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The Labour Party manifesto proposals on renationalisation: a personal comment from Mike Toms

The UK Labour Party's 2017 manifesto contains a proposal to renationalise some of the UK's largest networks—electricity, gas, rail and post. Mike Toms, Non-Executive Director of Oxera, shares his reflections on this policy, which has risen in significance due to the recent growth in support for the Party

In May 2017 I was asked for some thoughts on the proposals for renationalisation in the Labour Party manifesto. Back then, I thought that by the time of publication this article would be merely a footnote to history. But a month is a very long time in politics. The result of the June general election leaves the manifesto on the table as a statement of intent by a party seriously seeking power. And it can't be dismissed as something on the far edge of economic thinking. Nobel Laureate, Joseph Stiglitz, endorsed the general thrust of Labour's economic policy in a piece for *The Guardian* on 7 June,[1] and over a hundred academic economists signed a letter of support in *The Guardian* online on 4 June.[2]

Objectivity is very difficult to maintain on matters political, and I approached the challenge as someone with a longstanding affinity for Labour. I hoped that the manifesto would reveal answers to a number of the questions that proponents of public ownership have struggled with. These centre around the two core issues: what benefits would renationalisation bring, and at what cost? The subscript is whether the need to pay dividends to shareholders is at the root of all the problems faced by utilities.

So what did I find?

Labour's proposals on public ownership are all contained on page 19 of the manifesto,[3] with some additional insight in two of the resource documents that accompany it.[4]

The vision is ambitious. The manifesto states that the Party will:

- 'Bring private rail companies back into public ownership as their franchises expire.
- Regain control of energy supply networks through the alteration of operator licence conditions, and transition to a publicly owned, decentralised energy system.
- Replace our dysfunctional water system with a network of regional publicly-owned water companies.
- Reverse the privatisation of Royal Mail at the earliest opportunity.'

The list contains a few ambiguities. Does bringing rail companies back into public ownership include the rolling stock companies, and what does it mean for infrastructure manager, Network Rail? If it does not include the rolling stock companies, why not? The commitment to transition to a publicly owned energy system would need to include the core components of the industry—energy generation and supply—but the statement refers directly only to the networks. It is unclear to me whether these are to be fully nationalised or restructured in some other way.

Notwithstanding these grey areas, the commitment is so significant that it is worth asking what benefits are expected to flow from it. We are told that public ownership will benefit consumers, ensuring that their interests are put first, and that there is democratic accountability for the service. At the core of this is the belief that privatisation has led to higher prices and poorer quality as prices are raised to pay dividends.

Starting with service quality, Appendix 3 to one of the resource documents, 'Alternative models of ownership',[5] contains an interesting essay on service quality issues, but no analytical evidence on the deterioration in quality of service in water, rail or energy since privatisation. I assume that the authors of the manifesto struggled to make the case that water was cleaner, energy was greener, or indeed that trains were more punctual, before they were privatised.

Turning to prices, the manifesto gives two powerful examples of price increases in privatised industries. So it's worth a look behind the headlines.

The 40% increase in water bills since privatisation is particularly eye-catching. It's a number that can be found in a 2015 report on the water industry by the National Audit Office (NAO).[6] The same report gives a little more depth to the numbers. It points out that the increases were largely confined to the first five years following privatisation in 1989. Over the last 27 years the increase has been a slightly less headline-grabbing 9% (less than 0.3% a year).[7] Looking forward, the water regulator for England and Wales, Ofwat, expects an average reduction of 5% in water bills over the five years to 2020.[8] Nonetheless, price increases require some explanation, and the same NAO report concludes that the privatised water companies have delivered improvements in service across the board, from water quality to water pressure and reductions in hosepipe bans and the danger of outage.[9] At the same time, the water efficiency organisation, Waterwise, in a factsheet in 2012, makes the point that increased water bills have been accompanied by an increase in per capita household consumption averaging 1% each year since 1930.[10] All other things being equal (which of course they aren't), the volume effect alone might underlie an increase of over 30% in household bills since privatisation. So an alternative reading of the impact of privatisation might be that bills have indeed risen, but largely to pay for increases in water quality and the amount of water used. If one were to accept this view, the case for renationalisation might be less compelling.

