, then, was rather late in the day. The UK was no longer in the vanguard: Austria, The Netherlands, Belgium and Germany[64] had moved postal services into the private sector some years previously, and international comparisons (Hooper et al. 2008) indicated that they were more efficient than the Royal Mail on a number of dimensions. It was becoming apparent that without radical change, the Royal Mail, faced with a rapidly declining letters market following the universal spread of email, increased competition and very slow progress in modernisation, could not hope to maintain its role as universal service provider while covering its costs.

The process of sale of the Royal Mail was controversial. In 2013 the government sold the first tranche of 60 per cent of the shares to employees and private investors at a price of £3.30 a share. This price increased by

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63 Now Post Office Ltd.

64 The German privatisation in particular proved highly successful: Deutsche Post AG is now a multinational package delivery and supply chain management company operating around the world and still delivering over 60 million letters a day within Germany.

38 per cent on the first day of trading, leading to Opposition politicians and the National Audit Office suggesting the shares had been underpriced (National Audit Office 2014). However, an informal review of the sale by a Labour peer, Lord Myners, concluded that the price seen after the sale could not have been achieved if set in advance.

Box 5: Privatised mail services

Royal Mail primarily operates in the letters market and the parcels markets.

- In the letters market there are two types of delivery services: 'end-to-end' service (where the same postal operator undertakes the entire process of collecting, sorting and delivering mail) and 'access service' (where an operator collects and sorts letters but hands over final delivery to Royal Mail, which is obliged to open its network to access providers.
- There is little competition in end-to-end, where Royal Mail has over 99 per cent of the market, but around 60 per cent of the access market is in the hands of competitors.
- There is considerable competition in the parcels market from both domestic and international operators.

Royal Mail is the UK's universal service provider: it is required to deliver letters to every UK address six days a week, for a fixed charge. It must deliver parcels five days a week.

Postal services are regulated by Ofcom, which produces an annual report on mail services, imposes conditions on Royal Mail (including performance targets and a cap on the price of second-class mail) as universal service provider, and other service providers as appropriate. It can levy fines for breaches of obligations.

The Post Office is government-owned and separate from Royal Mail.

Initially, Royal Mail's performance improved significantly. £1.5 billion of private capital came into the business and was invested in modernising IT and the delivery network. The business met Ofcom's performance targets and saw its ratings with residential consumers and business users improve. At the beginning of 2018, the Financial Times[65] could not see why renationalisation was being advocated, for 'Royal Mail continues to demonstrate why – and under what conditions – privatisation can deliver for everyone'.

However, more recently its performance has given cause for concern. In November 2018 Ofcom reported that a faster-than-expected decline in letter traffic and slower-than-anticipated efficiency gains meant that Royal Mail profit targets were being missed (Ofcom 2018). While continuing to believe that the universal postal service will remain financially sustainable in the immediate future, Ofcom would monitor progress closely.

Since then, the share price has fallen sharply as letters continue their long-term decline and the increase in parcel volume was not matched by an equivalent rise in revenue as competition kept charges down. While there is still scope for productivity gains, and Royal Mail has a recovery plan for the next few years, it operates a highly unionised business, unlike some of its parcel delivery rivals, and resistance to change is still considerable. In this context renationalisation might mean that, in addition to the costs of buying back the assets, continuing injections of taxpayers' money would be necessary to keep letter charges down, especially if strengthened union influence after nationalisation made productivity improvements less likely.

65 'Royal Mail continues to show how privatisation can deliver', *Financial Times,* 18 January 2018 (https://www.ft.com/content/fd051332-fc54-11e7-9b32-d7d59aace167).

New organisational forms?

Today's advocates of renationalisation want to do things differently from the past. Few now believe that the Morrisonian model of nationalised industries offer 'the best possible system of popular administration'. But what alternatives are there?

Many want to see moves towards worker representation and greater 'democratic accountability'. In an online consultation document,[66] Labour has argued that:

> Active and broad participation of workers, community members, and other stakeholders can deliver better outcomes by utilising the practical knowledge of those groups regarding operating conditions on the ground.

