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Public ownership of industries and services

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1. Introduction

The post-Second World War economic history of Britain is sometimes analysed in terms of the shifting ownership of industries between the public and private sector.[1]

According to this analysis, a consensus existed from 1945 until the mid-1970s which accepted nationalisation and government ownership of utilities and some industries. This consensus broke down in the late 1970s and 1980s. By the mid-1990s, a new consensus had emerged which accepted the role of private companies in the ownership of utilities and the vast majority of industries.

The consensus appears to be in flux again. The Coalition Government's 'Big Society' ambition included "rolling out new rights across public [services]…to provide employees and citizens with a [role in]…the services they use."[2]

The Labour Party's manifesto at the 2015 General Election called for "more public control" in the transport system.[3] The 2017 Labour Party manifesto stated that a Labour government would "bring key utilities back into public ownership".[4]

In addition, the prospect of the UK leaving the EU following the referendum in June 2016 has raised questions about the role of the state in industry. Some argue that Brexit increases the government's ability to take ownership of some industries.[5] Others have argued that the post-Brexit rules will be similar to the ones under which the government currently operates whilst the UK is in the EU.[6]

This paper presents the key concepts in this area, a history of public ownership in the UK, some of the economic arguments around the public ownership of services and an analysis of specific industries.

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1 For example, in Millward and Singleton, *The political economy of nationalisation in Britain 1920-1950*, Cambridge University Press, 1995, pp309-319

2 Department for Communities and Local Government Commons Select Committee, *Mutual and co-operative approaches to delivering local services*, Fifth Report of 2012-13, p5

3 Labour Party, *2015 General Election manifesto*, 2015, p35

4 Labour Party, *2017 General Election manifesto*, 2017, p19

5 Independent, *How our post-Brexit trade deal could put nationalisation on the agenda*, 15 December 2017

6 Guardian, *Labour Leavers' claims that EU blocks state takeovers are rejected by experts*, 1 October 2017

2. A brief history of public ownership in the UK

2.1 Public ownership before 1945

The 1920s and 1930s saw industry and utility provision dominated by a proliferation of small firms. Government interventions to consolidate industries and ensure adequate supply of power and water were described as "hesitant and piecemeal".[7]

This era did see the creation of a number of "public corporations" which ran some utilities in the absence of viable private sector alternatives, such as the Central Electricity Board (founded in 1926) and the London Passenger Transport Board (founded in 1933). The owners of the key companies in these sectors were often members of the Boards.[8]

The Second World War led to an enormous expansion of the role of government in coal production, energy, agriculture and manufacturing. Government intervention took the form of "planning,…[the] allocation of resources, subsidy and rationing" in all of these industries to provide the materiel needed to fight the War and the resources required by a population with reduced access to imported food and goods.[9]

At the end of the War, 94% of industrial raw materials in the UK were controlled by the state.[10] However, though the government had taken *control* of many industries during the War, *ownership* remained largely in private hands.

The only firms taken into national ownership during the War were Short Brothers (aircraft manufacturers), Brown Ltd (precision machine manufacturers) and Power Jets Ltd (manufacturers of propulsion jets). These full nationalisations provoked controversy and were viewed as a "last resort" by the Government at the time.[11]

2.2 Post-War nationalisations

The Labour Party was elected in 1945 on a manifesto which pledged to nationalise the control and ownership of a wide range of industries and companies.[12] This was to be the largest ever transfer of ownership

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7 Millward and Singleton, *The political economy of nationalisation in Britain 1920-1950*, Cambridge University Press, 1995, p10

8 *Ibid*, p9

9 National Archives, *Cabinet Papers summary: control of industries and production in the Second World War*, 2016

10 Millward and Singleton, 1995, p248

11 Millward and Singleton, 1995, p237 and Cairns, M.B. (1951), "Some legal aspects of compensation for nationalized assets", *Law and Contemporary Problems* Vol. 16, p599)

12 Labour Party, *Let us face the future*, 1945

between the public and private sector in Britain, measured by the number of employees transferred.[13]

Over the course of the 1945-1950 Parliament, legislation was passed which allowed for the nationalisation of the Bank of England, the coal industry, the telecommunications industry, the transport industries including railways, canals and civil aviation, the gas and electricity supply industries and the iron and steel industry.

The mechanism by which these industries were nationalised is discussed in Section 3 of this paper. In brief, legislation gave the government the power to value an industry, to compensate its previous owners and to transfer control to a board which would then own and run the industry.

The programme of nationalisation cost the equivalent of around 25% of the value of annual GDP (though the cost was spread over several years), paid to the previous owners of nationalised industries in the form of government stock.[14]

The passage of the coal, transport, electricity and gas Acts took almost 700 hours of Parliamentary time in total.[15] Legislating for nationalisation proved so lengthy a process that the Government took the significant step of passing the 1949 Parliament Act to further limit the House of Lords' power to delay legislation passed in the Commons (although the Parliament Act was not used during the 1945-1950 Parliament).[16]

The administrative process of bringing utilities and industries into public ownership was also very complicated. For example, the coal industry was nationalised in 1947 and involved the transfer of ownership and control of 1,200 pits owned by 800 companies and employing 700,000 people to the National Coal Board.[17] The nationalisation of the land transport industries involved the transfer of ownership of 60 railway lines, 1,640 miles of canal, 70 hotels and 50,000 houses.[18] In total, all nationalisations carried out in the post-War Parliament transferred 2.3 million employees from the private to the public sector.[19]

Although the post-War programme of nationalisation was controversial and provoked extensive debate at the time, the Conservative Party's opposition to the programme has been described as "lacking coherence." The Party opposed nationalisation "as a principle" but they did not favour the de-nationalisation (privatisation) of the coal industry

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13 Floud, R. and Johnson, P., *The Cambridge Economic History of Modern Britain, Volume III: Structural Change and Growth, 1939-2000*, 2004, p90
14 Chester, N., *The nationalisation of British industry 1945 to 1951*, HM Stationary Office, 1975, p1017 and Commons Library calculations (using GDP in 1947)
15 Chester, N., 1975, p1004
16 Parliament website, *Parliament Act 1949*, accessed 11 May 2018
17 Millward and Singleton, 1995, p37 and Parker, D., 2009,*The Official History of Privatisation, Volume 1: The Formative Years 1970-1987*, p6
18 HC Deb 05 May 1947 vol 437 cc36-171 (Debate on the Third Reading of the Transport Bill)
19 Parker, D., *The official history of privatisation, volume 1,* 2009, p7

or the utilities, and these would remain in the public sector until the 1980s.[20]

One case where the Conservative Party did vehemently disagree with the Labour Government was over the nationalisation of the iron and steel industry. The Conservative Party argued that this nationalisation was "totally unacceptable" because they regarded a manufacturing industry where companies competed for business as qualitatively different from a utility or 'natural monopoly' such as the water industry.[21]

2.3 Continuity from the 1950s to the 1970s

All of the major utilities and industries mentioned above had been brought into public ownership by 1951 when the Conservative Party took power (although the full transfer of the iron and steel industry from private to public ownership had not been completed).[22]

Between the 1950s and the 1970s, the two main parties each had periods in office, but the coal, energy, rail and telecommunications industries remained in public ownership. The iron and steel industry and the road haulage industry were both de-nationalised during the 1951-1955 Parliament. The nationalisations of the sugar, meat distribution and cement industries were planned by the Labour Government of 1950-1951 but were never carried out.[23]

In 1967, the steel industry was re-nationalised by the Labour Government as the British Steel Corporation. It remained in public ownership until 1988.[24] British airports and British Leyland (the car manufacturer, as part of a rescue deal) were nationalised in the 1960s and early 1970s respectively.

2.4 The era of privatisation: 1980s to 2010s

Political agreement about the public ownership of industry broke down in the late-1970s. In the 1980s, the 1990s and to a lesser extent the 2000s, nearly all of the major industries and public corporations were privatised.

Notable privatisations included British Telecom in 1984, British Gas in 1986, the English and Welsh regional water authorities in 1989 and British Rail in 1993. As well as transferring the ownership and control of industries in to the private sector, privatisation was also characterised by the creation of a system of economic regulation for the utilities to enforce certain service and pricing standards.

[20] Millward and Singleton, 1995, pp22-24
[21] Millward and Singleton, 1995, p24
[22] Parker, D., 2009, p6
[23] Millward and Singleton, 1995, p25
[24] Financial Times, *The long slow decline of the British Steel industry*, April 2016

The term ‘privatisation’ was rarely used in the 2000s, but there were notable transfers of publicly owned companies to the private sector, including the partial privatisation of National Air Traffic Service in 2001 and British Nuclear Fuels in 2006. In 2013, Royal Mail was privatised under the Coalition Government.

More information on the history and process of privatisation is available in the Library briefing paper, *Privatisation*.

Although this era was characterised by the movement of industries and companies from the public to the private sector, there were some examples of parts of industries being taken over by the public sector, normally as a result of a crisis in the privately-owned businesses. For example, when Network Rail took responsibility for rail infrastructure in 2002 after Railtrack went into administration.[25]

During the financial crisis of 2007 to 2009, a series of financial institutions were placed in public ownership, including Northern Rock in February 2008 after the bank collapsed the previous summer, and Bradford and Bingley in 2008.[26] The government also took an 84% stake in Royal Bank of Scotland. This paper does not cover the public interventions in the banking sector around the time of the financial crisis. More information on this topic can be found in the House of Commons Library briefing paper, *UK Government bank rescues: financial consequences.*

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25 House of Commons Library Briefing Paper, *Network Rail*
26 House of Commons Library Briefing Paper, *Northern Rock and financial supervision*

3. Bringing industries into public ownership

Industry specific regulations and arrangements mean that the process of increasing public control will differ depending on the sector. The type of and degree of public control sought will also make a difference to the process.

3.1 How was it done in the 1945 Parliament?

This section outlines the steps taken to fully nationalise some industries and services during the 1945-1950 Parliament by the Labour Government led by Clement Attlee.

Legislation

Section 4.1 of this paper outlines the characteristics of the fully nationalised industries. To create these arrangements, the 1945-1950 Government passed a number of nationalisation Acts which transferred control of the industry to government.

The following table shows the nationalisation Acts and the date that they transferred their industry into national ownership.

Nationalisation Acts, 1945-1951

Nationalisation Act	Transfer to state ownership
Bank of England Act 1946	1 Mar 1946
Civil Aviation Act 1946	1 Aug 1946
Coal Industry Nationalisation Act 1946	1 Jan 1947
Cable and Wireless Act 1946	1 Jan 1947
Transport Act 1947 (including the railways, canals and road haulage)	1 Jan 1948
Electricity Act 1947	1 Apr 1948
Gas Act 1948	1 Apr 1949
Iron and Steel Act 1949	15 Feb 1951

Source: Chester, N., *The Nationalisation of British industry 1945-1950* (1975), p38

Although each Act addressed the specific issues and structures of its industry, they had the following elements in common:[27]

1. They all transferred property and assets from the private owners to the newly created Boards or public bodies that would oversee the industry.
2. They all set out the terms of compensation for the property transfers and how this would be paid.
3. They set out transitional arrangements which determined what would happen before and during the transfer of responsibility.

[27] Chester, N., 1975, pp44,45

4 They outlined functions, duties and powers of the new Boards that would own and run the industries were set out

5 They set out the financial arrangements for the new bodies, including borrowing powers.

6 They included arrangements for safeguarding the interests of consumers, customers and employees.

The complexity and scale of the programme meant that almost 700 hours of Parliament was taken up by the nationalisation Bills, despite the Labour Government having a Parliamentary majority of over 140.

The time taken on each Bill is shown in the following table.

Parliamentary time taken for selected nationalisation Bills, to the nearest hour

	Commons	Lords	Total
Coal Industry	94	21	115
Transport	151	71	222
Electricity	107	29	136
Gas	178	24	202

Source: Chester, N., 1975, The nationalisation of British industry 1945-1951, p1004

There were many hundreds of amendments tabled to these bills, some by the Government itself in order to tidy up errors and omissions in the drafting stage, but many by the Opposition. For example, the Gas Bill saw more than 800 amendments tabled by the Conservative Party at Committee Stage alone.[28]

The most contentious of the nationalisation bills was the Iron and Steel Bill. The Conservative Party argued that this industry was efficient and competitive unlike the 'natural monopolies' found in the public utilities, and that in principle, a manufacturing industry made up of multiple competing companies was qualitatively different from the other industries or utilities being nationalised.[29] Some senior figures in the Labour Party agreed with these concerns.[30]

The Iron and Steel Bill was the only nationalisation Bill that was actively opposed, rather than just amended, in the House of Lords.[31]. The Labour Government was so concerned that the Bill would be blocked by the Lords before the end of the 1945-1950 Parliament, that they took the constitutionally significant step of passing the 1949 Parliament Act which amended the 1911 Parliament Act by reducing the amount of time that the House of Lords could delay bills from three sessions over two years to two sessions over one year.[32] Further information on the

[28] Chester, N., 1975, p1004-7
[29] Millward and Singleton, 1995, p24
[30] Millward and Singleton, 1995, p23-4
[31] Chester, N., 1975, p1007
[32] Parliament website, *Parliament Act 1949*, accessed 11 May 2018

operation and significance of the Parliament Acts can be found in the House of Commons Library briefing: *The Parliament Acts.*

Compensation

Questions around compensation paid to the previous owners of nationalised industries were also controversial. Some members of the Labour Party had argued in the 1920s that no compensation at all should be offered, but by 1945 a consensus had emerged that "a fair deal" for owners and the public would be the best course of action.[33]

The differing nature of the assets of each industry meant that different approaches to the valuation and transfer of ownership had to be adopted. However, a broadly common approach to compensation for former owners was adopted.