The £2bn in excess electricity bills referred to in the manifesto[11] is taken from a recent study by the Competition and Markets Authority (CMA).[12] The CMA attributes these increases largely to prices charged to households by energy suppliers, not to excess costs of energy networks. It also proposes a number of measures to deal with this problem without recourse to renationalisation. So it is not clear how the manifesto commitment to change network licences and/or renationalise the energy network providers would be either necessary or sufficient to deal with the problem unless the Labour Party also has in mind the nationalisation of the electricity generators and the electricity and gas suppliers.

The manifesto makes a particular point of the consequences of privatisation of Royal Mail. The cost of postage and quality of service appear to be part of a set of issues in relation to Royal Mail that are perhaps best viewed as a political special case rather than as part of a broader economic policy. Certainly the manifesto makes play of the underpricing of the Royal Mail flotation, but it is not clear how renationalisation will address this as many of the initial shareholders will have taken their profits long ago.

So the benefits of nationalisation may be a little less certain than might at first appear. But what of the costs? The manifesto and its accompanying documents contain no estimate for the cost of buying these industries. This is not to say that there is no cost, but just that the cost may not have been accounted for. While no one can know the number accurately, it is clear that it would be very large.

The value of the regulated assets in the water sector in England and Wales totals £65bn,[13] but that number is likely to underestimate the total value of these companies, given the premiums above the asset value that have been observed in recent sector transactions. Using average premiums paid over the regulated asset base would generate a higher valuation of around £80bn. Add a similar sum for the national electricity and gas networks and a further £5bn for Royal Mail,[14] and the total bill could be headed towards £200bn. That would represent an increase of over 10% in the gross national debt, or over three times the increase in net borrowing in 2016.[15]

Such increases in debt would result in increased debt interest payments. Therefore, in practice the savings to consumers from not having to fund dividends to shareholders would be offset in part by interest charges on the money spent to buy out these investors (funded through increased government borrowing). Even at the currently low rate, interest payments would be significant and one cannot disregard the danger that the scale of the increase in debt might itself contribute to upward pressure on interest rates.

Unless we believe that capital funds are costless and infinite, this amount has major implications for the public finances. In short, it implies either a major increase in debt and interest costs, or a need to cut other elements of spending to keep within the Party's promise that it will not increase the national debt.[16] Cuts of this kind are not suggested elsewhere in the manifesto. To the contrary, the manifesto contains significant capital spending commitments including the building of High Speed 2, major northern rail links ('Crossrail of the North'), Crossrail 2, and a new London to Brighton mainline.

No allowance for the costs of renationalisation is contained in the manifesto's supporting document, 'Funding Britain's Future',[17] a point picked up by commentators such as BBC Political Editor, Laura Kuenssberg, as long ago as 16 May on Twitter.[18] In the heat of the election this apparent anomaly gained no traction, but if there is another general election soon, the Labour Party might want to equip itself with some more detailed answers to the kinds of questions that always accompany nationalisation plans.

Mike Toms

The views expressed in this article are those of the author alone.

[1] Stiglitz, J. (2017), 'Austerity has strangled Britain. Only Labour will consign it to history', Opinion, *The Guardian*, 7 June, https://www.theguardian.com/commentisfree/2017/jun/07/austerity-britain-labour-neoliberalism-reagan-thatcher.

[2] *The Guardian* (2017), 'The big issue: Labour's manifesto proposals could be just what the economy needs', 4 June, https://www.theguardian.com/news/2017/jun/03/the-big-issue-labour-manifesto-what-economy-needs.

[3] Labour Party (2017), 'For the many, not the few', The Labour Party Manifesto 2017, 16 May, http://www.labour.org.uk/page/-/Images/manifesto-2017/Labour%20Manifesto%202017.pdf.