This is echoed by Green Party policy, which also speaks of 'Partnership Bodies', 'the circulation of local finance', 'democratic accountability' and so on.[67]

Quite what this could mean in practice is unclear. If there were scope to make better use of the 'practical knowledge' of communities to improve quality and bring down costs, why wouldn't a profit-driven privatised company be keen to do so too? Free-market capitalism would allow for many different ways to involve stakeholders in running a business.

Various examples of alternative organisational forms have been suggested, but most are decades old. Reference is made to long-standing codetermination in German firms, but this seems to have little overall effect

66 'Democratic public ownership', Labour, 2019 (https://policyforum.labour.org.uk/commissions/economy/democratic-public-ownership).
67 'Policy: Economy', Green Party (https://policy.greenparty.org.uk/ec.html).

on the conduct of businesses, except possibly slowing down decision-making (Gorton and Schmid 2000).

Another familiar reference is to the Mondragon cooperative complex in Spain,[68] which was much quoted in the 1970s, although Labour has ruled out running renationalised industries as cooperatives. There are favourable references in its consultation document to the Institute for Workers Control, founded in 1968 and influential with Tony Benn when he was Secretary of State for Industry. Mention is also made to the failed initiative at Lucas Aerospace,[69] where in 1976 a Combined Shop Stewards Committee came up with a plan to switch production from weaponry to 150 'socially useful' products.

A more up-to-date initiative which is much discussed and promoted by the New Economics Foundation, is the 'Preston experiment'.[70] This involves local 'anchor institutions' in Preston, Lancashire – colleges, police, the university - being induced to spend more of their budgets locally, and using Lancashire's County Pension Fund to invest up to £100 million in Preston and South Ribble developing student flats, new hotels and office space as part of a 'City Deal' to revive the local economy. But this scheme of 'community wealth building', while no doubt an interesting experiment, seems to negate the advantages of national, let alone international, trade and capital mobility. It may also be unwise for pension funds to be used in this way, as it increases the risk to pensioners' incomes.

If applied to, say, energy, this model would imply a bias towards local self-sufficiency and ignoring the benefits of scale and networks. There is certainly a role for local non-profit energy suppliers – Robin Hood Energy, set up by Nottingham City Council, is often favourably mentioned. However, Cardiff Energy has just ceased trading and Ofgem has appointed SSE as supplier of last resort for its 800 or so domestic customers. Non-profit supplier Our Power, set up in Edinburgh four years ago with support of Scottish ministers, went bust in January 2019 with 38,000 customers,

68 'Mondragon: Spain's giant co-operative where times are hard but few go bust', *The Guardian*, 7 March 2013 (https://www.theguardian.com/world/2013/mar/07/mondragon-spains-giant-cooperative).

69 'Story of the Lucas Plan', *The Lucas Plan*, 2019 (http://lucasplan.org.uk/story-of-the-lucas-plan/).

70 'Preston: Jeremy Corbyn's model town', *The Economist*, 19 October 2017 (https://www.economist.com/britain/2017/10/19/preston-jeremy-corbyns-model-town. For a more favourable view see 'The "Preston Model" and the modern politics of municipal socialism', 12 June 2018 (https://neweconomics.opendemocracy.net/preston-model-modern-politics-municipal-socialism/).

causing a loss of £10 million in loans from the Scottish government. None of the English local authority suppliers have yet made a profit.

Whatever organisational form of renationalisation is settled on, it is likely to involve ‘stakeholder’ representation of unions and environmental pressure groups, as well as consumers. The latter at least is nothing new: consumer councils were part of the Morrisonian model (Griffith 1951). There has also been a significant extension of consumer voice in Ofgem and Ofwat decision-making, via customer engagement procedures. There is some difference of view as to how effective and desirable this is, but it seems to have been useful, and it is not obvious that it has led to higher prices.

However, it would be optimistic to assume that all these interests will easily align within the context of a business that at least covers its costs. Unions want higher pay and stable or increasing employment. Consumers want lower rail fares and energy prices and improved mail delivery, while environmentalists want expensive restrictions on industrial activity. Accommodating these objectives is likely to end up involving considerable taxpayer subsidy.