Compensation was paid in the form of 'government stock', also known as government bonds. Once the value of the assets of the industries were determined, bonds with the equivalent value would be exchanged for those assets on the Vesting Date (the date when the transfer of ownership would take place). The previous owners of an industry would have their assets taken away but would get government bonds as compensation.

The government stock used for compensation was not issued by the Treasury and were therefore not Gilts. Instead, the board of each industry would use specially issued bonds for its industry. These were fully backed by the Treasury and typically paid annual interest of 3%. For example, the British Electricity Authority issued £445 million of British Electricity Stock that was then given to the previous owners of the electricity industry.[34]

In cases where ownership lay with companies quoted on the stock exchange, the value of these securities was determined by its price on the market on specified dates in either 1945 or a more recent year (whichever was higher).[35] For instance, the *Electricity Act 1947* specified that the value of the concern to be nationalised would be determined by the average stock price on the dates in early November 1946 or the average price on specified dates in 1945 (one day in the middle of the months from February to July).[36]

Where ownership of the asset to be nationalised was held by other public sector bodies, particularly local authorities in the electricity and gas industries, the method of compensation was different. This took the form of a lump sum payment, which reimbursed local authorities for

[33] Chester, N., 1975, p218
[34] HC Deb 24 May 1949, c70W [Electricity Stock]
[35] Cairns, M.B. (1951), "Some legal aspects of compensation for nationalized assets", *Law and Contemporary Problems* Vol. 16, pp594-619, p615
[36] *Electricity Act 1947, S20 (2)*

debts they had taken on in the provision of the service they provided, and a severance payment.[37]

Exceptional cases – coal and transport

There were some notable exceptions to this approach. The coal industry was made up of around 800 companies prior to nationalisation. The assets of these companies, such as the actual mines, colliery plants and physical assets, were purchased instead.[38] To determine the value of compensation for these assets, a Central Valuation Board was created to determine the total sum of compensation for the entire industry, with Regional Valuation Boards then set up to divide this amount among districts and companies.

Tens of millions of pounds was paid in compensation to the previous owners of mine assets. This was issued by the Treasury and exchanged for stock from the Coal Commission, with additional amounts issued by the Coal Commission itself. There is no consensus around the precise amount of stock issued due to the number and complexity of the deals.[39]

The method to nationalise the transport industry bore similarities to the coal industry in that a large number of physical assets were acquired, this time not just from private companies but from public ones too, such as the London Passenger Transport Board.[40] Compensation was paid in the form of stock issued by the British Transport Commission (BTC).[41]

A detailed analysis of the compensation arrangements made in the 1940s nationalisation programme is provided by Cairns (1951). The following is a succinct summary the methods of compensation across the industries:

> …the physical assets of the electricity and gas undertakings have been transferred under their appropriate Acts to their respective statutory boards, in the same way that physical assets of companies engaged in the coal mining industry and road haulage transport and railway industries were transferred by the Coal Industry Nationalisation Act, 1946, and Transport Act, 1947, to their respective statutory boards. On the other hand, compensation was awarded under the Electricity Act, 1947, and Gas Act, 1948, not in respect of assets as was the case of the industries just cited, but in respect of the securities of the companies operating electricity and gas undertakings, as in the case of the companies engaged in the iron and steel industries which are nationalized by the Iron and Steel Act, 1949. The

37 HC Deb 24 May 1949, c70W [Electricity Stock] and Cairns, pp.615-6
38 Cairns, pp.605-6
39 Chester, pp240-58, pp1017-18, Cairns, p609
40 Cairns, pp609-10
41 HC Deb 19 May 1960 vol 623 cc129-31W; the BTC was established under the *Transport Act 1947* to provide "an efficient, adequate, economical and properly integrated system of public inland transport and port facilities within Great Britain for passengers and goods", excluding transport by air and came into operation on 1 January 1948 when the various interests in shipping, railways, hotels and road transport were nationalised

compensation awarded for local authorities, however, was similar in the cases of the Transport, Electricity, and Gas Acts.[42]

The cost of compensation

Given the complexity of the nationalisations in the 1940s, statistics on the amount of compensation provided to industries should be treated as estimates, not precise figures. Comparisons between compensation paid to the previous owners of different industry should be made cautiously because of the different assets and ownership models in the industries.

Chester (1975) provides the following figures for the total amount of compensation paid for industries nationalised in the 1945-51 Parliament. The prices are also expressed as a percentage of GDP in the year the industries were transferred to public ownership.

In total, compensation for the nationalised industries cost £2.6 billion in the 1940s (in current prices, not adjusted for inflation). This was equivalent to around 25% of the value of annual GDP.

Compensation paid for industries nationalised in the 1945-1950 Parliament

	£ millions	% of GDP
Cable and wireless	32	0.3%
Bank of England	58	1%
Gas	220	2%
Iron and Steel	245	2%
Coal	392	4%
Electricity	542	5%
Transport	1,150	10%
Total	*2,639*	*25%**

Source: Chester, N., 1975, The nationalisation of British industry 1945 to 1951, p1017

House of Commons Library calculations Nominal GDP, ONS series YBHA; and Bank of England, *A millennium of macroeconomic data*

As a % of GDP in the year of transfer of ownership.

*Total is % of GDP in 1947

3.2 State owned enterprises (SOEs)

The public sector can set up and own companies in the same way as the private sector. For example, as of October 2017, councils in England have set up around 150 local housing companies.[43]

A second example is central government setting up Directly Operated Railways (DOR). DOR is a limited company which was incorporated on 2 July 2009 by the then Secretary of State for Transport "to manage

42 Cairns, p.616

43 The Smith Institute, Delivering the renaissance in council-built homes: the rise of local housing companies, 16 October 2017, p6

Train Operating Companies that are returned to temporary public ownership".[44]

Searching the Fame database of UK companies, it is possible to find 303 companies that are jointly, majority or fully owned by the public sector (i.e. with direct shareholding by the public sector of at least 50%). The ten largest (by number of employees) are shown in the table below.

State owned companies in the UK: ten largest by number of employees

Company name	Public sector owner	Revenue, £ millions	Number of employees
The Royal Bank of Scotland Group	United Kingdom	15,572	82,400
Highways England Company Limited	Secretary of State For Transport	N/A	4,122
NHS Property Services Limited	United Kingdom	792	3,809
Transport for Edinburgh Limited	The City of Edinburgh Council	157	2,493
Suffolk Group Holdings Limited	Suffolk County Council	65	2,244
Culture and Sport Glasgow	Glasgow City Council	127	2,124
Corserv Limited	Cornwall Council	148	2,058
Hertfordshire Catering Limited	Hertfordshire County Council	37	1,853
David Macbrayne Limited	Scottish Ministers (The)	195	1,658
Cumbria County Holdings Limited	Cumbria County Council	41	1,318

Source: Company accounts via Fame database

Note: Revenue and employees are as of the latest accounts (December 2016 or March 2017)

In turn, these 303 companies have 1,034 subsidiaries (441 excluding RBS). For example, NatWest bank is a company owned by RBS, which is part-owned by the government.

3.3 Purchase of existing companies

The government can directly buy existing companies, normally in unusual circumstances. For example, the financial crisis of 2007-2008 led the UK Government to nationalise RBS by buying the bank's shares.

Another option is for the government to set up a State Owned Enterprise (SOE) as a vehicle to buy the individual companies in an industry. For example, in the steel industry, the government could set up an SOE which would then acquire and run all the steel firms operating in the UK, although EU state aid rules might be relevant in this situation (discussed in Section 7 of this paper).

Competition law and the takeover code

Competition law may have a bearing on how the government sets up an SOE. Competition law seeks to curb practices that would undermine or restrict competition to the detriment of consumers: the abuse of a dominant market position by a firm, anti-competitive agreements between firms, and mergers or takeovers which, if allowed, would result in a substantial lessening of competition. The rules apply equally to privately-owned firms and SOEs.

44 DOR, Directly Operated Railways Limited: Annual Report and Financial Statements For the year ended 31 March 2015, 9 November 2015, p15

In the UK, the responsibility for enforcing competition law lies with the independent competition authority: the Competition & Markets Authority (CMA). The legislative framework for the UK regime is established by the *Competition Act 1998* and the *Enterprise Act 2002*, as amended by the *Enterprise and Regulatory Reform Act 2013* which created the CMA.[45]

The government's power to intervene in mergers and takeovers is legally limited to certain specified areas: where mergers give rise to issues of national security; media quality, plurality and standards; and, financial stability. These exceptions are examined in detail in the Library paper *Contested mergers and takeovers.*

The prohibition in UK competition law of the abuse of a dominant position and anti-competitive agreements is underpinned by equivalent provisions in EU law (specifically, Articles 101 & 102 of the Treaty on the Functioning of the European Union).[46] More information on competition law and a summary of the enforcement arrangements in this country can be found in the Library briefing paper, *The UK competition regime.* Mergers in regulated sectors tend to face additional rules and hurdles. For example, water is subject to a special merger regime which has been in place since the water industry was privatised in 1989 (the special water merger regime):

> The intention of the special water merger regime is to ensure that a merger between two or more water or sewerage enterprises in England and Wales will not prejudice the Water Services Regulation Authority's (Ofwat) ability to make comparisons for the purpose of carrying out its statutory functions (such as setting price controls on regulated water enterprises and other regulatory functions).[47]

The government would also have to follow the procedure for taking over a publicly traded company. This is determined by the Takeover Code and administered by the Takeover Panel. The Code seeks to provide an orderly framework for takeovers that delivers fairness to shareholders – and implements the EU-wide rules on the regulation of takeovers.[48]

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45 Parliament's Bill pages collates material on the passage of this legislation, including the Library paper prepared for its Second Reading (Library Research paper 12/33, 7 June 2012), and a summary of the Bill's scrutiny in Committee (Library Research paper 12/56, 3 October 2012).

46 European Union, *Treaty on the functioning of the European Union*, Articles 101 and 102, 2008

47 CMA, Water and sewerage mergers: Guidance on the CMA's procedure and assessment, 13 November 2015, p5

48 The Takeover Panel, The Takeover code, [last accessed 23/01/18]

Box 1: Potential impact on the public finances

The initial impact of bringing industries into public ownership

How the government brings an industry or public service into public ownership will influence how the acquisition impacts on the public finances. For an industry brought into public ownership through a financial transaction, such as shares purchased at market value, the following general points can be made:

- *The transaction would not increase the government's deficit*. The purchase of shares would be considered a financial transaction: the exchange of cash for shares. The government's preferred measure of the deficit – public sector net borrowing – is not increased by these transactions.
- *The transaction would increase the government's debt*. While financial transactions do not increase the deficit, they do impact on the government's debt, which is measured on a cash basis. The cash borrowed to purchase the shares would be added to the government's debt.

For many economists the cost of bringing the industry into public ownership isn't the most important aspect of nationalisation for the public finances – they view this as the government buying something for what it is worth. For them, the important issue for the public finances is how effective the government is in running the industry.

The ongoing impact

If the Office for National Statistics classifies an industry as part of the public sector then its day-to-day running costs, investment costs, revenues and debts are all included in the public sector finances. The government would also face the debt interest costs on any cash borrowed to nationalise industries. How effectively the government runs the industry will determine how well they manage the future costs and how cost effective it is for the taxpayer.

3.4 Municipalisation

Municipalisation involves a local authority (or some branch of local government) providing a utility within its area. Sometimes this means that the local authority competes to provide a service with private sector providers (as in the case of the Robin Hood Energy in Nottingham), or the local authority operates as a monopoly in their area (as in the case of Eau de Paris, the water provider in Paris).

The details of how a public authority would become involved in a utility market depend on the requirements of the local area, the country's regulatory framework and various industry specific issues.

However, one important decision that faces all local authorities seeking to municipalise services is whether the local authority creates a new organisation to provide a utility, or contracts an existing third party utility provider. The first option involves the local authority setting up an entirely independent utility company over which they have control. The local authority would then take on any financial and reputational risk associated with this service, but would also be able to control prices.[49] Robin Hood Energy in Nottingham and Eau de Paris both use this approach.[50]

The second option is known as 'white labelling'. This involves the local authority contracting another utility provider to provide the utility in

[49] The Energyst, *Rise of the local authority energy companies*, April 2017

[50] Transnational Institute, *Paris: local authorities regain control of water management*, August 2010

their area. The local authority would be able to market the new service, but control over how the utility is provided and the prices are decided by the contracted firm (although it is possible for local authorities to stipulate some conditions of service in contracts with utility providers). The Leccy was set up by Liverpool City Council on this basis in 2016, with Robin Hood Energy contracted to provide the services.[51]

4. Forms of public ownership

'Nationalisation' is often used as shorthand for the many ways in which private companies and industries can be taken into public control or ownership. These range from nationalisations as seen after the Second World War (in which the government owned and ran whole industries), to municipal ownership in which local authorities operate a utility network, to cooperatives in which employees or customers take a stake in the operation and ownership of companies.

