What Europe can learn from British Privatisations

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The Welfare Impact of British Privatisations 1979-1997

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www.econ.cam.ac.uk/dae/research/regulate/

The business of Government

'The Conservative party has never believed that the business of Government is the government of business' (Lawson, 1981).

Sales receipts:

non-utilities: £(95) 30 billion

utilities: £(95) 37 billion

55% from sale of public utilities

Scale of UK privatisations

- Govt receipts £87 billion (1995) prices

= 12% GDP

- privatised co.s ~5% of GDP
- consider efficiency gain of 10%

$\Rightarrow$ increase GDP by ½ of 1% for ever

$\Rightarrow$ PDV ~ 10% GDP

- worth having but not large

Types of privatisation

- commercial activities
  - airlines, oil, aerospace, cars, banks, etc
- utilities/essential facilities
  - BT, gas, water, electricity, airports, ports
- non-commercial service providers
  - rail, prisons, …

Objectives

- increase the role of the market
- increase the share of private ownership
- reduce the power of unions

$\Rightarrow$ stimulate productivity

- remove constraints on investment
- reduce budget deficits, national debt

$\Rightarrow$ stimulate growth

Lessons from commercial sales

- removes obstacles to competition
  - British Airways and airline liberalisation
- replaces Government by market financing
- motivates managers and workers
  - commercial test relaxes investment constraint
  - National Freight Co: workers gain, performance improves

Privatising utilities

- Privatise potentially competitive utilities
- telecoms: rapid technical change
  - State poor at managing innovation and risk
  - enables BT to catch up with best practice
- gas, electricity - unbundle, restructure
  - competition delivers impressive results
  - but market power creates problems
- water - to shift financing to private sector

The critical role of regulation

- competition may be possible over networks
- but networks are natural monopolies
- regulation inevitable
  - to protect consumers
  - to finance investment
- benefits from separation from ownership
- but who regulates the regulators?

Restraining regulatory opportunism

US system:

- Constitutional guarantees
- Separation of powers: DoJ, FCC, PUCs
- Administrative law to challenge regulatory discretion

UK problem: Parliament sovereign

- need to restrain Government
- licences upheld by courts

The British contribution

- Legislation defines duties
- Licences to provide credibility
- Regulator to insulate from politics
- RPI-X for incentives and inflation
- periodic review for rent transfer
- MMC/CC for dispute resolution

Price-caps

- RoR leads to gold-plating
- Price-cap to mimic competitive market
- but how is X reset?
- Benchmarking, efficiency audits
- Resetting requires agreement
- must be able to finance investment

The British utility experience

- BT privatised 1984 as *de facto* monopolist
- Facilities-based competition
- Duopoly ends 1991 - competition starts
- Gas privatised as monopoly 1984
- lengthy strong regulatory pressure to unbundle until 1996 Gas Act
- Electricity unbundled *before* sale in 1990

Lessons from utility privatisation

Before privatisation:

- restructure for competition
- clarify regulation and licence conditions
- create dispute resolution procedures
- ensure strong competition authority
- National champions extract domestic rents!

Lessons from Britain

- competition improves performance
- unbundling needed for effective competition
- competition requires privatization?
- Privatization precipitates further reforms?
- But better to get it right at start.

‘Non-commercial’ privatisation

- Railways - face competition from road

$\Rightarrow$ cannot charge average cost

$\Rightarrow$ requires continuing public subsidy

- tension between independence of regulation and control of subsidy
- complicated by Health and Safety
- contrast with Water

Water - a monopoly service

- only constraint on charges is political
- privatising relaxes this constraint
- multiple regulation raises costs
  - Drinking water quality, river/beach quality,..
- Lack of public budget constraint raises costs
- Need for Cost-benefit test for regulations

Impact on capital markets

- wider share ownership encouraged
- IPOs develop capital market
- share ownership facilitates private pensions
- Inappropriate privatisations and breaking regulatory compact increases risk/cost
  - Windfall tax
  - Railtrack put into administration
  - PPP/PFI as off-balance sheet manipulation

Impact on public balance sheet

- Britain has curious PSBR constraints

$\Rightarrow$ public borrowing bad, private good

- Privatisation relaxes self-imposed constraint
- but public sector still needs to invest
- Underlying problem has not been resolved
- Public net assets have been eroded

Unlearned lessons

- RAB and RPI-X work for privatised capital-intensive natural monopolies
- ensure investment financed at WACC
- so why cannot public sector do this?
- What is role of PFI/PPP?
  - Risk allocation?
  - Management?
  - Creative accounting?

Part II

Cost-benefit studies of British Electricity privatisation

British contrasts

- England and Wales
  - unbundle CEGB into 3Gs, T, gross pool
  - separation and competition
- Scotland
  - retain 2 vertically integrated companies
  - no imports, little competition

Audit of CEGB: first five years

- labour productivity doubled
- coal prices fell 20% real
- coal sales fell from 74mt to 30mt
- CCGT rose from 0 to 25%
- fossil fuel cost/kWh fell 45% real
- nuclear fuel cost/kWh fell 60% real
- emissions/kWh fell dramatically

Net benefits of privatizing CEGB

Cost savings: *PDV at 6%*	*£ billion*
net fuel switching	3.6
efficiency gains	8.8
restructuring costs	<u>-2.8</u>
Total R&P gains	9.6
Environmental gains:	
SO_2 (£1b) CO_2 (£1.4b)	2.4

levellised reduction per kWh 5.7%

CEGB: who gained, who lost?

	£ billion
Consumers	-1.3
Govt. excl sales	-8.5
After-tax profits	<u>19.4</u>
Net benefits	9.6
Govt. sales proceeds	<u>9.7</u>
Net govt. position	1.2

RECs: who gained, who lost?

Discounting at 6%		*£ billion*
	to 2000	incl post 2000
Producers	12.2	8.9
Government	-0.7	-0.5
Consumers	-7.2	-2.1
Total	*4.3*	*6.3*

Scottish ESI: who gained, who lost?

	£ billion
Consumers	-1.5
Govt. excl sales	-5.2
After-tax profits	6.7
Net benefits	-0.09
Govt. sales proceeds	3.6
Net govt. position	-1.6

Structural reforms

- initial choice of unbundling critical
- in Gas achieved by regulatory pressure 1984-96
- Licences the key to negotiated restructuring
- MMC can investigate structural problems
- divestiture “encouraged” by threat of MMC