Public Talks

Privatisation

Kensington Town Hall, London

22nd September 1984

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Privatisation is a word that a lot of people object to – they say that it is an ugly word, and so on, but certainly it's new. It was a new word introduced by the present 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 very common form of macro-economic order is the trading community, that is to say, a type of 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 United Kingdom is just 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 also 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 in which all the property rights to 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 amount of taxation is very unlikely to be the cause of any major distortions in the economy, or to be the direct cause of substantial personal hardship.

For example, at the beginning of this century, in this country, 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, and 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.

As I have said, while at the beginning of this century United Kingdom taxes took about a ten percent slice of the national cake, during the inter-war years this bite had more than doubled – in the twenties and thirties, the tax take was around twenty-five percent.

But there is a more important cause of a sharp increase in public spending, and it comes of necessity in any trading community in which both labour and property incomes are private incomes. A sharp increase in the tax take comes when the social conscience is aroused by the inevitable and growing disparity between the 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, for no person can work every day for say more than about 16 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 of things, 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 may be generated 24 hours a day, seven days a week, year in and year out.

Thus, in a trading community where both labour and property incomes are generated as private incomes, there arises the near inevitability of a few multi-billionaires counter-balanced by a mass of underprivileged persons and those close to the poverty line.

Now, when that arouses the social conscience, that conscience can at first be soothed away by gifts from the rich to the poor. But that solution doesn't last very long, and very soon there arises the demand for the government to do something.

One of the popular demands that normally arises under these circumstances is that for redistributive taxation – the Robin Hood concept of robbing the rich to give to the poor. But you see, this cannot really 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 so-called redistributive taxation, and that is that the slice of the national cake appropriated by taxation will increase, and the rest of the trading 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 that 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 all 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 – like Topsy,[1] it just grows and grows, but it's at just this point where economic forces take over.

1 A fictional character in *Uncle Tom's Cabin* by Harriet Beecher Stowe (1852).

Irrespective of the intentions of government, irrespective of the nominal 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, whilst about 40% to 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% and 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 units of production that are producing this output for sale? It means that, at the margin, their net revenue after paying taxation will be 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 be able to 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 must 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 itself in danger. Protection and subsidies prove to be 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 perhaps 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.

The post-war Labour governments may have believed in the idea of nationalisation, but certainly Mr. Heath didn't, and he still had to nationalise,[2] or at least he 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, there is a fundamental change in the trading economy.

It immediately ceases to be a trading economy in which all property income is generated as private income. It ceases to be so, because some of the property rights to the means of production have now become vested in the State. Thus, there is brought into existence what we now call today the mixed economy; a mixture that is neither one thing, nor the other – somewhere between those 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 losses and funds needed for new investment mean more public spending. More public spending means an increased tax take, and 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, so that more firms go to the wall, and so on and so on.

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2 For example, the Rolls Royce aircraft engine manufacturing business was nationalised under the Heath government in May 1971.

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 if it were a cockle shell from one extreme to the other, in the 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[3] 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, to 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 to 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 further taxation, and with only the loss-making nationalised industries.

But there is more to it than just that, for unless the conditions in the trading economy have been radically changed, then the same economic forces that caused these newly privatised firms and

3 King of England from 1016; also King of Denmark; and later, of Norway.

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 arise situations where either they go out of production, or are re-nationalised.

King Canute demonstrated to his courtiers that wishful thinking will not turn the tide; now equally, wishful thinking will not turn economic forces. Privatisation may appear enticing, and 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, then privatisation is bound to be a futile policy in the longer run. You cannot just dam the tide, for it will eventually break through.

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 to be included in the public sector, or whether it remains in the private sector, or is tossed backwards and forwards from one to the other – all this is determined by political beliefs and expediency.

Successive governments have acted in this manner as if there were no economic principles on which to 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, the goods and services move from the seller to the buyer, whilst a sum of 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 across the other way.

That’s trade. All trade is like that; it is the individual building block of which a trading community is constructed.

One can show it diagrammatically. Let us suppose 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, as shown in Figure 1.

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, and the flow of goods and services in one direction does not automatically give rise to a flow of money in the opposite direction, as shown by the diagram in Figure 2.

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, be it central or local, 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. It's going so well that there is only one thing that is certain – 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.

Surely, therefore, justice demands that the price of the service should be paid by those who receive the benefit. But how is that price to be apportioned between all these householders who have benefitted? And even if you manage to resolve that question, how is the fire service to enforce payment?

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".

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 very much interest in Anglo-Saxon schools of economic thought.

Professor A. R. Prest, for example, devotes a whole chapter of his recent work *Public Finance in Theory and Practice*[4] to the matter of allocating resources as between government and the rest of the economy – how big should the public sector be, and so on

4 In Chapter 3, *The Allocation of Existing Resources*, penultimate section.

and so forth – and yet, from all that discussion, he concludes, and his final few 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 the public and private sectors in a trading community is essentially an economic issue, and economists are falling down on their job if they try to opt out with a few smooth words. Let us leave smooth words to the politicians – but equally, of course, one can’t blame the politicians for basing their decisions on their political beliefs and expediency when the advice they get from leading economists is: “Well, that’s the only way.”

Now, whilst that may be true for the Anglo-Saxon schools of economic thought, there was at the turn of the last century a much more lively debate among the continental schools of economic thought, and the issue was probably most clearly put by the 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 simply cannot be carried out for private account, for they would ruin private entrepreneurs whilst being highly remunerative for the society as a whole.

But you see, eighty years ago Leroy-Beaulieu illustrated the fact that there are indeed certain economic activities necessary for the well-being of a trading economy as a whole, which simply 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 a payment from, then of course it would price itself out of the market and as a result it would go 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 – a special arrangement has to be made by government, central or local, acting on behalf of the trading community as a whole.

Now, when it comes to making all these special arrangements, governments must of necessity look outside of the tax system. You see, Leroy-Beaulieu was making a good case, but he assumed that government would pay for it out of the taxes they collected.

But this won't really work, or won't work for very long, for 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 which 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 quite arbitrary, therefore it can't work.

The detail of these special arrangements is a matter for weekly seminars, and in a public talk like this 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. Now, we used to have regular annual re-valuations before the war, when local authorities looked after it. 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 now 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.

Again, for the last revaluation in 1973, while there had been inflation and all kinds of things, rateable values in the country had grown in line with the level of 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 the rateable values in aggregate do reflect the quantity and quality of the public goods and services being provided by local government, so that if the arbitrary element and the tax on private development element in the local rates were to be 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 researches 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 political solutions based on political ideology, or on meeting the needs of political expediency.

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 remains an attempt to swim against a strongly flowing economic tide, and therefore it cannot succeed in the long run.

If we object to being carried ever closer towards 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 sound economic principles; and privatise only those firms and industries which should operate, 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 currently making a profit, and can for the moment therefore be sold off in the markets. That cannot be right.

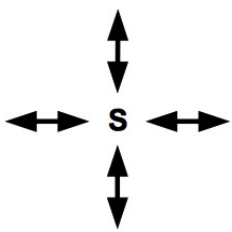

Figure 1

Automatic return
to the specialist

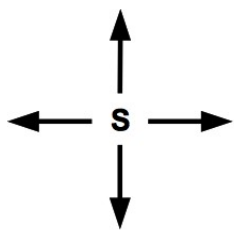

Figure 2

No automatic return
to the specialist