There is variation in how much of an industry is taken into public control. Full nationalisation typically involves all assets and operations of an industry being transferred to government control. But other options include part of a utility network being run by a local authority, or a state-owned company competing with private sector companies to provide services.

Transferring an industry or company into the public sector can be contrasted with 'privatisation' when an industry that was publicly owned becomes privately owned. This concept is addressed in detail in another Library briefing paper: *Privatisation*.

4.1 Nationalisations after the Second World War

Full nationalisation is when the government takes ownership and control of an entire industry or company. This has occurred on only a handful of occasions in the UK, mostly in the years immediately following the Second World War. Full nationalisation can have a lasting impact on the structure of the economy, with affected industries sometimes remaining in public ownership for several decades.

The industries fully nationalised after the Second World War had the following characteristics:

- They were organised into **one national unit**, or in some cases, several regional units responsible for their product or service in their region.[52]

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51 The Energyst, *Liverpool Council to launch new energy company called 'the Leccy'*, November 2016

52 Chester, N., *The nationalisation of British industry 1945 to 1951*, HM Stationery Office, 1975, p1027

- Nationalised industries faced **no commercial competition**.
- They were managed by **Boards**. These were appointed by the relevant Minister and their size and direct responsibilities were set out in the relevant legislation. Ministers could give **"general directions"** to the Boards as defined in legislation (including in areas such as research, training and investment) but this was limited.[53]
- The **Treasury was ultimately responsible for the finances** of the nationalised industries, although the Boards oversaw these on a day to day basis. Boards could borrow by issuing their own stock, and this was guaranteed by the Treasury.[54]
- The **conditions of employment were set by the Board** for each industry, in consultation with the relevant Minister and Trade Union.[55]
- The Boards were **accountable to Parliament** in the following ways: Parliamentary Questions could be asked of Ministers about the nationalised industries if they were "of public importance"; there were periodic Parliamentary debates on nationalised industries; Annual Reports and Accounts were laid before Parliament.[56]

4.2 State-owned enterprises (SOEs)

State Owned Enterprises (SOEs) are enterprises over which the public sector exercises control and which are either owned or part-owned by the public sector.[57]

SOEs are a means by which the government can exercise control of public services. In some cases, an SOE constituted the entire industry, for example in the case of the British Steel Corporation prior to privatisation. This kind of SOE is rare in Europe.[58]

SOEs in the UK typically control only part of an industry. For example, Network Rail is responsible for the maintenance of railway infrastructure in Great Britain, and is an arms-length body of the Department for Transport. Rail services are run by privately owned operating companies. (See Section 8 for more information on the rail industry).

Another model for SOEs is when they operate on a commercial basis and compete with other private sector companies. Prior to privatisation in 2013, Royal Mail was an example of this model in the UK – it competed in the parcel delivery market with other private sector firms, whilst being publicly owned and controlled (see Section 11 for more information on Royal Mail). European Union rules on state aid mean SOEs operating in a commercial market cannot receive state subsidies or

53 *Ibid*, pp457,878
54 *Ibid*, pp 559, 610, 614
55 *Ibid,* p 745
56 *Ibid,* pp 956, 974
57 OECD, *Guidelines on corporate governance of state owned enterprises*, 2015, p14
58 PWC, *SOEs: Catalysts for public value creation*, 2015, p8

support which would give them an advantage over private sector competitors. State aid is discussed in more detail in Section 7.

4.3 Municipalisation

An approach which has attracted increased attention in recent years is the idea of the 'municipalisation' of services – that is, bringing services normally delivered by the private sector into the control of local authorities.

Municipalisation has occurred frequently in the rest of the world in recent years: the campaign group Transnational Institute state that there have been 835 instances of municipalisation or re-municipalisation since 2000.[59]

For example, the urban water supply became municipally owned in Paris in 2010[60] and energy distribution became almost entirely municipally owned in Germany between the mid-2000s and 2012.[61]

There are several examples of municipalisation in the UK. Robin Hood Energy is a municipal company set up by Nottingham City Council in 2015 to supply energy in the city, particularly to low income residents. The Tyne and Wear Metro has been under the control of the municipally owned transport company Nexus since 2017.[62] There are 12 municipal bus companies in the UK – two in Scotland, two in Wales and eight in England.[63]

4.4 Co-operatives and mutuals

Co-operatives and mutuals are often used as examples of different models of ownership for industries and services, but are not necessarily 'public' ownership because it could be that the government or local authorities do not own and have no role in their management.

The International Co-operative Alliance defines co-operatives as follows:[64]

> Co-operatives are businesses owned and run by and for their members. Whether the members are the customers, employees or residents they have an equal say in what the business does and a share in the profits.

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59 Transnational Institute, *Reclaiming public services*, 2017, p49
60 Bayliss, K. and Hall, D, *Bringing water into public ownership*, (paper from the Greenwich University Public Services International Research Unit) 2017, p5
61 Hall, D. *et al, Liberalisation, privatisation and public ownership*, 2013 (paper for Public Services International conference 2013), p5
62 Transnational Institute, *Reclaiming public services*, 2017, pp134, 137
63 Blackpool Transport Services Ltd.; Cardiff Bus; Lothian Buses Ltd.; DGC Buses; Halton Borough Transport Ltd.; Ipswich Buses Ltd.; Newport Transport Ltd.; Nottingham City Transport Ltd.; Reading Buses; Rosso; Thamesdown Transport Ltd.; and Network Warrington. For further information, see the House of Commons Library briefing paper, *Bus Services Act, 2017*, p10
64 International Co-operative Alliance, *Co-operative Identity*

This is in contrast to traditional private sector businesses, in which investors own the business and any profits, and appoint executives to make day to day decisions about running the business.

One type of co-operative is a workers-co-operative, in which employees own the company that they are employed by. In this kind of co-operative, employees would take a share of the profit. All members of a co-operative have an equal say in decisions related to the business.[65]

In 2017, there were 6,800 co-operatives in the UK, some of which were very small with only a handful of members. In total, Co-operatives UK estimate that 226,000 people work for co-operative organisations.[66]

The largest co-operatives in the UK by turnover are the John Lewis Partnership, the Co-op Group and Arla Foods UK.[67]

Cooperatives and 'mutuals' are terms for the same kind of organisation. In both, a group of people owns the business with the intention of running it for their own benefit, rather than to reward investors, and the owners have a say in how the business is run. However, "any co-operative is expected to have subscribed to the statement of identity agreed by the International Co-operative Alliance", which is quoted at the beginning of this section.[68]

Municipal co-operatives

In municipal co-operatives, the services being provided are directly relevant to a local community and in other circumstances would be delivered by a local authority or district council. This form of public ownership has been characterised as "the localisation of economic activities" – meaning that decision making and delivery happen in the community benefiting from the service, including employees and users.[69]

The Department for Communities and Local Government (DCLG) Select Committee found in 2012 that "a small number of local authorities are using or have established mutual or co-operative bodies to deliver their services."[70]

Lambeth Council declared an ambition in 2012 to become "the country's first co-operative council."[71] Although the local authority retains its status as the accountable body in the borough, services are

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65 European Commissions, *Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society - Part II. National Reports*, 2010, p654

66 Cooperatives UK, *Cooperative Economy 2017*, November 2017

67 *Ibid*

68 DCLG Select Committee, *Mutual and co-operative approaches to delivering local services*, Fifth Report of 2012-13, p7

69 Labour Party, *Alternative models of ownership*, 2017, p21

70 DCLG Select Committee, *Mutual and co-operative approaches to delivering local services*, Fifth Report of 2012-13, p10

71 *Ibid*, p11

now delivered after "systematic engagement with citizens" to find out what is required and how it should be delivered.[72]

Box 2: Private Finance Initiative (PFI)

PFIs are a type of Public Private Partnership (PPP) in which the government and the private sector both contribute to the creation or renewal of infrastructure. PFI schemes have existed since the early 1990s and have been used to build and run hospitals, schools and prisons among other things. There are currently about 700 PFI projects in the UK.[73]

In a PFI deal, a private finance company is set up and borrows to construct a new asset such as a school, hospital or road. The public sector then makes payments over the contract term (typically 25 to 30 years), which cover debt repayment, financing costs, maintenance and any other services provided over the life of the contract.

PFI is controversial, with some opponents arguing that it can be an inflexible and expensive way to deliver services. The National Audit Office note that "there is still a lack of data available on the benefits of private finance procurement". [74]

Buying out or nationalising PFI contracts

PFI contracts could be bought out early in line with the terms in the PFI contract (or whatever could be negotiated with the PFI company on a voluntary basis). PFI contracts generally set out the costs to be included in the calculation of the compensation payment to be made by the public authority in the case of a voluntary termination. These are usually "an amount that would leave the contractor in the same position as if the contract had run to full term".[75]

Alternatively the government might buy the equity of the PFI company (with its debts), and then refinance the debt later if required.[76]

72 Lambeth Council, *Behaviours for a co-operative council*, 2012, p1
73 HM Treasury, Private Finance Initiative and Private Finance 2 projects: 2016 summary data, 20 December 2016
74 National Audit Office, PFI and PF2, 18 Jan 2018
75 Elements include: an amount for terminating long-term debt obligations, the cost of redundancy payments for employees involved in the contract; break costs; and compensation for equity and (junior) debt.
Source: HM Treasury, PPP Policy Note: Early termination of contracts, June 2015
76 National Audit Office, PFI and PF2, 18 Jan 2018

5. Economics of state ownership

The debate about the role of the state in the economy has been said to be "as old as the economics discipline".[77] While there is agreement that the state provides the indispensable framework – such as the legal enforcement of contracts and ensuring law and order – for a market economy to function successfully, there is disagreement as to the scope of the state's role in the production of goods and services. This section provides a summary of the main economic arguments in this debate.

5.1 Economic theory of markets

A key argument for private ownership is that the incentive for firms to maximise profits leads to increased efficiency in producing goods and delivering services. In theory, under certain conditions such as a market that does not create negative side-effects for others and that includes several competitors, private ownership should result in social welfare being maximised.[78] In practice, these conditions sometimes do not exist all at the same time, but the general concept that markets and the price mechanism lead to beneficial outcomes is one of the main arguments for private ownership.

The economic argument for government intervention is strongest when not all of the above conditions are met. For example, when others are impacted by pollution generated during the production of a good or delivery of a service, the government may take action to reduce the negative effects.[79] Or when competition in the normal sense is limited in a 'natural monopoly' such as the water network, the government may regulate prices to ensure consumers are treated fairly.[80]

Market failure means that market forces on their own do not lead to a fully efficient allocation of resources.[81] In other words, the pursuit of self-interest from producers and consumers leads to a level of production (and price) that is too high or too low.

It does not necessarily follow that the government should take ownership or control of the means of production when there is market failure. The state could instead implement laws or introduce taxes or subsidies that would result in the amount produced being higher or lower than would be the case if purely left to the markets. For example,

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77 Bortolotti, B., and Siniscalco, D., *The Challenges of Privatization: An International Analysis*, Oxford University Press, 2004, p5

78 Megginson, W. and Netter, J., *From State to Market: A Survey of Empirical Studies on Privatization*, Journal of Economic Literature Vol. 39, 2001, pp321–389

79 These are known as externalities and can be positive or negative. For instance, a factory polluting nearby rivers or education which provides a wider benefit to society

80 Another example of when the market alone fails to provide a socially-optimal level of something is in the case of 'public goods', such as in national defence or street lighting, where one person benefitting from it does not stop someone doing so as well and individuals can't be excluded from using it.

81 Megginson and Netter (2001) and Bortolotti and Siniscalco (2004)

excise duties on cigarettes lead to higher prices and lower demand for them.[82]

5.2 Social and political arguments

The state's ability to promote social objectives, such as reducing inequality, is often cited as an argument in favour of public ownership. In other words, instead of pursuing profits, the public sector can prioritise other objectives that improve overall social welfare (and that can be harder to measure than financial indicators typically used to denote social wellbeing).

