Economic Reform

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Privatisation

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Privatisation is a word a lot of people object to - they say it's ugly, and so on, but certainly it's new. It was a new word introduced by the present administration, the Conservative administration, to distinguish their approach to economic issues from the approach of other political parties. Like all labels the term Privatisation tends to obscure and so I want to begin tonight by looking behind this label, Privatisation - just how did the notion come into existence? What is behind it?

Well now, in this 20th century a common form of macro-economic order is the trading community, that is to say a community in which the units of production produce an output for sale, or at least primarily for sale, and not for the consumption of those directly engaged in a particular process of production.

The idea is you produce something and sell it; and the U.K. is such a trading community. Now a characteristic common to these trading communities of the 20th century is that the return to labour, that is take-home pay, or wages - call it what you will - the return to labour is a private personal income. It accrues to those who supply the labour, which is a necessary factor in all productive processes and they may dispose of this labour income as they wish. It is theirs to do with as they please. The condition of slavery is today an exception and this country is not one of the exceptions.

But we may distinguish between trading communities by reference to another form of income which in economics is known as property income. That is the income that accrues to those who enjoy property rights over the non-human means of production.

Now, one extreme we may envisage is a trading community in which the property rights to the non-human means of production are vested in the state. In this circumstance all the property income is public revenue and is available to government for the financing of public spending. That's one extreme.

The other extreme we may envisage is a trading community where all the property rights to the non-human means of production are vested in private persons or private corporate bodies. In this circumstance all the property income is, like all the labour income, private income. This of course creates a problem for government and indeed for the trading community as a whole, for in the process of production and trade there does not arise automatically any public revenue available to government for the financing of public spending. The problem is usually resolved by the trading community accepting the need for government to impose by force or the threat of force an arbitrary levy on all or any private income, as in their wisdom they may so decide called taxation. In the absence of an automatic public revenue, government appropriates a tax revenue which is used to finance public spending - the way it works in this country for example.

In the early stages of a developing trading community the incidence and the amount of taxation is very unlikely to be the cause of any major distortions in the economy or be the direct cause of any substantial personal hardship. For example, at the beginning of this century, in this country, U.K. taxation appropriated only a ten percent slice, or slightly less than a ten percent slice of the national cake - the bite was not very large, and it didn't cause much trouble.

But you see as a trading community grows and develops it has to start spending increasing amounts on all kinds of things, such as securing its trade routes or, at home, more roads, street lighting, police forces, whilst in the industrialised areas and expanding towns more and more money has to be paid out on such things as public health. Of course, as public spending grows, then so also must the tax take out of which this spending has to be financed.

And as I said, while at the beginning of the century U.K. taxes took about a 10% slice of the national cake, during the interwar years this had more than doubled - in the twenties and thirties, the tax take was around 25%.

But a more important cause of any sharp increase in public spending and of necessity in a trading community in which both labour and property incomes are private incomes, a sharp increase in the tax take, now this comes when the social conscience is aroused by the inevitable and growing disparity between a few very rich and the many who are relatively poor, and it arises from the very nature of things. You see nature in any event does not bestow individual abilities equally as between one person and another. And even when labour incomes are generated as private personal incomes, there will be a spread of incomes as between the well-endowed and the not so well-endowed. But in that case nature does impose a limit. No person can work every day for say more than about sixteen hours a day without losing edge, you just can’t do it. Everyone has to cease work in order to eat and sleep, and in the normal way it is beneficial to take some time off for a holiday every so often.

So, irrespective of ability the amount that can be earned or truly earned by a person from their labour is very definitely limited. But you see when one turns to property incomes then no such limits apply. Property rights over non-human means of production may be accumulated almost without limit and property income is generated 24 hours a day, seven days a week year in and year out. Thus in a trading community where both labour and property income is generated as private income there arises a near inevitability of a few multi-billionaires counter balanced by a mass of underprivileged and those close to the poverty line. Now when that arouses the social conscience, well at first that conscience can be soothed away by gifts from the rich to the poor.