The cost of renationalisation

Compensation

> The right to compensation is one of the features which distinguish the nationalisation of basic industries in Britain from the expropriation of property carried out in communist countries.
>
> (Schmitthoff 1951: 566)

Appropriate compensation for firms proposed for nationalisation is difficult to calculate and has led to hugely varying estimates. At the top end, the Centre for Policy Studies[71] has suggested a total cost of £176 billion for Royal Mail, water, energy and the ending of PFIs, although other estimates are much smaller (Rhodes et al. 2018).

Historically, compensation for UK nationalisations has been provided in government bonds corresponding to the market value of the enterprises. This value is not straightforward to determine, though, and different methodologies give different answers. The simplest way to do this might be to take the average value over a pre-nationalisation period of, say, six months. However, the period chosen should ideally be before the plan to nationalise is made public, as the announcement will affect the share price.

Others have argued that compensation should be based on the book value of assets, which gives a very different result. For instance, the Social Market Foundation's estimate[72] of the market value of the 15 English water companies was estimated in 2018 at £44 billion, while the book value

71 'The eye-watering cost of Labour's nationalisation plans', *CapX*, 22 January 2018 (https://capx.co/the-eye-watering-cost-of-labours-nationalisation-plans/).
72 'The cost of nationalising the water industry in England', *Social Market Foundation*, 5 February 2018 (http://www.smf.co.uk/publications/water-nationalisation/).

estimated by Moody's was just £14.5 billion.[73] In addition to the cost of the equity, the government would have to take over the debt (bonds and other liabilities) of the water companies, estimated to be roughly equivalent in value to the equity.

The Shadow Chancellor has said, however, that 'Parliament will decide' on the amount of compensation paid.[74] While this is a truism, Mr McDonnell has indicated that he has in mind to recommend to Parliament a starting figure of £15 billion for the water industry, and that there ought to be deductions from this valuation to reflect such factors as 'asset stripping' in the past, by which is meant enabling the payment of higher dividends by taking on more debt, and the value of previous government subsidies. Shareholders today, however, are not necessarily those who benefited from higher dividends in the past. This is only one type of unfairness which arbitrary valuations may produce.

In seeking to justify paying less than market value, Labour has cited the case of Northern Rock, where no compensation was paid for nationalisation during the financial crisis. However Northern Rock was insolvent. In reviewing nationalisation precedents across the OECD, law firm Clifford Chance was unable to find any cases of a solvent business being nationalised for less than its market value. It argues that any UK nationalisation which does not provide for market value compensation, or is otherwise perceived as unfair, would almost certainly be challenged in the courts (see Clifford Chance 2019).

Challenges

Back in the 1940s when the Attlee government nationalised private sector businesses, they were taking over companies devastated by the war effort, often loss-making and short of capital. Importantly, they were almost exclusively owned by UK shareholders for whom the bonds they were offered may have been welcomed.

Even as late as 1975, when the left of the Labour party was pushing its 'alternative economic strategy', calling for a substantial new programme of nationalisation, less than five per cent of shares of UK-domiciled quoted

73 'Water renationalisation to cost as little as £14.5 billion', *Financial Times*, 25 April 2019 (https://www.ft.com/content/8ee5d48a-6103-11e9-a27a-fdd51850994c).

74 'Labour to pay £15 billion to renationalise the water industry', *Financial Times*, 5 May 2019 (https://www.ft.com/content/876e456e-6f42-11e9-bbfb-5c68069fbd15).

companies were owned by overseas investors (Holland 1975). By 2016 that figure had risen to 54 per cent.[75] And if we look at the candidates for renationalisation, many of the most prominent are majority-owned by overseas investors.

For example, Wessex Water is owned by the YTL Corporation of Malaysia, Sutton and East Surrey Water by Sumitomo of Japan, and Northumbrian Water by Hong Kong's Cheung Kong Infrastructure Holdings. Anglian Water is part-owned by the Canada Pension Plan Investment Board.[76] In the energy sector, EDF Energy is part of the French EDF Group. E.ON and N Power are German-owned. Scottish Power is part of the Spanish Iberdrola Group.