In addition, advocates of public ownership cite private companies' profits used to pay shareholder dividends as money that could be better used elsewhere, such as in investment in the industry, employee pay, or lower prices for consumers.[83] A further argument is that the state, not beholden to short-term pressures from investors, can think strategically and engage in long-term planning of the economy.[84]

The counter-arguments to the above usually run as follows. Having social objectives can be inconsistent with economic efficiency and can thus lead to taxpayers subsidising loss-making state-owned enterprises, either via direct payments to the enterprise or through higher prices.[85]

Objectives can alter when there is a change of government, creating uncertainty and inefficiency in the allocation of resources. Short-term political decisions can also lead to certain groups, perhaps those with a strong lobby, benefitting at the expense of wider society via higher taxes or an inferior quality of products and services.[86]

In addition, with the state unlikely to let large state-owned organisations go bankrupt, the spur to innovate and keep costs down is reduced.[87] The link between risk and reward is also less clear, which could result in weaker incentives for government managers and employees to reduce costs and to innovate.[88]

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[82] In the jargon this is internalising the externality; using the price mechanism of the market to take account of the side effects of producing or consuming the product.
[83] For example, Labour leader Jeremy Corbyn's speech to 'Alternative Models of Ownership' conference, 10 February 2018
[84] Labour Party, Report to the Shadow Chancellor of the Exchequer and Shadow Secretary Of State for BEIS, "Alternative Models of Ownership", June 2017
[85] Megginson and Netter (2001), p330
[86] Simon Less, Policy Exchange, "The false lure of renationalisation", November 2013
[87] Megginson and Netter (2001), p330
[88] Shleifer, A., State versus Private Ownership, *Journal of Economic Perspectives*, Vol.12, No.4 (Fall 1998), pp133–150, p138

The debate on the merits of state versus private ownership are summed up in the following quote from Megginson and Netter (2001):

> [T]he arguments for state ownership or control rest on some actual or perceived market failure, and countries have often responded to market failure with state ownership. Privatization, in turn, is a response to the failings of state ownership.[89]

5.3 The importance of competition

Many economists believe it is the degree of competition that drives efficiency and not whether an enterprise is in the public or private sector *per se*.[90]

In a competitive market, if customers dislike the service they receive they can choose a competitor. Generally speaking, this can influence competing firms to improve their performance and the services they provide in order to attract more customers.

In natural monopolies, such as the domestic water industry, there is very little or no competitive pressure. This means there is potentially scope for privately-owned monopolies to exploit customers due to the absence of competition in the market.[91] In cases like this private firms may be inefficient, accruing 'excessive' profits and/or failing to invest. One way to counter this is state ownership of the service. Another option (and the one that has been adopted in this country) is government regulation.

5.4 Natural monopolies and regulation

To counter the potential negative effects of natural monopolies, a system of economic regulation is often set up to act as a substitute for competition and to rein in monopolistic behaviour. In the UK this has often involved capping price rises, while allowing reasonable rates of return for owners (see section 6 for more on regulation).

Even if the market is regulated, effective regulation can be difficult. Balancing the goals of ensuring a 'fair price' for consumers while allowing companies to make enough profit to invest and innovate is not straightforward.[92]

There is also a risk of the regulator acting in a more favourable way towards producers rather than to consumers.[93] This may occur because the regulator, in the course of undertaking its responsibilities, will have

89 Megginson and Netter (2001), p329
90 For example, Tim Harford, "The pendulum swings against privatisation", Financial Times, 29 September 2017
91 In natural monopolies there is usually a very high cost to entering the market which makes it inefficient for there to be more than one producer. For example, having multiple electricity grids which are hugely expensive to build would not be beneficial to the economy and social welfare as a whole.
92 Financial Times, "Pioneering Britain has a rethink on privatisation", 22 January 2018
93 So-called 'regulatory capture'

regular interactions with producers and more limited interactions with consumers.[94]

Those in favour of state ownership argue that a publicly-owned monopoly would avoid or mitigate these problems and would be better able to act in the public interest. Those favouring state-run regulation rather than ownership would note that regulators are set up to act in the public interest already while attempting to retain the profit motive.

6. Economic regulation

Regulation is typically defined as a set of rules, normally imposed by government, that seeks to modify or determine the behaviour of firms or organisations. Before the 1980s, regulation in the UK covered areas such as health and safety or planning rules.

Since privatisation, a new kind of regulation (known as 'economic regulation') developed in the UK, which has been used by government to exert influence on a market which may not operate in consumer interests if left unregulated. Economic regulation is carried out using instruments or targets such as prices, output levels, rates of return, disclosure of information and standards.[95]

Privatisations were typically accompanied by legislation that established sector-specific regulators. These regulators were given statutory duties and powers, but free from direct Ministerial control or political intervention. Regulated companies were typically issued with licences that stipulate their behaviour in the market through various rights and obligations.

The reason for regulation in the case of privatisation was that the companies being sold operated in monopoly markets, or were likely to maintain positions of monopoly power even after some element of competition had been introduced. A system of regulation was therefore needed to deal with the risk of higher prices and lower standards of service than might otherwise have been expected. There was an expectation that the scope and size of the regulatory offices would decrease over time, as a competitive market was introduced.[96] This paper does not discuss the level of regulation but it is worth noting that regulatory methods change over time – as industries evolve so can the system of regulation.

In 2017 the National Audit Office (NAO) published an updated version of their Short Guide to Regulation. This covers the issue of regulation

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94 Lipsey and Chrystal, *Economics*, Twelfth edition, Oxford University Press, p291; Financial Times, "Pioneering Britain has a rethink on privatisation", 22 January 2018

95 Based around definition provided by OECD in their Glossary of Statistical Terms: Regulation [accessed 12 March 2018]

96 House of Lords Committee on Regulators, UK Economic Regulators, 13 November 2007, HL 189, para 2.1-2.4.

more broadly (rather than just economic regulation), noting that at the time:[97]

> There are more than 90 regulatory bodies in the UK, with total expenditure in excess of £4 billion a year. They cover a wide range of areas, from education, healthcare and charities to transport, communications and the media, utilities and the environment.

The NAO provide a description of why you may regulate:[98]

> Regulation is used to protect and benefit people, businesses and the environment and to support economic growth. Regulation is one of the primary ways in which government can achieve its policy objective…
>
> Regulation is primarily used to address market failures. The characteristics of some markets mean that, left to their own devices, they risk failing to produce behaviour or results in accordance with public interest (for example, clean air) or policy objectives.
>
> Regulation exists to correct these types of deficiency, and is used to achieve a wide range of social, environmental and economic goals in the UK. Good regulation can also enable innovation, for example by prompting necessary legislative change or improving consumer confidence in a sector. Where regulation fails, the need for subsequent intervention can lead to significant liabilities for the taxpayer, as occurred in the bail-out of the UK financial sector in 2008.

Wider competition issues within a sector, or anti-competitive behaviour come under the jurisdiction of the Competition and Markets Authority (CMA). The CMA replaced many of the functions of the Competition Commission and Office of Fair Trading in 2014. An example of CMA power in regulated markets is their investigation into the consumer energy market ending in 2016.

Rationale for the current system of regulation

In April 2011 the Government published its 'Principles of Economic Regulation', intended to provide a high level overview of how economic regulation should work in the main regulated infrastructure areas.

This document sets out the Government's view on the importance of regulation – to encourage competition but also to regulate in areas where a monopoly power is likely to limit the prospect of competition:[99]

> …In certain sectors network effects and/or economies of scale create circumstances, such as natural monopolies, which, under current technological patterns, limit the prospects for effective competition. In these areas, independent economic regulation will be needed over the long term to continue to provide vital consumer protections and ensure consumers' interests are promoted through efficient provision of good quality, reliable and sustainable services.

97 NAO, *A short guide to regulation*, p5, September 2017
98 *Ibid,* pp6,7
99 HM Government, *Principles of economic regulation*, April 2011, p1

> In the UK, economic regulation has aimed to promote effective competition where this is possible, and to provide a proxy for competition, with protection of consumers' interests at its heart, where it is not meaningful to introduce competition. Regulation has typically capped the prices that dominant companies can charge in order to promote efficiency and fairness, while providing them a return on their assets and investments.

The document states that in 2011, the Government's view was that the system was "not in need of major reform."[100]

The Government describes their high-level principles of economic regulation:[101]

> **Accountability**
>
> • independent regulation needs to take place within a framework of duties and policies set by a democratically accountable Parliament and Government
>
> • roles and responsibilities between Government and economic regulators should be allocated in such a way as to ensure that regulatory decisions are taken by the body that has the legitimacy, expertise and capability to arbitrate between the required trade-offs
>
> • decision-making powers of regulators should be, within the constraints imposed by the need to preserve commercial confidentiality, exercised transparently and subject to appropriate scrutiny and challenge
>
> **Focus**
>
> • the role of economic regulators should be concentrated on protecting the interests of end users of infrastructure services
>
> • economic regulators should have clearly defined, articulated and prioritised statutory responsibilities focussed on outcomes rather than specified inputs or tools by ensuring the operation of well-functioning and contestable markets where appropriate or by designing a system of incentives and penalties that replicate as far as possible the outcomes of competitive markets.
>
> • economic regulators should have adequate discretion to choose the tools that best achieve these outcomes
>
> **Predictability**
>
> • the framework for economic regulation should provide a stable and objective environment enabling all those affected to anticipate the context for future decisions and to make long term investment decisions with confidence
>
> • the framework of economic regulation should not unreasonably unravel past decisions, and should allow efficient and necessary investments to receive a reasonable return, subject to the normal risks inherent in markets

[100] *Ibid,* p2
[101] *Ibid,* pp4,5

> **Coherence**
>
> • regulatory frameworks should form a logical part of the Government's broader policy context, consistent with established priorities
>
> • regulatory frameworks should enable cross-sector delivery of policy goals where appropriate
>
> **Adaptability**
>
> • the framework of economic regulation needs capacity to evolve to respond to changing circumstances and continue to be relevant and effective over time
>
> **Efficiency**
>
> • policy interventions must be proportionate and cost-effective while decision making should be timely, and robust

Changes to the principles of economic regulation in the future could have an impact on an industry. In particular, the document warns that increased risk of political intervention could impact on customers through higher prices. On 'reaffirming the independence of regulation' it says:[102]

> Investment in infrastructure is often capital-intensive, long-term and with significant sunk costs. However, the utilities and transport sectors provide services on which every business and every citizen relies and this confers on them a high political profile.
>
> Given these features, investors will price any risk of political intervention and demand higher returns for their investment or, in the most extreme cases, might even decline to invest. This is likely to be detrimental to consumers and to the economy in the long-term. Given the scale of the regulatory asset base and of the investments needed, small changes to the cost of capital can have a significant impact on the propensity to invest and on the bills consumers pay.
>
> A solution to this time inconsistency problem is to design regulatory frameworks that prevent unexpected changes to the rules of the game, thus offering a credible commitment to investors. In the UK the statutory framework of independent economic regulation encapsulates a commitment by the UK Government not to intervene other than in clearly specified ways. Independence helps provide stability and consistency over time. This in turn helps to anchor market participants' expectations and increase the predictability of regulatory outcomes. The independence of regulators also protects consumers' interests by ensuring that consumers only pay for efficient investment that is required to deliver services.
>
> Government needs to ensure the independence of regulation is not eroded over time.

102 *Ibid,* pp6,7

6.1 Examples of economic regulation

Economic regulators are in place for many consumer markets where there is a monopoly supplier, particularly in areas where the firms were previously owned publicly. Examples include:

- The Office of Gas and Electricity Markets (Ofgem) – who regulate the electricity and gas market
- The Water Services Regulation Authority (Ofwat). A report from the NAO in October 2015 looked at the *Economic regulation of the water sector.*[103] Regulation in the water sector is discussed in more detail in Section 9 of this paper.
- The Office of Communications (Ofcom) – who regulate postal services, phone and broadband, spectrum and television and radio.

6.2 Is regulation always required?

Is economic regulation of infrastructure or natural monopolies required under different ownership models?

The basis for regulation is set out above – normally because there is a move towards competitive markets and/or regulation to protect consumers and create an environment for commercial investment.

Different ownership models for the same industries could call for different models of regulation (assuming no other legal constraint). For example:

- Under a system of simple government control, where the government Department is responsible for an industry, decisions on prices and investment could be made by a Minister and so would be subject to political influence. In this case, no formal regulator would be required;
- Where an industry or company is owned by the government at 'arms length', there might be multiple options: decisions could be influenced by Ministers, via a regulator, via Parliament (through Committees or Legislation), or via a Non-Departmental Public Body,[104] or a combination of these. In this case a regulator would exist to ensure the government's priorities were passed onto consumers
- Companies held or run without shareholders as not for profit companies, may set up different supervision structures, but may still be subject to regulation or government influence.
- Broader international law, EU or other trade agreements may influence or constrain the policy choice.

If the ownership structure of utilities was to change, the model of regulation and supervision would need to be reviewed. The case for

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103 NAO, Economic regulation of the water sector, HC 487, 14 October 2015

104 For example, shareholdings held by the Government are managed through UK Government Investments

some form of economic regulation or supervision is likely to made in any industry that involves:

- Pricing decisions, particularly where they depend on a series of financial or economic variables;
- Investment decisions, where they are complex, use firm revenue and result in a long term impact;
- Where service standards need to be set and monitored;
- Where there a multiple actors, including the private sector.

Government's may also choose to use economic regulators (albeit with different guidance) to ensure separation from political influence.

7. EU, state aid and public ownership

In June 2016, the UK voted to leave the European Union. This section summarises how EU rules affect the government's role in financially supporting and running businesses, and what might change after Brexit.

7.1 EU rules

Article 345 of the *Treaty on the functioning of the European Union* can be interpreted as stating that the EU has no stance on whether member states choose public or private ownership of industries or utilities:[105]

> The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership.