But that doesn’t last very long and very soon there arises the demand for government to do something, now one of the popular demands that normally arises in this circumstance is for re-distributive taxation - the Robin Hood concept of robbing the rich to give to the poor - but you see that cannot reduce the disparity, for however good may be the intentions of government, taxes are by definition and in practice, arbitrary. With redistributive taxation some poor may become a little bit richer and some rich may become a little poorer. But you may rest assured there will be some poor who will be poorer and some rich who will be richer. There is only one certain outcome from a policy of redistributive taxation, so-called, and that is that the slice of the national cake appropriated by taxation will increase, and the rest of the community as a whole will be that much poorer.

Eventually there will arise, as has arisen in just about every one of these trading communities, there will arise demands leading to what we now call the welfare state, that is public spending on a wide variety of social services and social security payments. Now a welfare state does work to mitigate the worst results of poverty, but in so doing it sharply increases public spending and in the kind of trading community we are considering, this means an inevitable sharp increase in the tax take.

I trust I have said enough to demonstrate to you that in a trading community where both labour and property incomes are generated as private incomes and where public spending is financed by taxation - an arbitrary levy on those private incomes - that in this circumstance there is an inevitable and persistent tendency from a variety of causes for the slice of the national cake appropriated by taxation to steadily increase. It just sort of happens - it’s like Topsy, it just grows and grows, but it’s at that point or this point where economic forces take over. Irrespective of the intentions of government, irrespective of the basis on which taxes are assessed, the effective incidence of taxation, where it finally rests is always and everywhere upon property incomes.

As the share appropriated by taxation increases so the share accruing as disposable net property income falls. As I said earlier, at the turn of the century in this country taxation appropriated about a 10% share of the national cake; about 40-45% accrued as Disposable Net Property Income (DNPI).

Today the position is more or less reversed. It is taxation that appropriates around 40% of the national cake, and Disposable Net Property Income (DNPI) is left with between 10 to 15%. As one rises, the other falls. This is the way economic forces operate irrespective of government intentions, irrespective of the way they assess the tax, whatever basis they use.

But now what does that overall picture mean to individual firms? The unit of production that is producing this output for sale? It means that at the margin their revenue after paying taxation is insufficient to pay a decent living wage to their employees and have sufficient left over to finance the investment necessary to keep them in a competitive position. Such firms if they have political power may get some protection sufficient for their survival at everyone else's expense. They may obtain a government subsidy which in turn must mean an increased tax take, paid for by the rest of the economy; if they lack political power, then they go to the wall. That's the way market forces work. Pay up or else, and if you can't pay up and you can't remain competitive then you go out of business.

But you see that's fine - good free market stuff - but sooner or later a basic industry, one whose continued production is necessary for the well-being of the trading community as a whole, is in danger. Protection and subsidies prove insufficient. Then, it appears to government they have no alternative but to nationalise, and nationalisation of course must happen before you can privatise anything. Political ideology may aid and abet nationalisation but, as Mr. Heath discovered, political ideologies cannot counter economic forces and when it comes to the push the government get driven, irrespective of their beliefs. Post-war Labour governments may have believed in nationalisation, but certainly Mr. Heath didn't, and he still had to nationalise, or thought he did, for he could see no other option.

But you see with nationalisation whether it stems primarily from political beliefs or is wholly the result of economic forces or some combination of those two, with nationalisation there is a fundamental change in the trading economy. It immediately ceases to be a trading economy where all property income is generated as private income; it ceases to be, because some property rights to the means of production have become vested in the state. And there is brought into existence what we now today call the mixed economy, a mixture that is neither one thing or the other - somewhere between these two extremes that I mentioned at the outset.