On the railways, the bulk of franchises are held by overseas operators – many of which are subsidiaries of state railways. Thus, for example, Trenitalia operates the c2c franchise, while the French SNCF part-owns the Govia franchises such as Thameslink and Great Northern. Abellio, a subsidiary of the Dutch government's Netherlands Rail, operates Greater Anglia, Scotrail and Stansted Express. With Mitsui and East Japan Railway it runs London Northwestern and West Midlands Rail; it also has a share in the operation of Merseyrail. Deutsche Bahn is particularly heavily involved in the UK: its interests include Chiltern Railways, Cross Country, Northern, London Overground, open access company Grand Central and freight operator DB Cargo UK.[77]

The majority of these investments are profitable, and their owners will seek redress through the courts if compensation is offered at less than market value. Those investors domiciled in countries which have a bilateral investment treaty with the UK – for example, Hong Kong, India or Singapore – will have a strong case. This is alleged to have already led some pension and insurance funds with stakes in water companies to shift shareholdings

75 'Ownership of UK quoted shares: 2016', *Office of National Statistics*, 29 November 2017 (https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2016).
76 'Labour's water nationalisation plans can only spell disaster, *Spectator Life*, 25 May 2019 (https://life.spectator.co.uk/articles/labours-water-nationalisation-plans-can-only-spell-disaster/).
77 'Who owns Britain's trains, energy and postal service?', Full Fact, 29 January 2018 (https://fullfact.org/economy/who-owns-britains-trains-energy-postal/).

to Hong Kong,[78] while the National Grid is said to be considering setting up overseas subsidiaries simply to attempt to protect investors.[79]

UK investors may be able to pursue claims under the Human Rights Act, although their position may be weaker. This raises the possibility that the government might have to pay more compensation to a foreign sovereign wealth fund than to a UK pensioner, a position which may not be politically sustainable with more than four million UK public sector workers having pension funds invested in the English water industry.

But even if the government were forced by the courts to pay enhanced compensation, the damage would have been done. A strong negative signal would have been sent to other investors, driving up future borrowing costs and undermining the prices of other assets, including sterling. Britain's ability to attract foreign investment, a mainstay of its economy for many years, could be seriously undermined. It might also lead to retaliatory action against Britain's overseas assets.

In view of this, it seems unlikely that other parties who might support nationalisation in a coalition or supply arrangement would accept an attempt by Labour to undercompensate.

78 'John McDonnell's plot to track down water giants' shareholdings as they move them off shore to dodge Labour's renationalisation plan', *Daily Mail*, 14 July 2019 (https://www.thisismoney.co.uk/money/markets/article-7246497/John-McDonnells-plot-track-water-shareholders.html).

79 'National Grid's overseas plan to thwart Jeremy Corbyn', *The Times*, 28 July 2019 (https://www.thetimes.co.uk/article/national-grids-overseas-plan-to-thwart-jeremy-corbyn-v58p58jqv?ni-statuscode=acsaz-307).

Conclusions

The current candidates for renationalisation are old industries which have always had a close involvement with the state. Given the problems we have identified, there may well be a case for resetting this relationship in line with the views of many members of the public, not just ideologically driven politicians. However, straightforward nationalisation across the board is unlikely to resolve all these problems and could well cause new ones.

The *water industry* is currently a mixed economy, with public and private providers across the UK. There is little or no direct competition for retail customers, but competition for industrial customers is now quite extensive and effective. Some would argue that it could be for domestic customers too, if only Ofwat were more ambitious. The privatised companies have invested large sums and their performance has (mostly) been satisfactory. Expecting the taxpayer to fund investment would not necessarily be a great deal cheaper, nor more reliable.