However, EU rules do limit the extent to which member states can support and operate companies in competitive market places. And there are also some relevant EU rules that refer to specific sectors – these are addressed later in this paper.

7.2 State aid

EU state aid rules prohibit member states giving financial and other types of assistance to individual enterprises, if that assistance gives an unfair advantage to the enterprise receiving the support. This includes state-owned enterprises competing with private companies, and private companies in industries threatened by international competition.[106]

Detailed information on State Aid can be found in the Library briefing paper, *EU State Aid rules and the WTO Subsidy Agreement*

There are some exceptions when government support is allowed, including if the aid would directly support a deprived area in the EU, if

[105] European Union, *Treaty on the functioning of the European Union*, Article 345, 2008
[106] European Commission, *State aid control*, September 2016

the supported business has certain environmental aims, and for small businesses.[107]

Member states offering support to enterprises must notify the European Commission which then rules on whether the support is 'allowable'. Complaints from other companies or other member states about alleged state aid can be raised with the European Commission who can open investigations into alleged instances of state support not in line with the state aid rules.

7.3 Do state aid rules prevent more public ownership?

State aid rules do not prevent public ownership of utilities or companies. For example, the municipal energy firms in Germany and Network Rail in the UK are legal under state aid rules.

However, state aid rules in conjunction with the EU's rules on competition do mean that all enterprises have to behave competitively. This means that fully state owned enterprises cannot receive subsides to prevent their failure, or benefit from a tax regime which discourages other entrants into a market.

It has been argued that most examples of public ownership can be structured in such a way that they are allowed under the state aid rules.[108] And the wide variety of State Owned Enterprises that exist in EU countries supports this view.[109]

7.4 World Trade Organisation rules

It is not clear what the precise nature of the UK's relationship with the EU will be after the UK formally leaves. Even if no deal at all is reached with the EU, the UK government will still be bound be World Trade Organisation (WTO) rules on state support for industries.

The UK is party to the WTO Agreement on Subsidies and Countervailing Measures. Under the Agreement, some subsidies are prohibited outright while the rest are 'actionable' – meaning that the subsidy is allowed, but other countries can take certain actions if the subsidy harms them.[110]

However, EU State Aid rules are more stringent than WTO subsidy rules for a number of reasons:

- The default position in WTO rules is that subsidies are generally allowed, while EU rules consider subsidies to be generally illegal.

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[107] Department for Business Innovation and Skills, *State aid manual*, 2015, p22
[108] Tarrant, A. and Biondi, A., *EU law is no barrier to Labour's economic programme,* September 2017
[109] OECD, *The size and sectoral distribution of state owned enterprises*, 2017, and Peretz, G., *Calls for EU "commitments" on state aid are a fantastical solution to an imaginary problem*, New Statesman, 15 May 2018
[110] WTO, *Agreement on subsides and countervailing measures*, website accessed January 2018

- EU rules also apply domestically, while WTO rules only concern themselves with international trade.
- EU rules are applied prospectively (i.e. legality must be proved *before* awarding any subsidy), while WTO rules are only reactive, and are only triggered if another country lodges a complaint.
- Finally, under WTO rules, only 'financial contributions' count as subsidies, whereas EU rules look at assistance in any form, whether financial or not.

A summary of EU provisions regarding competition law and state aid can be found in the Coalition Government's *Review of Balance of Competences on competition and consumer policy*, published by the UK Government in July 2014.[111]

8. Specific industries or services: passenger railways

8.1 Current ownership model

Following privatisation in 1993, British Rail (BR) was divided into two main parts: one part being the national rail infrastructure (track, signalling, bridges, tunnels, stations and depots) and the second being the operating companies whose trains run on that network. These were all sold off in the mid-late 1990s but the infrastructure was brought back into the public sector in 2002 after the privatised infrastructure company, Railtrack, went into administration.[112]

Today, the **infrastructure** is owned, maintained and operated by Network Rail, a public company, with the exception of the HS1 route through Kent, which is maintained and operated by a private company as part of a concession agreement. **Investment** in rail infrastructure is planned and delivered in five-year cycles known as control periods (CP). This process has recently changed, with the Secretary of State proposing to use a "pipeline" approach to developing and delivering projects in a three-step "develop, design, deliver" approach, on a "case by case" basis, in line with a Memorandum of Understanding between the DfT and Network Rail, signed in March 2016.

Network Rail is **regulated** by the Office of Rail and Road (ORR), which is also the **safety regulator**.

Rail services are run by privately-owned train operating companies (TOCs) and freight operating companies (FOCs). The Rail Delivery Group (RDG) represents the industry and develops policy on its behalf.

[111] HM Government, *Review of Balance of Competences* on competition and consumer policy, July 2014

[112] There is a large number of Commons Library briefing process which explain privatisation, the collapse of Railtrack and how it was brought back into the public sector, and how the railways work today. These can all be found on the railways briefings page of the Parliament website.

Passenger services are let as multi-year franchises by the DfT except in London and Merseyside where they are let as concession agreements by the relevant local body. There are a limited number of 'open access' operators on the network, who run rail services outside of the franchising process by securing timetable slots from the regulator. Intra-Scotland and -Wales services are devolved. Northern Ireland has an entirely separate, publicly-owned railway system.

The **trains** (rolling stock) are owned by private rolling stock leasing companies (ROSCOs) and leased to the TOCs.

Railway **stations** are owned by the network operator, most being leased to the TOC that is the main user of that station. Network Rail retains the operation of the main passenger terminals.

8.2 Bringing the railways back into the public sector

There are those, particularly the rail unions and the Labour Party, who believe that the key to improving passenger services and bringing down both fares and the overall cost of the railway is to bring rail services back under public control. They argue that the 'fragmented privatised railway' has been an expensive, inefficient failure.

A summary of different models for owning and operating railways around the world is set out in Library paper *Rail structures, ownership and reform*, CBP 7992.

Some sort of 'renationalisation' or move to a more devolved form of public ownership is usually perceived as a gradual process which would take a number of years – train services would not be renationalised in a 'big bang' but taken back in-house as they came up for renewal.

The Labour Party manifesto for the 2017 General Election stated that they would:

> Bring […] railways back into public ownership, as franchises expire or, in other cases, with franchise reviews or break clauses. We will introduce a Public Ownership of the Railways Bill to repeal the Railways Act 1993 under which the Conservatives privatised our railways […] A publicly owned railway system can be the backbone of our plans for integrated transport. It will be built on the platform of Network Rail, which we will retain whole, working with the devolved administrations. We will ensure new rolling stock is publicly owned and will encourage expansion of public freight services in a publicly owned railway…[113]

This, on the face of it, is a proposal to reform the rail system by making it a fully integrated, publicly owned monopoly.

In an article for the *New Statesman*, published in May 2017 the Shadow Secretary of State for Transport, Andy McDonald, put the policy in context. He said that: "public transport has increasingly become detached from the concept of public service. Too often it is seen as a series of opportunities to profit from an essential service that no government can let fail". [114] He further criticised the proportion of rail

[113] *Labour Party Manifesto 2017*, pp90-91

[114] "Passengers not profit: the case for public ownership", *New Statesman*, 11 May 2017

franchise bodies which are owned or part-owned by companies in which foreign governments are shareholders. He went on:

> The network of companies who operate passenger services on Britain's railways…[is]…a jumbled network that drives up the cost of improvement works, complicates ticketing structures, slows ticketing reform and extracts eye-watering profits that could instead go on improvements or keeping fares down from the system. The hit to the pockets of commuters stands in stark contrast to the hundreds of millions of pounds in dividends paid to shareholders of private train companies each year.
>
> The case for nationalisation is good economics, too. Last year, TUC research showed that the costs saved from bringing franchises which expire from 2016 to 2020 back in house could save up to £604 million a year by 2020, enough to lower regulated fares by up to 10 per cent.[115]

Labour's policy builds on the work of a number of groups, notably the trade unions and their Action for Rail campaign. One of the most cogent cases for bringing the railways back into public ownership is set out in the June 2012 report, *Rebuilding Rail*, commissioned by Aslef, the RMT, TSSA and Unite. It argued that the privatised railway is too expensive and too complex, leading to high ticket prices, inefficiencies and a service run for the benefit of shareholders rather than passengers.[116] The report set out a possible governance structure for a future nationalised and integrated 'GB Rail', derived from the Deutsche Bahn governance structure in Germany but modified to give broader accountability.[117]

In effect, the system they proposed was one where the existing infrastructure manager, Network Rail (NR), would become GB Rail Network & Operations, with its 'essential functions' of allocating and charging for network capacity hived off to GB Rail Access, but otherwise its current network operations could continue largely intact. Thereafter, the organisational changes to NR would centre around building its capacity to run train operations. It would also involve changes to rolling stock (train) procurement, whereby GB Rail would be able to procure new trains directly, using either government grant or government-backed debt. The report argued that procurement of rolling stock by GB Rail could be carried out in such a way as to support UK train manufacturing industry.[118]

A slightly different model was proposed by the Centre for Research on Socio-Cultural Change (CRESC) in 2013. They envisaged a more diffuse, regional model of rail provision to "provide a framework for political accountability and financial cross-subsidy as long as the railway system has to provide both an integrated national network and intra-regional

[115] *Ibid.*
[116] Transport for Quality of Life, *Rebuilding Rail*, June 2012, pp7-8; the TUC also put the case for public ownership more recently, see: "The rail franchise needs more than just a reboot", TUC Touchstone blog, 3 May 2017
[117] *Ibid.*, p72
[118] *Ibid.*, pp73-4

services".[119] Some sort of regionally or locally owned and run public railway has received support from other sources.[120] The Co-operative Party and Co-operatives UK have championed a different sort of mutually-owned and run railway.[121]

8.3 Implications of EU law

There is nothing in EU law which would prevent a future government from bringing rail services back into public ownership.[122] However, there might be an issue preventing private sector 'on track' competition in future, depending on what sort of exit deal the UK Government agrees with the EU.

If the UK Government and the EU were to agree some sort of exit deal that involved the UK continuing to apply certain parts of rail law (i.e. the **Market Pillar of the Fourth Railway Package –** see box below) in return for say access to the common European Railway Area, this could have the effect of mandating private sector competition for rail services. But this is very uncertain, not only because we do not know what deal the UK Government will get but also because we do not know exactly how the Market Pillar of the Fourth Package will work.

Box 3: Market Pillar of the Fourth Railway Package

The Market Pillar of the Fourth Railway Package means that anyone would be able to bid to compete on a commercially viable EU rail network from 2020, as already happens in GB (e.g. open access operators bidding to run services on the East and West Coast Main Lines to compete with the services offered by the franchised operator). Fourth Railway Package means that anyone would be able to bid to compete on a commercially viable EU rail network from 2020, as already happens in GB (e.g. open access operators bidding to run services on the East and West Coast Main Lines to compete with the services offered by the franchised operator).

From 2026 private companies would also be able to bid for public service contracts that are awarded by governments on lines that are not as profitable. At the moment, the majority of domestic rail lines across the EU are operated under public service contracts. This involves countries often directly awarding rail contracts to the local incumbent, which is either compensated or granted exclusive rights on the line.

The Commission's original proposal would have introduced mandatory competitive tendering for such rail contracts (i.e. the GB system). However, opposition from Member States resulted in changes which mean that governments will be able to directly award contracts where the geographical characteristics are such that it would result in service improvements, or where they do not receive enough bids.

In announcing agreement on the Market Pillar in October 2016 the Council said that competitive tendering would "become the norm for public service contracts, with some exceptions. Direct award will still be possible where it leads to better quality of service or cost efficiency". To ensure 'continuous and well-functioning services', Member States would also be able to limit a new operator's right of

[119] CRESC, *The Great Train Robbery: privatisation and after*, June 2013, p162
[120] e.g. Compass, see *All on Board: A publicly owned railway for an interconnected world*, July 2014 and Progress, see "Make rail regional", *Progress Online*, 9 July 2014
[121] Co-operatives UK, *Co-operative rail: a radical solution*, New Insight 6, 2011, p21 [written by Christian Wolmar, the noted transport commentator who stood to be the Labour candidate for Mayor of London in 2016]
[122] For a summary, see: "Renationalising Britain's railways – EU law not a barrier", *The Conversation*, 22 May 2018

access if the proposed new service "would compromise the 'economic equilibrium' of an existing public service contract".[123]

9. Specific industries or services: water

9.1 Privatisation and Ownership

The water industry in England and Wales was privatised in 1989. Over 50 million household and non-household customers in England and Wales receive services from one of 32 privately-owned companies (although the ownership of Welsh Water (Dwr Cymru) is different – see Box below).[124] Most water and sewerage companies are regional monopolies, with dedicated pipe networks and water supplies in each water company area. This means that most people cannot choose or switch their supplier and competition is limited. Consequently there is a need for economic regulation of the industry to ensure that customers get value for money.

The *Water Act 1989* provided for the privatisation of the Regional Water Authorities (RWAs) in England and Wales as public limited companies.

The assets and liabilities of the RWAs were vested in the ten water and sewerage businesses – Anglian, Northumbrian, North West, Severn Trent, Southern, South West, Thames, Welsh, Wessex, Yorkshire – which were publicly floated on 1 September 1989.