Of course with a mixed economy, with the coming of a mixed economy the financial difficulties of government are intensified. They are intensified because the property rights they have taken over generate not a property income but a loss - that is why they were taken over. Further these industries now working at a loss, have been impoverished by taxation over many years and they need a substantial injection of new funds to finance necessary new investment. The loss, the funds for new investment, mean more public spending. More public spending means an increased tax take, with the increased tax take more firms go to the wall, leading to more loss making property rights for the government to take over. More public spending leading to yet further increases in the tax take, more firms go to the wall, and so on and so on.

So you see, starting from a trading economy in which labour and property incomes are both generated as private incomes and public spending is financed by an arbitrary levy on those incomes, then economic forces cause as it were a tide, carrying the economy evermore closer to a condition in which all property rights to the means of production are vested in the state, a tide which carries the economy as a cockle shell from one extreme to the other, in popular terms of today from the right to the left.

What then is a policy of privatisation? In reality it is an attempt to stem and turn back this tide, a proclamation, that King Canute is alive and well and presiding over Whitehall. Is a 20th century Canute likely to be any more successful than the Dane of the dark ages?

Let us consider, private persons and corporations will not in general pay out good money to secure property rights over non-human means of production that are making a loss, they are likely however pay out considerable sums to secure property rights over the non-human means of production that are making profits, generating a positive Disposable Net Property Income (DNPI).

Now it is possible for government by spending public money to improve the efficiency and competitiveness of these firms and on occasion to secure that position by granting monopoly powers. When they manage to achieve that then of course these firms become candidates for privatisation, they can be sold off to private persons or corporations in return for a capital sum. This capital sum will for a time ease the government's financial difficulty, but we know as a repeated experience, we know, that the government will soon dissipate these capital sums. They will soon get rid of it, and then once again they're left with no money other than what they can raise by taxation and with only the loss making nationalised industries.

But there is more to it than just that, for you see unless the conditions in the trading economy have been radically changed, then the same economic forces that caused these newly privatised firms and industries to be nationalised in the first place will still be at work, and in time it is to be expected that these firms will once again become impoverished and once again there will be situations, either they go out of production or are re-nationalised.

King Canute demonstrated to his courtiers that wishful thinking will not turn a tide; now equally wishful thinking will not turn economic forces. Privatisation may appear enticing, it may even show some signs of success in the short run, but in the absence of a radical change sufficient to turn the tide of economic forces, privatisation is bound to be a futile policy in the longer run. You cannot just dam the tide, it will eventually break.

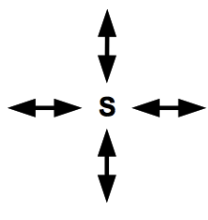
But even while all that may be so, the more immediate issue is that in this flowing economic tide, industry has become as it were a beach ball of political ideology. Whether a firm is included, or an industry is in the public sector, or remains in the private sector, or is tossed backwards and forwards from one to the other - all this is determined by political belief and expediency.

Successive governments have acted in this manner as if there were no economic principles on which they could base their decisions.

Now this is to ignore the mechanism which is fundamental to a trading community, the process of striking a bargain from which the outcome is trade. This is where we have to look, right at the smallest mechanism of a trading community, in which on one side is what we call a seller wishing to exchange goods and services for money and on the other side there is a buyer wishing to exchange money for goods and services. The buyer and seller come together and strike a bargain. As a result goods and services move from the seller to the buyer, whilst money known by convention as the price, moves from the buyer to the seller.

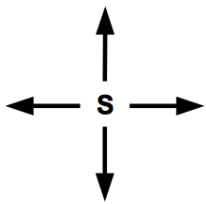
This is all quite simple - when you walk into your local pub, your friendly neighbourhood landlord pushes a drink one way across the bar and you push a pound note the other way. That's trade. All trade is just like that, the individual building block of which a trading community is constructed.

One can show it diagrammatically. Let us supose that there is a supplier of goods and services, whatever it may be, and he has a number of customers, all over the place. He pushes out his goods and services and automatically as the result of the bargain the money flows back to the supplier. The arrow is double headed.



