**Privatisation & nationalisation**

***Author****:* [*Geoff Riley*](http://www.tutor2u.net/blog/index.php/site/author/3/)***Last updated:*** *Sunday 23 September, 2012*

**What is privatisation?**

* Privatisation means the **transfer of assets** from the public (government) sector to the private sector.
* In the UK the process has led to a sizeable reduction in the size of the public sector of the economy. State-owned enterprises now contribute less than 2 per cent of GDP and less than 1.5% of total employment. Privatisation has become a common feature of microeconomic reforms throughout the world not least in the **transition economies** of Eastern Europe as they have made progress towards becoming fully-fledged market economies.
* But over recent years privatisation in the UK economy has given way to a new wave of nationalisation including some high profile banks, building societies and transport services.

**Major privatisations**
The major privatisations in the UK over the last thirty years have occurred with the following businesses (the year of privatisation is in parenthesis).

* [Associated British](http://www.abports.co.uk) Ports (1983)
* British Aerospace (1980) – eventually merged with Marconi Electronic Systems
* [British Airports Authority](http://www.baa.com) (1986) – subsequently bought by Grupo Ferrovial in 2006
* [British Airways](http://www.britishairways.com) (1987)
* British Coal (1994) – in 1994, UK Coal’s assets were merged with RJB Mining to form [UK Coal plc](http://www.ukcoal.com)
* [British Gas](http://www.britishgas.co.uk) (1986) - In 1997 British Gas plc de-merged Centrica plc and renamed itself BG plc (later BG Group plc). in Britain it is used by Centrica, while in the rest of the world it is used by BG Group
* [British Petroleum](http://www.bp.com/subsection.do?categoryId=10&contentId=2001674) – Gradually privatised between 1979 and 1987. In August 1998, British Petroleum merged with the Amoco Corporation (Amoco), forming "BP Amoco."
* British Rail (privatised in stages between 1994 and 1997) – created Railtrack – it was renationalised in 2002.
* British Steel (1988) – British Steel merged with the Dutch steel producer Koninklijke Hoogovens to form [Corus](http://www.corusgroup.com) Group on 6 October 1999. Corus was bought by [Indian steel firm Tata](http://news.bbc.co.uk/1/hi/business/6315823.stm) in 2007.
* British Telecom (1984) – sold in a £4bn floatation (51% sold) – further tranches sold off at later dates
* National Power and PowerGen (1990) - 1990 the Central Electricity Generating Board was split into three generating companies (PowerGen, National Power and Nuclear Electric plc.) and electricity transmission company, National Grid Company.
* Regional water companies

**Changing nature of privatisation in the UK**

* The early examples of privatisation such as the sale of British Telecom to the private sector in 1984 represented a **simple transfer of ownership** as shares were offered for sale via the stock market.
* More recently the privatisation process has become more complex. The focus has switched to **breaking up existing statutory monopoly power** through a process of **deregulation and liberalisation of markets** – basically designed to introduce competition where once monopoly power was well established.

Market forces have been introduced in social services, the NHS and in higher education.

**The public sector of the UK economy**

What is best provided by the market? And what might be more appropriately provided by the government sector of the economy? [Privatisation](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/privatisation/) has radically changed the public or government sector of the economy although since the current Labour government came to power, there has been a huge rise in total public sector employment, in part the result of a large rise in government spending on the national health services. The following businesses remain part of the public sector:

[British Nuclear Fuels plc](http://www.bnfl.com) - an international company, owned by the British government, concerned with nuclear power.

[Network Rail](http://www.networkrail.co.uk) - Network Rail is a "not for dividend" company that owns the fixed assets of the UK railway system that formerly belonged to British Rail, the now-defunct British state-owned railway operator. Network Rail owns the infrastructure itself, railway tracks, signals, tunnels, bridges, level crossings and most stations, but not the rolling stock. Network Rail took over ownership by buying Railtrack plc, which was in "Railway Administration", for £500 million from Railtrack Group plc.

**East Coast Rail Line**. In June 2009

[The Royal Mail](http://www.royalmail.com/portal/rm) - Royal Mail has been a state-owned company since 1969 and remains a public limited company wholly owned by the UK government. The Royal Maul is regulated by [PostComm](http://www.postcomm.gov.uk) which has the power to grant licences to new competitors entering the deregulated market for household and business mail services. The market was opened up [to full competition in January 2006](http://news.bbc.co.uk/1/hi/business/4506286.stm). The Royal Mail retains a universal service commitment.

**The Tote** – a betting business that remains in state ownership and has done since it was created by an act of parliament in 1928. The government has announced [plans to privatise the business](http://news.bbc.co.uk/1/hi/business/7684690.stm) but this has not yet been completed in part because of difficult stock market conditions following the credit crunch and the recession.

[Northern Rock](http://news.bbc.co.uk/1/hi/in_depth/business/2008/northern_rock/default.stm) - In the autumn of 2007 the government announced the nationalisation of Northern Rock - all shares in the business were handed over to the Treasury. The main justification for the decision was that Northern Rock's business model had failed but that the economic and social consequences of allowing the business to go bust were too severe - hence the need for [government intervention](http://www.tutor2u.net/blog/index.php/economics/C185/). Weeks earlier Northern Rock ran into a financial crisis which led to the first run on a major UK bank since the nineteenth century. It was forced to ask the Bank of England for emergency funding. With nationalisation, the debts of the bank were taken onto the public sector finances. These loans and guarantees were estimated to be worth more than £50bn. In the months since the nationalisation, Northern Rock has been downsizing its activities, reducing the size of its mortgage loans book and making several thousand employees redundant.