The principal objectives of privatisation were to raise revenues and to rely on the capital market to fund the future large capital requirements of the industry. There was no provision for the introduction of competition in the water industry, unlike the other main utility privatisations, particularly electricity and gas.

The Act also established the National Rivers Authority (with responsibilities for water pollution, flood defences, fisheries, recreation and navigation); the Drinking Water Inspectorate (with responsibility to regulate water quality); and the office of Director General of Water Services (OFWAT) (with responsibility for regulation of the economic provision of water and sewerage services).

Water services have not been privatised in Scotland. Box 5 below sets out how ownership and regulation in Scotland works.

123 European Council press notice, "Better rail services: Council adopts 4th railway package market pillar", 17 October 2016
124 Ofwat, Water sector overview

9.2 Regulation

Ofwat is the economic regulator for England and Wales. Its primary statutory duties are:

- to further the consumer objective;
- to ensure that water and sewerage companies properly carry out their functions and are able to finance them; and
- to secure the long-term resilience of water supply and wastewater systems.[125]

Ofwat also has a number of secondary duties which are set out on its webpage *Our duties.*

Box 4: Welsh Water

Welsh Water was privatised in 1989.

In 1996, following the end of the Government's golden shares in utilities, Welsh Water bought Swalec (the regional electricity company) to create the multi-utility company 'Hyder'. The purchase was mostly financed by debt. In the late 1990s, Hyder started to run into financial issues, for a number of reasons: debt levels, the windfall tax, and regulated price reviews reducing revenue. A takeover battle followed in 2000, with one bidder being the current business 'Glas Cymru'. The Hyder business was bought by Western Power Distribution but the water element was then sold to Glas Cymru for £1 (alongside a transfer of debt).

Their website provides further details of how they operate:

> Glas Cymru is a single purpose company formed to own, finance and manage Welsh Water. It is a 'company limited by guarantee' and because it has no shareholders, any financial surpluses are retained for the benefit of Welsh Water's customers.
>
> Under Glas Cymru's ownership, Welsh Water's assets and capital investment are financed by bonds and retained financial surpluses. The Glas Cymru business model aims to reduce Welsh Water's asset financing cost, the water industry's single biggest cost.
>
> Financing efficiency savings to date have largely been used to build up reserves to insulate Welsh Water and its customers from any unexpected costs and also to improve credit quality so that Welsh Water's cost finance can be kept as low as possible in the years ahead.

Price Review Process

Ofwat carries out a price review process every five years in which it sets wholesale price controls which apply to customers' bills and the services they receive for five-year periods. These five-year cycles are often referred to as Asset Management Planning Periods or AMPs. When setting the price controls, Ofwat must balance the interests of the customer with the need to make sure the water company can finance its delivery of infrastructure and services to customers, as well as meeting their other legal obligations.

The last price review was carried out in 2014 and set price limits from April 2015 to March 2020.

By accepting Ofwat's price limits, water companies agree what they will deliver for customers in return for the revenues that they can expect to

[125] Section 2, Water Industry Act 1991 (as amended).

recover. They also accept the risk associated with delivering services in line with the price limits. The price review approach and five year periods means that companies can make gains if costs turn out to be lower than Ofwat's assumptions during the price review; but companies also bear the risk of the losses if costs turn out to be higher than Ofwat's assumptions. Costs may turn out to be lower if companies take actions to make efficiency savings within their operations; but can also be lower (or higher) due to aspects outside a company's control, such as taxation or financing costs. There has been recent criticism of gains from financing costs (see below).

Box 5: Scottish Water

The supply of mains drinking water and the treatment of waste water in Scotland is undertaken by Scottish Water. Scottish Water is a publicly owned company who are also responsible for delivering water and waste water infrastructure investment programmes defined by Scottish Ministers within funding limits set by the Water Industry Commission for Scotland (WICS, or Scottish Water Commission). The Commission also set prices for the domestic industry (see below).

Scottish Water was established by the *Water Industry (Scotland) Act 2002*. It replaced three regional water authorities (North, East and West of Scotland Water) which were established by the *Local Government etc. (Scotland) Act 1994*. Prior to that water and waste water services in Scotland were provided by regional councils. Scottish Water is a public corporation sponsored by the Scottish Government.

The *Water Services etc. (Scotland) Act 2005* introduced competition in the retailing of water and waste water services to non-domestic premises in Scotland. Licensed providers, who must obtain a license from the Water Industry Commission for Scotland, purchase wholesale services from Scottish Water and retail them to non-domestic customers.

Further information on how Scottish Water works can be found in the Scottish Parliament (SPICe) briefing: Environment: Subject Profile, May 2016

Regulation and Comparisons

While the systems of water regulation and management are different in Scotland, comparisons between the system in England and Wales have been made for regulation reasons. The Scottish Water Commission noted in 2013 that[126]

> …It is now more than a decade since Scottish Water was established. In that time the company has transformed itself as an organisation. It has caught up with the top performing companies in England and Wales on cost efficiency and levels of service and has regularly reached – and outperformed – its targets. The transformation is such that Scottish Water has set itself the goal of being 'Scotland's most valued and trusted business'.

The Commission noted that in the future there would be less need for comparisons with England and Wales water companies.

Price increases are set by the Commission after submissions by Scottish Water, and are guided by over-arching principles and guidance from the Scottish Government. Domestic price controls through to 2021 are based on nominal price increases and increases linked to CPI.[127]

126 Water Industry Commission for Scotland, Strategic Review of Charges 2015-21: Innovation and choice, May 2013

127 Water Industry Commission for Scotland, The Strategic Review of Charges 2015-21: Final determination

Questions over future controls

OFWAT are currently in the process of setting new price controls from 2019 onwards.[128]

The system of regulation has been previously criticised, particularly for being too generous to the water companies. For example, a recent opinion piece in the *Financial Times* suggested that the industry did not do enough to support consumers; another editorial argued for major reform.[129] Equally Ofwat have criticised the management of some companies – for example, Jonson Cox, Chairman of Ofwat, has queried the running of Thames Water, reflecting concerns over performance on sewage and leaks combined with current financial arrangements.[130] An issue raised recently has been the allowed cost of capital (and that it has been too high in the past).[131]

Following the announcement of the final methodology for the new price control from 2019 onwards, the falling allowed cost of capital was welcomed but concern was raised around the financial rewards allowed for meeting certain service targets.[132]

The Public Accounts Committee looked at the economic regulation of the water industry in 2015 and criticised the regulator's approach in previous price controls – particularly around the over estimating of financing costs and benchmarking efficiency, which has resulted in higher customer bills.[133]

Ofwat have responded to recent criticism over regulation. For example, following a 2017 Financial Times comment article, the Chief Executive of Ofwat defended Ofwat's role, stating that it safeguarded customers via five yearly price controls and that "we do not allow companies — including Thames Water — to pass on the costs of their financing arrangements beyond that of an efficient notionally structured company."[134] A response was also written by Michael Roberts, the Chief Executive of Water UK, which argues for continued price regulation by

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128 See OFWAT website

129 "UK water regulator talks tough but households are hung out to dry", *Financial Times*, 17 September 2017 and "The UK water regime calls out for change", *Financial Times*, 21 September 2017

130 "Thames Water needs 'serious scrutiny', says regulator", *Financial Times*, 26 June 2017

131 For example by the Consumer Council for Water in "Water watchdog urges regulator to set record low cost of capital", 4 December 2017

132 For example "Water regulator criticised for removing cap on performance rewards", *Financial Times*, 13 December 2017 and from the Consumer Council for Water in "CCWater statement: Water company rewards could cause bill instability", 13 December 2017

133 Public Accounts Committee, Economic Regulation of the Water Sector, 16 December 2015.

134 "Water watchdog has held companies to account", *Financial Times*: *Letters to the Editor*, 12 September 2017

Ofwat, highlighting improvements in leakage and water quality, high levels of investment and effective control of prices.[135]

Company Structures

The government have indicated their concern with the structure of companies in the industry. In January, in an exchange of letters between the Secretary of State, Michael Gove MP, and the Chair of Ofwat, Jonson Cox, issues around the financial structure and behaviour of water companies were raised, with the Government willing to consider changes to the regulatory framework if current powers were insufficient.

On 1 March 2018, Michael Gove, gave a speech to a water industry conference. Whilst he praised investment in the industry since privatisation, he criticised the corporate structures and dividend payouts in the industry:[136]

> …Overall, I believe that despite the undoubted gains in efficiency and investment since privatisation, the system is not working as well as it should.
>
> Far too often, there is evidence that water companies - your water companies - have not been acting sufficiently in the public interest.

Ofwat replied to the Secretary of State on 9 April and set out a series of actions it would take alongside PR19 (the next system of regulation), particularly around financial arrangements of the companies. The Secretary of State welcomed the proposals on 18 April 2018 and noted that water companies appeared to support the plans, but that the Government would consider giving Ofwat stronger powers if subsequently it appeared they were needed.

9.3 Proposals for change

Although Michael Gove strongly criticised the water industry in the March speech, he also said that "renationalisation would be a terrible backward step" and that the industry should remain in the private sector.

In the speech the Secretary of State also warned that[137]

> …should companies continue to drag their feet, I have already said I am prepared to consider changes to the regulatory framework to ensure that consumers receive the service they deserve - and the natural world is better protected in line with our 25 Year Environment Plan.

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135 "Water companies have improved their service", *Financial Times: Letters to the Editor*, 13 September 2017
136 DEFRA website, A water industry that works for everyone, 1 March 2018
137 DEFRA website, A water industry that works for everyone, 1 March 2018

Reforming the ownership of the water industry has been proposed by the Labour Party and also in a number of comment articles in the last year.[138]

The Labour Party has stated that they would like to bring the water companies into public ownership. Labour proposed that the industry could be nationalised, with Parliament setting the value for any nationalisation, that the value will depend on 'the behaviour' of the company, and that shareholders will be paid via government bonds.[139] The CBI have expressed concern over Labour's plans, noting the impact on investors.[140] Cathryn Ross, Chief Executive of OFWAT, also responded to the 2017 Labour Conference, through an article in the *Evening Standard*: "*The water sector has improved —and we need to keep it that way.*"

On 9 May 2018 the House of Commons Environment, Food and Rural Affairs Committee launched an enquiry on regulation of the water industry.

9.4 Possible cost of bringing the water industry into public ownership

Researchers have also looked at the gains or losses from a change in ownership structure. A range of values have been suggested for buying water companies– which vary depending on the assumptions put in place, as well as how any debt could be handled (a lower cost if debt is not paid off but continues on the same terms with the new company). Estimates of market values (excluding debt) have been made in the range of £35-£40 billion. However, along with the treatment of debt, higher and considerably lower estimates have been made due to arguments around whether the Government would pay a 'takeover premium' (higher price) or whether the Government would consider paying below market price to take account of past behaviours or the circumstances of the original privatisations (lower price).

Research from Greenwich University[141] in May 2017 looked at how a government might go about a water nationalisation. It argues that:

138 For example, in the *Financial Times* – although this article suggests a not for profit public interest company: "Water privatisation looks little more than an organised rip-off" 10 September 2017; and "The scandal of privatised water is going to blow", *The Spectator*, 16 September 2017

139 "Labour conference: CBI says nationalisation plans 'will send investors running for hills' - Politics live", The Guardian, 26 September 2017, p5 and previous commitment to use Government Bonds in "Labour's McDonnell proposes nationalisation of water companies", *Financial Times*, 16 May 2017

140 ' "No time for warning flags" ', CBI Press Release, 25 September 2017

141 "Bringing water into public ownership: costs and benefits", Bayliss, K and Hall, D, May 2017

- Public sector ownership would gain through saving on dividend payments (which it estimates at an average of £1.8 billion a year between 2007 and 2016);
- Public sector ownership could also reduce the cost of debt held by the companies by borrowing on lower cost government bonds in the medium to long run (they estimate debt costs at an annual average of £1.5 billion a year between 2007 and 2016);
- They set out ways the industry could operate in the public sector, and noted that Parliament would have to set the payment for the transfer of assets or stockholding, citing legal research on compensation rules;
- They estimate the current market value of the shareholding in water companies is £37 billion, based on the value of those listed on the stock exchange but also cite potentially lower figures that could take account of other factors in the running of the companies since 1989:

> …But Parliament will surely want to take into account other factors in negotiating compensation, including: the actual level of shareholder equity in the companies, or book value of the companies, which is only £14.3bn (Table 3); the substantial public subsidies given to the companies in 1989 (worth £12bn at today's prices); the failure of shareholders to invest new equity since 1989; the inflation of share prices by the extraction of dividends; the very low level of actual tax payments; and the use of subsidiaries in offshore tax havens like the Cayman Islands. Parliament may also want to address the remarkable feature of the companies' current licenses as providers of water and sanitation services, which states that they can only be terminated after giving the firms 25 years notice.