Now, so long as production and trade give rise to this automatic two way flow of goods and services in one direction and money in the other, so long as there is this automatic two way flow, then as a general proposition the operation is best left to the private sector. The less government interfere in the operation the better for all concerned. Mind you in this day and age of course the government always interfere, because to start with you will always have taxation increasing the amount of money that has to flow in that way, or at least the amount of money that chap has got to pay, because the government will probably siphon some of it off on the way, and so on, so you always get interference. Nowadays such a thing as free trade doesn't exist in a country such as ours, but so long as you've got that automatic two way flow, then one can say as a general proposition that the less government interference the better it is for everyone who is concerned in that operation.

But whilst that diagram illustrates the general case, it may be observed also that there are exceptions. In some cases there is no automatic two way flow; the arrow head is not in the nature of things double headed, the flow of goods and or services in one direction does not automatically give rise to a flow of money in the opposite direction.



Now when that is the case, special arrangements have to be made, and where special arrangements have to be made then it is best for the operation to be included within the public sector, so that the government may make these special arrangements and apply them to the community as a whole.

Let us take the case of the local fire brigade; you return home and find your house ablaze from top to bottom. Its going so well that there is only one thing that is certain that regardless of whether you call on the services of the fire brigade or not you will be left with no more than a pile of ashes.

Now if you have to pay for the services of the fire brigade, why call on them in those circumstances? Why add to your already certain loss? If anyone is going to benefit from your calling the fire service it is the other householders in the vicinity, who as a direct result of the fire being contained are not left with a pile of ashes. Now surely justice demands that the price of the service be paid by those who receive the benefit. But how is that price to be apportioned as between all these householders who have benefitted? And even if you manage to resolve that one, how is the fire service to enforce payment?

You see, when the fire service presents its demands to the householder whose house was not yet on fire, and maybe a street away from it, is not the householder entitled to say “Yes, I did benefit from your service and thank you very much, it was most kind, but I didn’t request the service, I struck no bargain with you, and I do not see that I am obliged to pay your demand for money”.

You see there has to be some special arrangement by which the services rendered to the community by such as the fire brigade are paid for by the community that benefits from that service and the two way flow will not arise automatically as a result of a bargain between a willing buyer and a willing seller - it just doesn’t happen.

Now this issue as to the firms and industries that should be properly included in the public sector has not aroused much interest in Anglo-Saxon schools of economic thought. Professor Prest for example devotes a whole chapter of his recent work Public Finance in Theory and Practice to the matter of allocating resources as between government and the rest of the economy - how big should be the public sector, and so on and so forth, and from all that he concludes - his final sentences read: “The very bareness of the economic principles set forth will make it clear that we are now on the border land where economic and political considerations meet and mingle inextricably one with another. Recent years have in fact have seen the publication of various ideas by economists on the appropriate principles of voting, on the grounds that one simply has to seek a political solution to these issues.”

The issue as between public and private sectors in a trading community is essentially an economic issue and economists are falling down on their job if they tend to opt out with a few smooth words. Leave the smooth words to the politicians, but equally of course one can’t blame the politicians for basing their decisions on political beliefs and expediency when the advice they get from leading economists is “Well that’s the only way”.

But as I say that is true for Anglo-Saxon schools of economic thought, but there was at the turn of the century a very lively debate amongst continental schools of economic thought and I think the issue was probably most clearly put by a French economist Paul Leroy Beaulieu. This is what he wrote: “a new branch railway exerts a beneficial influence over a very wide sphere, it increases the receipts of neighbouring lines which it feeds and augments the income of not only those who use the new line for the transport of their product, but also of those who do not send their product any distance away, but simply bring them to the nearest market which is now less glutted”.