[4] Barrott, C., Brown, M., Cumbers, A., Hope, C., Huckfield, L., Calvert Jump, R., McInroy, N., Shaw, L. and anon. (2017), 'Alternative models of ownership', report to the Shadow Chancellor of the Exchequer and Shadow Secretary of State for Business, Energy and Industrial Strategy, http://www.labour.org.uk/page/-/PDFs/9472_Alternative%20Models%20of%20Ownership%20all_v4.pdf; and Labour Party (2017), 'Funding Britain's Future', 16 May, http://www.labour.org.uk/page/-/Images/manifesto-2017/FUNDING-BRITAINS-FUTURE.PDF.

[5] Barrott, C., Brown, M., Cumbers, A., Hope, C., Huckfield, L., Calvert Jump, R., McInroy, N., Shaw, L. and anon. (2017), 'Alternative models of ownership', report to the Shadow Chancellor of the Exchequer and Shadow Secretary of State for Business, Energy and Industrial Strategy, http://www.labour.org.uk/page/-/PDFs/9472_Alternative%20Models%20of%20Ownership%20all_v4.pdf.

[6] National Audit Office (2015), 'Ofwat: the economic regulation of the water sector', report by the Comptroller and Auditor General, 8 October, https://www.nao.org.uk/wp-content/uploads/2014/07/The-economic-regulation-of-the-water-sector.pdf, p. 4.

[7] National Audit Office (2015), 'Ofwat: the economic regulation of the water sector', report by the Comptroller and Auditor General, 8 October, https://www.nao.org.uk/wp-content/uploads/2014/07/The-economic-regulation-of-the-water-sector.pdf, p. 7.

[8] Ofwat (2014), 'Final determinations', http://www.ofwat.gov.uk/regulated-companies/price-review/price-review-2014/final-determinations/.

[9] National Audit Office (2015), 'Ofwat: the economic regulation of the water sector', report by the Comptroller and Auditor General, 8 October, https://www.nao.org.uk/wp-content/uploads/2014/07/The-economic-regulation-of-the-water-sector.pdf, p. 23, Figure 6.

[10] Waterwise (2012), 'Water – The Facts', http://www.waterwise.org.uk/data/resources/25/Water_factsheet_2012.pdf.

[11] Labour Party (2017), 'For the many, not the few', The Labour Party Manifesto 2017, 16 May, http://www.labour.org.uk/page/-/Images/manifesto-2017/Labour%20Manifesto%202017.pdf.

[12] UK government (2016), 'CMA sets out energy market changes', press release, 10 March, https://www.gov.uk/government/news/cma-sets-out-energy-market-changes.

[13] National Audit Office (2015), 'Ofwat: the economic regulation of the water sector', report by the Comptroller and Auditor General, 8 October, https://www.nao.org.uk/wp-content/uploads/2014/07/The-economic-regulation-of-the-water-sector.pdf, p. 4.

[14] Based on a market capitalisation of c. £4.5bn (London Stock Exchange (2017), 'RMG ROYAL MAIL PLC ORD 1P', http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/summary/company-summary/GB00BDVZYZ77GBGBXSET1.html, accessed 16 June), and debt of c. £0.4bn (Royal Mail (2016), 'Royal Mail plc: Annual Report and Financial Statements 2015–16', http://ar2015-16.royalmailgroup.com/pdf/Royal_Mail_Annual_Report_2015-16.pdf).

[15] £1,731bn gross national debt at the end of 2016. £57.2bn increase in net borrowing between December 2015 and December 2016. Office for National Statistics (2017), 'UK government debt and deficit as reported to the European Commission: Oct to Dec 2016', Statistical bulletin, 18 April, https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicspending/bulletins/ukgovernmentdebtanddeficitforeurostatmaast/octtodec2016.

[16] Specifically, that the national debt will be lower at the end of the next Parliament than it is now. Labour Party (2017), 'For the many, not the few', The Labour Party Manifesto 2017, 16 May, http://www.labour.org.uk/page/-/Images/manifesto-2017/Labour%20Manifesto%202017.pdf, p. 10.

[17] Labour Party (2017), 'Funding Britain's Future', 16 May, http://www.labour.org.uk/page/-/Images/manifesto-2017/FUNDING-BRITAINS-FUTURE.PDF.

[18] Kuenssberg, L., Twitter account, https://twitter.com/bbclaurak/status/864427561018953728.