The research concentrates on nationalisation rather than looking at other types of ownership structure. The research was featured in the *Financial Times* which carried a response from Michael Roberts, chief executive of Water UK: the "flawed report does not do justice to the achievements of the water industry since privatisation." [142]

Other research has suggested a higher cost would apply. A report by the Social Market Foundation (SMF) in January 2018, suggested higher costs and contested some of the Greenwich research.[143] The report was commissioned by a number of water companies although the SMF notes that it retained 'full editorial independence'. The report examines the different approaches that could be used, basing the analysis around the takeover values that might be expected in a commercial landscape, highlighting for example the expectation of a 'takeover premium' in some circumstances. It includes three values:

- The Regulatory Capital Value (RCV) – a measure used by Ofwat and adjusted each year by the regulator taking account of

142 "Privatised water costs consumers £2.3bn more a year, study says", *Financial Times*, 6 June 2017
143 'The Cost of Nationalising the Water Industry in England', Social Market Foundation, 5 February 2018

investment, depreciation and inflation. At the end of March 2017 the RCV of water companies in England was around £64 billion.

- The SMF argue that water assets have previously changed hands at a value of 'RCV times 1.3', producing a value of around £83 billion. The reason for the higher value is an expectation the company may perform better in the future than the regulator expects
- The SMF also cites 'Enterprise Value' as a possible valuation method – this is based on market capitalisation, plus debt, other shares and cash. The SMF estimated market capitalisation by looking at the value of the three listed water companies. They calculate an enterprise value of £80 billion, or £90 billion if a 30% premium is paid on the share price.

They note these estimates do not include any transaction costs and that debt is valued and paid off at current levels. It also notes that debt would not need to be bought out – which would reduce the takeover cost by £46 billion, but still add this value to government debt levels.

The SMF include some discussion of whether the 'takeover value' would apply. They acknowledge there are arguments for a lower value, such as in the Greenwich paper above, but argue that paying below market price would come with an associated loss for shareholders (and highlight where some companies have domestic or UK pension-based investors), along with lower tax revenues from sources such as capital gains tax.

They also highlight other unknown issues around nationalisation such as whether future rises in government debt costs would undermine benefits from lower interest costs, transitional costs, whether the public sector could deliver efficiency gains and the politicisation of price setting. They also argue that future capital investment costs for the water industry are expected to be in the region of £4 billion a year, which would add to the public sector capital requirement.

A report from the Centre for Policy Studies (CPS) in January 2018 estimated the cost of water nationalisation at the RCV times 1.25 – meaning a value (including debt) of £86 billion. They argue against a nationalisation policy but in favour of domestic water competition to provide cost benefits to consumers.[144]

The Financial Times have run a series of articles on privatisation and nationalisation which include discussion of the water industry. For example, an article in January 2018 looked at some of the arguments around nationalisation of the water industry, including a number of charts on the financial changes in the water companies (see "Pioneering Britain has a rethink on privatisation"), a further article in February 2018 looked at the arguments and costs around renationalisation (see "Returning the UK's privatised services to the public").

[144] "The Cost of Nationalisation", Centre for Policy Studies, January 2018, p9-12

10. Specific industries or services: energy

10.1 Current ownership model

The *Gas Act 1986* and the *Electricity Act 1989* privatised the energy sectors in Great Britain and also created the Director General of Gas Supply and the Director General of Electricity Supply and led to the formation of Ofgas, the Office of Gas Supply, and OFFER, the Office of Electricity Regulation as regulators independent from government but accountable to Parliament.

The current regulator Ofgem was created by the *Utilities Act 2000*, which merged electricity and gas regulation. Ofgem, the Office of Gas and Electricity Markets, is the 'practical arm' supporting GEMA, the Gas and Electricity Markets Authority, which is the actual regulatory authority.

Price controls for domestic energy consumers were introduced during privatisation of the electricity and gas companies from the mid-1980s and early-1990s. Supply price controls were removed in the market in Britain several years after the introduction of competition for domestic consumers in the late 1990's.

Domestic energy supply prices are therefore no longer capped and suppliers operate in a competitive market where they set their own prices and consumers can make a choice of supplier based on primarily on price but also on service.

While Ofgem does not impose price controls for energy suppliers, it supervises the structure of the market. For example, it is responsible for issuing energy market licences; a supplier licence is required to operate in the supply market, and changes to them can control the way companies operate and obligations they must meet. They set out on their website how they aim to influence the market:[145]

> Suppliers buy energy from the wholesale market or directly from generators and arrange for it to be delivered to the end consumer. They set the prices that consumers pay for the electricity that they use. Allowing consumers to choose their supplier helps to keep pressure on prices and drives better customer service. It also promotes innovation in products and services.
>
> Our role is to make sure that the electricity retail market works in the interests of consumers. We do this by monitoring the market and, where necessary, taking action to strengthen competition or enforce the rules with which suppliers must comply.
>
> Over the coming decade, the roll-out of smart meters to homes and businesses has the potential to transform how the retail market operates to the benefit of consumers. These meters will be capable of measuring the amount of energy used in short time

[145] Ofgem website, *The GB electricity retail market*

> periods. They will also be capable of remote two-way communications.
>
> We are responsible for ensuring that regulation protects and promotes the interests of consumers during the transition to smart metering and beyond.

Parts of the energy market are directly regulated and do have revenue controls: for example the regional distribution networks for electricity (wires from the UK-wide transmission network to individual properties) is owned in each region by one company and is a monopoly. The National Audit Office (NAO) guide to regulators from 2015 notes:[146]

> …Ofgem sets price controls for monopoly networks where competition would be impractical and inefficient. These price controls are a means to incentivise monopoly providers to deliver efficiently, with a focus on providing good value for consumers. In areas where competition is established, such as retail markets, Ofgem defines the rules for competitive markets and ensures high standards of service for consumers, backed by effective market monitoring and the sanction of enforcement action where companies fail to deliver.

In recent years the method of regulation for networks moved from a RPI – X system, to one called RIIO (Revenue = Incentives + Innovation + Outputs).

10.2 Future regulation and change

Discussion of regulation or future ownership of energy industries is commonly divided into two different parts of the market: between the retail or supply market and the regulated areas of energy networks which still represent a more traditional monopoly provider. This paper does not consider any future regulation of the generation market.

Generators in the UK also operate in the private sector, after following a privatisation process. Typically new large scale generation, such as power plants or large scale renewable technology, are delivered by the private sector but supported by the public sector through contract for difference (CfD) arrangements, whereby future delivery of energy is guaranteed has a guaranteed price to support the required capital investment. [147]

Energy supply

Concern over the energy supply market has been around the level of competitiveness and whether large, dominant suppliers have been able to raise prices excessively. The Library briefing Energy bills and proposals for reform, last updated in October 2017, sets out the actions Government and Ofgem have taken in recent years to investigate levels of competition and put actions in place to improve competitiveness. The most recent, and substantial, investigation was Ofgem's referral of the

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146 NAO, *A Short Guide to Regulation*, July 2015

147 For example, see further detail in Library Papers on New Nuclear Power and Tidal lagoons

energy market to the Competition and Markets Authority (CMA) in 2014. It reported in 2016 and for domestic customers concluded that:[148]

- Around 70% of the domestic customers of the 'big six' are still on an expensive 'default' standard variable tariffs (SVT)
- These customers could potentially save over £300 by switching to a cheaper deal
- Customers could have been paying about £1.4 billion a year more than they would in a fully competitive market.

The CMA proposed a number of remedies, and the Library note tracks the implementation of these.

Most recently the Government introduced The Domestic Gas and Electricity (Tariff Cap) Bill, which proposes to limit the level of the 'default' tariff suppliers can charge. This was not put forward as a remedy by the CMA in their formal report (although one panel member supported a cap). The system of regulation, and Ofgem, have been criticised for their work to protect customers and support competition. The Business, Energy and Industrial Strategy Committee provided pre-legislative scrutiny of the price cap Bill and criticised Ofgem:[149]

> We conclude that Ofgem have failed customers, especially vulnerable customers, by being overly cautious and reactive on the issue of poor-value standard variable and default tariffs. They should have removed the obligation to move customers at the end of their fixed-term contracts on default tariffs sooner and set mandatory targets for suppliers to take customers off standard variable tariffs when it was still appropriate to do so. We urge Ofgem to be faster and more proactive in using their extensive powers to protect customers from overcharging in the future.

The Committee supported the Bill and the need for intervention in the market.

Change in the energy supply market?

The number of new suppliers in energy markets has been growing in recent years, and these have included both small new commercial suppliers, as well as local suppliers supported by local authorities. The largest current example is Robin Hood Energy, which was set up in 2015, and is owned by, Nottingham City Council. It has been reported that to date the company has acquired 100,000 customers, and finance to set up the company was provided by the council at commercial rates[150]. The company has made losses to date but expects to break even after three years. It has been reported that other local authorities are considering similar approaches, or setting up 'white label' suppliers

148 CMA, Energy market investigation – Summary of final report, 24 June 2016
149 Business, Energy and Industrial Strategy Committee, Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill: Fourth Report of Session 2017–19, HC 517, 13 February 2018, also see articles such as: "Ofgem apologies for failing to act sooner on energy price cap", *Financial Times*, 10 January 2018
150 "Robin Hood Energy posts £7.6m loss", *Utility Week,* 16 January 2018

(which are based on a supply provided by a company such as Robin Hood; smaller commercial suppliers are also active in this market).[151]

The Labour Party manifesto proposed at the 2017 General Election that they would support the creation of 'publicly owned, locally accountable energy companies and co-operatives to rival existing private energy suppliers' in each region.[152]

The Scottish Government have indicated their intention to set up a publicly owned, not for profit, energy supplier by 2021.[153] They commissioned a report from consultants Ernst & Young on options for the company which was published on 29 March. The report identified possible options for the creation of a public sector operator including: partnering with another 'socially minded supplier', a government owned company, or a centrally owned company with local authorities acting as subsidiaries and providing a 'while label' service. The report also sets out some of the challenges and opportunities of setting up such a company.[154]

What about energy networks?

Energy networks, and the regulation of them, have been criticised for high levels of profits which some have suggested do not reflect the low risk industry. For example, in February 2018 it was reported that a cross-party group of 30 MPs wrote to Ofgem urging them to bring the profits of network operators under "tighter control".[155] Reports from organisations such as Citizen's Advice and the Energy and Climate Intelligence Unit have suggested that high profits were being generated by electricity distribution companies under the current period of regulation.[156] High returns have also been reported by Gas distribution companies.[157] Responding to the report from the Energy and Climate Intelligence Unit, the Electricity Networks Association, a trade body, are reported to have stated that the figures were misleading, that it made "basic errors in assessing the way that network companies make profits", and that Ofgem data showed network costs to consumers flat or falling in the coming years.[158] In response to broader concerns with the industry, National Grid was recently reported as highlighting the

151 "UK local authorities plug into energy market", *Financial Times,* 29 November 2017
152 Labour Party Manifesto 2017, p20
153 Scottish Government website, Publicly Owned Energy Company [accessed 16 April 2018]
154 Ernst & Young, "Publicly Owned Energy Company: Strategic Outline Case (SOC)" [for the Scottish Government], 29 March 2018; also see BBC News "Report sets out options for Scottish government-owned energy firm", 9 April 2018
155 See "MPs urge Ofgem to clamp down on electricity networks profits", *Utility Week*, 24 January 2018 and "John Penrose MP demands 'sleeping' energy regulator pulls plug on £7.5bn power rip-off" from website of John Penrose MP, 28 January 2018
156 "Energy Consumers' Missing Billions", Citizen's Advice, 12 July 2017 and "Network firms' high profits add £20 to energy bills", Energy and Climate Intelligence Unit, 15 January 2018
157 For example, "Ofgem calls on gas networks to join rest of sector in making customer repayments", Utility Week, 6 December 2017
158 "High electricity network profits 'adding £20 to household bills'", *Utility Week*, 15 January 2018

benefits of the current industry with falling transmission costs since privatisation and future planned investment.[159]

On 7 March 2018 Ofgem announced a consultation on the next period of regulation for electricity and gas transmission and distribution networks, called RIIO-2, which will apply from 2021 (2023 for electricity distribution networks).[160] This consultation includes a review of the cost of debt and equity returns, with lower equity returns proposed than under the previous period of regulation.[161]

Future challenges for the energy grid include managing a changing system, with a changing distribution of generation and supply across the networks, particularly for electricity (more local level generators and changing consumption trends). Dieter Helm's Government support review of the cost of energy considered these matters; the report criticises the level of returns made by distribution and transmission companies, and proposes reform of the system of regulation, with a system led by National and Regional System Operators, who are likely to be owned by public sector.[162]

The Labour Party proposed in their 2017 manifesto to bring energy back into 'public ownership' by, in addition to creating public sector suppliers, 'regaining control of energy supply networks through the alteration of the National and Regional Network Operator license conditions' and by 'Legislating to permit publicly owned local companies to purchase the regional grid infrastructure, and to ensure that national and regional grid infrastructure is brought into public ownership over time'.[163] It was reported in July 2017 that Dr Alan Whitehead MP, a Labour Energy spokesman, suggested the policy may not be to purchase existing asset bases but to create a system that was "municipalised and localised and under accountable control".[164] Further comment from Labour has suggested a decentralised system for transmission, distribution and supply is being proposed, reflecting the increase in renewable technology and the impact this may have on the grid.[165]

A PQ in November 2017 set out the Government's view of the performance of the distribution network after being asked whether the "Department has made an assessment of the potential merits for consumers of national grid privatisation". The answer stated that: [166]

> Network costs are now 17 per cent lower than at the time of privatisation (excluding inflation). Operating efficiency has

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159 "National Grid hits back at calls for renationalisation", *Financial Times*, 9 November 2017

160 For more detail see What is the RIIO-2 price control?

161 "RIIO2: what's new?", *Utility Week*, 18 April 2018

162 Dieter Helm, Cost of Energy Review*,* 25 October 2017 and "Network companies under scrutiny for rising UK electricity prices", *Financial Times*, 26 October 2017

163 The Labour Party Manifesto 2017

164 "Whitehead: Traditional renationalisation 'monumental misuse of public money' ", *Utility Week*, 21 July 2017

165 "Corbyn talks of green energy system under public ownership", *Utility Week*, 10 February 2018

166 PQ 109821 [on National Grid: Privatisation] 1 November 2017

> increased, for example, real unit operating expenditure has fallen by approximately 5.5 per cent, per annum across the electricity distribution networks since privatisation. Capital investment in the electricity networks is higher on average than the period immediately prior to privatisation. The improvements this paid for have reduced power cuts by around 40 per cent since 2002. There are also record levels of customer satisfaction with local electricity and gas distribution networks.