Some of the problems of the *railways* have arisen because the government has meddled too frequently and been over-prescriptive in its franchising policy, to the extent that it has made bidding for new franchises commercially unattractive. That part of the set-up which it controls directly, Network Rail, has a poor record for completing work on time and maintaining the infrastructure, leading to costly knock-on effects on passenger service which have unfairly damaged the achievements and reputations of the train operating companies. Renationalisation would reduce competition on some parts of the network where there is currently a choice of providers. It might improve coordination between the different parts of the sector, but there would still be a need to fit private freight services and any remaining open access passenger services into the overcrowded timetable, and it would be unlikely to eliminate the delays and disruptions which are a major source of consumer complaints.

Public ownership of passenger services would do nothing in itself to resolve the other main issue worrying the public: fares. Reducing the share of costs covered by passenger revenue and covering the deficit from taxation would suit commuters and regular travellers, but the distributive effects of this would be undesirable. Moreover, cheaper fares in peak times would increase overcrowding, another concern. To increase capacity to deal with this would be yet another charge on the taxpayer - and it would be wasteful if it led to rolling stock running nearly empty, or parked in sidings, outside rush hours.

The privatisation of *energy* was initially a considerable success story, encouraging large numbers of new entrants offering greater choice to the consumer. Its problems in recent years seem largely the result of increasingly ham-fisted government and regulatory interference, particularly over prices (where allegations of ‘rip-off’ pricing lack credibility) and renewable energy.

While it may be sensible, given concerns about climate change, for the government to encourage reduction of carbon emissions, many economists argue that an effective carbon tax or emissions trading are preferable policy instruments to detailed bans and mandates, or subsidies to particular types of renewable energy, inevitably pushed by suppliers with a vested interest. Competition in finding ways to reduce carbon emissions is likely to be more effective than state control.

The problems of *Royal Mail* are primarily the result of inevitable economic change as traditional mail delivery becomes a niche market. The business has diversified, but its expansion into new types of parcel delivery is stymied by the legacy of an old-fashioned, heavily unionised workforce. Changing this is unlikely to be achieved by renationalisation, which is a demand primarily driven by the Communication Workers Union and its political allies, rather than by angry consumers. While the universal service obligation, a particular concern in Scotland and Wales given the remoteness of some communities, may be worth maintaining at least in the short run, this could be done by providing a direct subsidy rather than by bringing the business back into the public sector.

So far, no clear plans have emerged which would offer alternative forms of organisation and management for nationalised businesses which would avoid the problems of the past. Although generalities about democratic accountability and community participation play well with some voters, there is as yet no usable template which would support sustainable large-scale enterprises.

Although the cost of nationalisation can be disputed, and has probably been exaggerated by some of its opponents, taking all of these businesses back into public hands would be expensive in the short run, would add to government borrowing and would almost inevitably crowd out other uses of public money. Unless handled very carefully, nationalisation is likely to deter foreign investors in UK companies, an issue which Attlee's government never had to face but which is central to the UK economy's prospects today.

In the long run, nationalised industries would bestow unending obligations onto the taxpayer, likely to increase over time as there would be less incentive to increase productivity and cut costs. The same sort of problems which arose before privatisation would be likely to return. The cutting out of dividends to shareholders, and dramatic cuts in executive pay, might play well to political activists, but the numbers suggest that the benefits to the consumer in lower prices from these factors alone would be limited. Consumer choices would certainly be constrained.

In 1981, as privatisation began to get underway, Nigel Lawson (then Secretary of State for Energy) asserted that 'no industry should remain under state ownership unless there is a positive and overwhelming case for it doing so' (Parker 2009: 82). The aim should be to reduce political interference and reduce disruption to business operations.

Much has happened since the privatisation of water, energy, the railways and Royal Mail. But despite the problems experienced by these businesses and their customers, there is no 'overwhelming' argument that these problems cannot be overcome by greater competition coupled with more astute regulation where necessary.

Without an overwhelming practical case being made for renationalisation, political soundbites about 'fat cat' executives and shareholders and 'rip-off Britain' are likely to drown out rational debate. There is certainly no sign at the moment of any attempt to secure cross-party consensus on detailed proposals. In the absence of such consensus, following any renationalisations there will surely eventually be a demand for future governments to re-privatise.

The instability created by this sort of ping-pong would damage these industries' performance, with consequent adverse effects for customers and taxpayers. It would not be good for anybody.

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