**Bradford and Bingley** - In September 2008 the UK government [nationalised Bradford and Bingley](http://news.bbc.co.uk/1/hi/business/7641268.stm) - it took control of the bank's £50bn mortgages and loans, while B&B's £20bn savings unit and branches was bought by Spain's Santander.

**Royal Bank of Scotland**: On the 13 October 2008 the UK government announced its plan to save the Royal Bank of Scotland from failing. It agreed a bail out of the bank in return for taking a seventy per cent stake in the business. The government also has a 43 per cent stake in **Lloyds Banking Group**

The pendulum seems to be moving back from the idea that all of the public sector is ripe was privatisation – when it comes to the public-private sector mix, it is likely that the UK will move towards different ownership models for different industries and decided on a case-by-case basis.

**Privatisation – is it good or bad for economic efficiency?**

Supporters of [privatisation](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/privatisation/) believe that the private sector and the discipline of free market forces are a better incentive for businesses to be run **efficiently** and thereby achieve improvements in **economic welfare**.

Privatisation was also seen as a way of reducing **trade union power, widening share ownership** and increasing **investment,** as privatised businesses were now free to raise finance through the stock market. Privatisation was regarded as an important supply-side policy designed to drive competition and improve productive and dynamic efficiency.

Opponents of privatisation argued that state owned enterprises had already faced competition when part of the public sector and that in several instances the transfer of ownership merely replaced a public sector monopoly with a private sector monopoly that then required [regulation](http://tutor2u.net/blog/index.php/economics/tagged/tag/regulation/).

There were criticisms that state assets were sold off by the government at too low a price and that the consequences of privatisation has been a decrease in investment and large scale reductions in employment as privatised businesses have sought to cut their operating costs.

**Deregulation of markets**

Deregulation involves opening up markets and encouraging the **entry of new suppliers**. Examples of this in the UK include the opening up of markets for bus services, household energy supplies, the liberalisation of household mail services and financial deregulation affecting both banks and building societies.

The expansion of the European Single Market has accelerated the process of market liberalisation. The Single Market seeks to promote **four freedoms** – namely the free movement of goods, services, financial capital and labour. In the long term we can expect to see the microeconomic effects of the EU Single Market working their way through many British markets and the general expectation is that competitive pressures for all businesses working inside the European Union will continue to intensify.

Product market liberalisation involves **breaking down barriers to entry,** boost market supply, bring down prices for consumers, and encourage an increase in competition, investment and productivity leading to a rise in economic efficiency. In the long term, if product markets become more competitive and investment flows into these industries, there are macroeconomic implications for example an increase in an economy’s underlying trend rate of economic growth which might contribute to an improvement in average standards of living.

**Government Intervention - The Private Finance Initiative (PFI)**

* The Private Finance Initiative (PFI) is an important but controversial policy designed to change the model of funding for large-scale investment projects
* The PFI was first launched in 1992 by a Conservative government and was extended heavily by the Labour government of 1997-2010. At the end of 2011, more than 700 hospitals, schools, prisons and other public sector projects had been built under the PFI scheme.
* It encourages groups of private investors manage the design, build, finance and operation of public infrastructure such as new schools, hospitals, social housing, defence contracts, prisons and road improvements. Typically a PFI contract is repaid by the government over a 30 year period.

**Benefits of the PFI**

* **Efficiency:** Belief that the private sector is better at managing investment projects and achieving overall cost efficiencies
* **Extra Investment:** Extra funding can kick-start many more projects – bringing economic and social benefits. The PFI provides extra private sector funds for projects that might prove difficult for the government to finance through higher borrowing and taxes
* **Delivery:** The private sector is not paid until the asset has been delivered. New PFI projects are nearly all fixed price contracts with financial consequences for contractors if delivered late
* **Dynamic efficiency:** Private sector better placed to bring innovation and good design to projects, higher quality of delivery, lowering maintenance costs

**Disadvantages of PFI**

* **Debt costs:** Since 2007 the cost of private sector finance has increased - financing costs of PFI are typically 3-4% over that of government debt. Some estimates find that paying off a £1bn debt incurred through PFI cost the UK taxpayer equivalent to a direct government debt of £1.7bn
* **Inflexibility and poor value for money:** Long service contracts may be difficult / costly to change – especially when the management of a project seems to have gone wrong. There have been many stories of flawed projects for example private firms contracted out to provide car parking, cleaning and other services in hospitals built and run as part of a PFI.
* **Risk:** The ultimate risk with a project lies with the public sector (government). Private finance agreements are very complicated to organise and there is no guarantee that the private sector will make a better cost benefit analysis of a project than the public sector
* **Administration:** High spending on advisors and lawyers and the costs of the bidding process. The Royal Institute of British Architects estimated that the cost of bidding for a PFI hospital was more than £11 million
* **Addiction:** Governments can become addicted to PFI - "the only game in town" rather than using government borrowing for key projects. The PFI has added to public sector debt but created many private sector fortunes

The media is rife with examples of some of the wasteful spending built into the public sector procurement agreements that are part of PFI projects – for example the Prison Service renting computersfor £120 per month, anger at rising car parking charges at many local hospitals, road and bridge projects over-budget (the M25 widening scheme cost £1 billion more than forecast. Another well known example is the kennels at the Defence Animal Centre in Melton Mowbray, which cost more per night than rooms at the London Hilton.