10.3 Public ownership – cost and comment

As with water, a range of estimates have been made for the cost of bringing parts of the energy industry into public ownership. These estimates are complicated by not knowing the political environment, but also that energy companies are not always listed UK companies, and often have complex operations that mean a value for a part of an operation if hard to make.

An article by David Hall at the University of Greenwich in 2016 proposed bring parts of the energy sector back into the public sector and estimated a cost. He proposed that the distribution and transmission businesses would be purchased, alongside some non-renewable power stations, and that a national, regional and local approach to planning and organising the sector would be put in place. Alongside this, local authorities would be expected to set up municipal energy supply companies (such as Robin Hood Energy, mentioned above), who could compete with existing large suppliers. He argues that the benefits of the proposal would come from more local and regional open planning as the system becomes more reliant on renewable and more distributed sources of energy. The paper provides estimates of the cost of the proposal based on estimates of equity value at the time, assumptions about the amount of the big six company would be purchased (for generation assets) and assumes a negotiation on this value bringing the cost down by a third. He estimates the capital cost is £24 billion (excluding set up and transaction costs, including for new businesses, and company debts). He estimates a saving from dividend payments of £3.2 billion after the cost of interest on Government debt from the purchase is taken into account.[167]

A report from the Centre for Policy Studies (CPS) in January 2018 estimated the cost of energy nationalisation would be higher. It cited earlier research by a city analyst firm that estimated total nationalisation of the energy sector would cost £185 billion, or £124 billion for National Grid and the 'big six'. This calculation is based on market capitalisation and debt, and assumes the whole company needs to be purchased rather than part of it. The CPS state that the 'Regulated Asset Value' (RAV) of energy networks as at March 2017 was estimated to be

[167] Hall, D, "Public ownership of the UK energy system – benefits, costs and processes", April 2016

£55.4 billion. The paper is an analysis of Labour plans, and it estimates the cost of these plans is likely to fall between these two values.[168]

The ongoing debate around ownership and regulation of the energy sector has been reported as having a potential impact on overseas investment. Some in the industry have argued that this may mean the cost of capital rises for UK energy companies.[169]

11. Specific industries or services: Royal Mail

Royal Mail was privatised in three parts between October 2013 and October 2015. Royal Mail now operates as an independent business in two main markets: the letters market and the parcels market. In letter delivery Royal Mail operates a near monopoly of end-to-end deliveries. Within parcel deliveries the Royal Mail is operating in a growing and competitive market.

More information about the privatisation of the Royal Mail can be found in the Library paper Privatisation of Royal Mail published at the time of the sale of the company.

Royal Mail reported an adjusted profit after tax of £438million in 2016/17. While profits have been stable for the last three years they are almost double what they were in 2012/13 (around the time privatisation began).[170] A full summary of Royal Mail's performance over the past five years can be found in the Library paper Postal Services.

11.1 Current regulation

The current regulatory framework for postal services was established in the Postal Services Act 2011 which also allowed for the privatisation of Royal Mail. There were three main outcomes from the Postal Services Act:

- The Royal Mail Group was restructured and restrictions on its sale lifted. The Post Office Ltd was separated from the Group and restrictions were placed to ensure the Post Office remained in public ownership (except a possible move to a mutual ownership).
- Historic pension liabilities were transferred to the Government from Royal Mail.
- Ofcom was made the regulator of postal services and required to create a regulatory framework. The Act stipulated that such a regulatory framework must protect the Universal Postal Service.[171]

As the regulator, Ofcom made Royal Mail the UK's Universal Service Provider, this gives it a unique position in the UK postal industry. For

168 "The Cost of Nationalisation", Centre for Policy Studies, January 2018, p9-12
169 "UK energy grid warns that political risks threaten investment", *Financial Times,* 4 March 2018
170 See Section 7 of Commons Library Postal Services [last accessed 24/01/18]
171 The Postal Services Act 2011 also set out what a Universal Service should be and required Ofcom to formulise a definition.

example, this requires that Royal Mail provides at least one delivery and collection of letters Monday through Saturday at a geographically uniform price.[172] In addition to providing the Universal Service, Royal Mail must make its network available to access competitors. Access competition is where another postal operator collects mail and hands it to Royal Mail for final delivery.

The Postal Services Act 2011 requires Ofcom to carry out its regulatory duties in a way which protects the Universal Service; they must also promote competition in the postal services market. In order to do so Ofcom monitors Royal Mail's performance against a number of performance measures. Ofcom publishes an annual update on its monitoring activities. Ofcom has some powers to levy fines against Royal Mail (and other postal operators) if they fail to meet obligations.

Ofcom published their review of the Universal Postal Service in March 2017 in which it concluded that Royal Mail performance had improved and that the current regulatory framework would be retained to 2022.[173]

Why the Royal Mail was privatised

The volume of letters being sent through the postal service has been falling as email and other substitutes have grown.[174] As early as 1999 it was recognised that reform was needed in order to protect the Universal Postal Service.[175] The liberalisation of the industry began with the passing of the Postal Services Act 2000 which allowed for more competition and gave Royal Mail more freedom to operate within a competitive market.

In 2007 the then Labour Government commissioned Richard Hooper to conduct a review of postal services. His report *Modernise or decline: Policies to maintain the Universal Postal Service in the United Kingdom* concluded that status quo was "untenable". [176] Hooper argued that Royal Mail was inefficient and financially unstable. [177] He concluded that, as government funding was inflexible, private capital was needed to protect the Universal Postal Service and secure the future of the business. [178]

The 2008 report stopped short of recommending the full privatisation of Royal Mail, as at the time the Royal Mail's financial performance was

[172] Ofcom, Universal postal service order, 12 July 2013: The Universal Service also includes a stipulation that Royal Mail must provide a similar service for other postal packets Monday through Friday and free end-to-end services for legislative petitions and certain services to blind and partially sighted people.
[173] Ofcom, Ofcom concludes review of Royal Mail regulation, [last accessed 19/06/17]
[174] See House of Commons Library, Postal Services [last accessed 23/01/17]
[175] Post Office reform: a world class service for the 21st Centenary, Cm 4310, 8th July 1999
[176] Hooper (2008) Modernise or decline: Policies to maintain the Universal Postal Service in the United Kingdom, p10
[177] Ibid, p11- p13
[178] Ibid, p13

deemed too weak.[179] The Labour Government introduced legislation to implement Hooper's recommendations but they did not proceed with their Postal Services Bill 2008/09 as they were unable to find an appropriate partner for Royal Mail.

Following the 2010 General Election the new Coalition Government agreed to bring forward legislation to reform postal services. The then Business Secretary Vince Cable asked Richard Hooper to update his report, and following its publication the government introduced the Postal Services Bill, subsequently passed as the Postal Services Act 2011 which initiated the privatisation of Royal Mail.[180]

11.2 Bringing Royal Mail back into public ownership

At the time of Royal Mail's sale the Labour Party supported the principle of Royal Mail having greater access to investment, though they did criticise the Coalition Government for selling a "great British institution at a knock down price"[181]. The Scottish Nationalist Party opposed to the privatisation.[182]

The Labour Party has however since changed its position. While Labour initially said it would not be able to support re-nationalisation, the 2017 Manifesto argued that:

> …in private hands, Royal Mail has increased stamp and parcel charges, and failed to meet its customer service obligations, while its owners trade shares at significant profit. The Conservative Government's privatisation of Royal Mail was a historic mistake, selling off another national asset on the cheap… [The Labour Party will]… reverse the privatisation of Royal Mail at the earliest opportunity.[183]

Details of stamp prices, Royal Mail's financial performance and their performance against quality of service targets can be found in the Library paper Postal Services

The Communication Workers Union (the largest union of postal workers) supports the renationalisation of Royal Mail.[184] It is currently conducting a campaign The People's Post which aims to

> …defend postal services and decent employment standards in the postal industry- both of which are (…) under serious threat from privatisation and aggressive regulation.[185]

In contrast Royal Mail itself has been vocal about what it sees as the benefits of privatisation. In a series of tweets published on the 16th November 2017 they stated that they had suffered underinvestment while in state ownership but had been able to invest £1.5bn since

179 Ibid, p71
180 Richard Hooper updated his report on the Universal Service for the Coaltion Government. His second report *Saving the Royal Mail's universal postal service in the digital age* (2010) came to the same conclusions as his previous report.
181 Milliband, E in Guardian, Royal Mail shares soar 38% on first day of dealings - as it happened, 11 October 2013 [last accessed 23/01/18]
182 See House of Commons Library Privatisation of Royal Mail for details
183 Labour Party (2017) Manifesto 2017: For the Many not the Few, p19
184 For example see The Voice (CWU Magazine) November 2017 issue, p6
185 Communication Workers Union, The People Post [last accessed 23/01/18]

privatisation and that they paid lower interest rates to private sector institutions that they did on previous loans to the Government.[186]

Financial Times business correspondent Matthew Vincent has similarly praised the benefits of privatisation. He cites growing revenues in parcels and better relations with unions as signs of success.[187]

Notwithstanding the arguments for and against renationalisation, there are a number of factors that a future government would have to consider if it were to pursue renationalisation:

Cost

It is difficult to estimate exactly how much returning Royal Mail to public ownership would cost. Royal Mail is a publicly traded company listed on the FTSE250. The current value of Royal Mail shares is around £4.7billion and so a majority shareholding would in theory cost around £2.4billion.[188] However the value of Royal Mail shares is affected by market moves. If the government stated its intention to buy a stake in Royal Mail this could change the value of the shares significantly. And, as with change in company ownership, there would be additional costs such as legal fees.

Market competition and EU rules

In addition to the competition and takeover rules outlined in Section 3.3 of this paper, the government would also have to consier the EU state aid rules about supporting particular businesses.[189] Whilst the UK is a Member of the EU the Government would likely need special permission from the European Commission to sanction any substantial investment in Royal Mail.[190] However; foreign governments (like for example France and Italy[191]) have secured the relevant permissions in the past and the Government currently applies for state aid permissions when it settles funding for the Post Office. Section 7 of this note provides more details on EU state aid rules.Section 3.3 of this paper, the government would also have to consier the EU state aid rules about supporting particular businesses.[192] Whilst the UK is a Member of the EU the Government would likely need special permission from the European Commission to

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186 Royal Mail News: *More British people own shares in Royal Mail than almost any other company*, *Under state ownership, we paid higher interest rates on loans from the Government than we do now to private sector institutions.*, *We have invested £1.5bn in our business since privatisation. Royal Mail suffered from underinvestment while in state ownership.*

187 Matthew Vincent, Royal Mail continues to show how privatisation can deliver, Financial Times, January 2018

188 Financial Times Equities, Royal Mail PLC, [last accessed 23/01/18]

192 See Commons Library, EU State Aid rules and WTO Subsidies Agreement

sanction any substantial investment in Royal Mail.[193] However; foreign governments (like for example France and Italy[194]) have secured the relevant permissions in the past and the Government currently applies for state aid permissions when it settles funding for the Post Office. of this note provides more details on EU state aid rules.

Impact of domestic regulations on Royal Mail management

Current legislation (The Postal Services Act 2011 described above) does not prohibit the renationalisation of Royal Mail, it does however establish a regulatory framework for Postal Services which essentially assumes an independent Royal Mail. If the Government wants to take on an active role in relation to Royal Mail, fresh legislation might be needed to establish that role and what relationship it would have with Ofcom as the regulator of postal services.

Some of the current shareholders are Royal Mail employees who were gifted their shares as part of the privatisation process. There is a question as to what compensation, or role in a publicly owned Royal Mail, these employees would have if the company was brought back into public ownership.

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193 European Commission, Competition policy brief: High quality and competitive postal services for citizens and businesses - State aid control in the postal sector, May 2014 [last accessed 23/01/18]

194 Ibid, p5

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