Thus the effect of the branch line is widespread, diverse and manifold, but the entrepreneurs cannot make all the beneficiaries contribute to the cost since many of them derive no direct benefit from the line nor even manifestly use it at all, simply stepping into the place of those who do use it. This is why many public works cannot be carried out for private account, for they would ruin private entrepreneurs whilst being highly remunerative for society as a whole.

But you see eighty years ago Leroy Beaulieu illustrated the fact that there are certain economic activities necessary for the wellbeing of a trading economy as a whole, which cannot be carried on within the private sector.

Such activities cannot be carried on within the private sector for the simple reason that private persons or companies cannot collect payment from all those who benefit from that economic activity and if in this kind of circumstance a private company attempted to collect the full cost from whomsoever it could collect payment from, then of course it prices itself out of the market and as a result goes to the wall, unless rescued by government using taxpayers' money.

Special arrangements have to be made so that those who receive the benefit pay for the benefit received. This is the distinguishing characteristic of a public sector operation, so that a special arrangement can be made by government acting on behalf of the trading community as a whole.

But you see when it comes to making these special arrangements governments must of necessity look outside of the tax system, you see Leroy Beaulieu was making a case, but he assumed that, alright, government would pay for it out of taxes they collected. But this won't really work, or won't work for very long. You see by definition and in practice taxes are arbitrary levies and to finance public sector activities out of tax revenue, results inevitably in some growing fat on public goods and services received but not paid for, and others being impoverished by being forced to pay for public goods and services that they do not receive and are not available to them. You see as tax is an arbitrary levy, it cannot be used in the way that is required by the nature of the special arrangements that have to be made. Because it is arbitrary, therefore it can't work.

Now of course the details of these special arrangements is a matter for weekly seminars and in a public talk I can do little more than point to a direction in which the answer may be found.

Local rates, as at present levied in this country, are a tax. They are a tax on development and their incidence as between various persons and groups is quite arbitrary. As I say they are a tax. But even though they are a tax, throughout this century, whenever there has been a full revaluation for rates, aggregate rateable values for the country as a whole have increased in step with the aggregate of local government spending throughout the country. For the country as a whole the two have gone up together all the while.

The last revaluation was in 1973, because we used to have annual re-valuations before the war when local authorities looked after it, and then it was handed over to central government or central government took it off the local authorities and since then for the past 40 years we have had only two full revaluations, and the poor old local councillors who are getting so much stick are forced to work on the 1973 list. Can you imagine the chaos there would be if the Chancellor of the Exchequer had to work on the 1973 tax declarations? But that's the way the councils have to work. But in 1973 the last revaluation again, while there had been inflation and all kinds of things, rateable values in the country had grown in line with local authorities total expenditure. I'm not saying so for every case, not in all cases but in aggregate.

Now you see the evidence then suggests that for the country as a whole rateable values in aggregate reflect the quantity and quality of the public goods and services provided by local government, so that if the arbitrary element and the tax on private development element in local rates were removed from the assessments then it is possible that some kind of reformed rating system would provide the government with the means by which it could charge those who receive public goods and services the current market price of the public goods and services being made available to them.

Economic Study Association (E.S.A.) researches do suggest that this is the way towards a solution, based on economic principles so that self-interest serves what justice demands - a real practical alternative to a political solution based on political ideology or political expediency.

You see a policy of privatisation may offer some short run advantage. Perhaps today the public sector is too big, and privatisation may offer some short run advantage but it is an attempt to swim against a strongly flowing economic tide and therefore cannot succeed in the long run. If we object to being carried ever closer to a state with a centrally controlled economy in which all the property rights to the non-human means of production are vested in the state, if we object to being carried in that direction then radical reforms have to be made sufficient to remove our trading economy from that tidal race. But more immediately the government should at least base its privatisation policy on economic principles and privatise only those firms and industries which should and in the right circumstances could operate within the private sector. It is the height of foolishness to base privatisation decisions on whether a firm or industry is making a profit and can for the moment therefore be sold off in the market place. That cannot be right.

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