CHRISTIAN ETHICS AND THE PRIVATIZATION OF UTILITY INDUSTRIES

An ethical critique of the privatization of the British gas, water and electricity industries.

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Abstract

This study offers an ethical assessment of the privatization of the gas water and electricity industries in the United Kingdom. The privatization policy of the 1979 conservative Government aroused considerable controversy, especially in relation to the utility industries. Not only were they large public monopolies, in important respects they were natural monopolies. In the discussion of the ethics of privatization they represented a limiting case.

The study traces the development of the privatization programme and the political and economic ideas which lie behind it. The political context is derived from an examination of the Parliamentary debates on the privatization legislation and the philosophy of the New Right. The macro-economic context is derived from an analysis of the theoretical positions of John Maynard Keynes and Milton Friedman, and the micro-economic context from the work of John Vickers and George Yarrow. The performance of the three utilities since privatization is assessed principally through the reports of the regulators, Ofgas, Ofwat and OFFER. The ethical criteria are derived from the Bible and modern Christian social doctrine.

Five ethical issues are identified: the proper role of the state in economic management; the control of the abuse of power; incentives; stewardship; and the balance of benefits. Privatization was based on the idea of the limited state and liberal economic theory; both are shown to be an inadequate foundation, and the study argues that the notion of the limited state cannot be maintained in modern society. Assessed against Christian conceptions of community, justice, gift and egality modern economic theory is shown to be at odds with more basic social models, and, more seriously, with the duty to conserve the environment and natural resources. The study concludes that the acid test of utility privatization is not economic efficiency, understood as better value for money, but better stewardship of the environment.

Contents

Introduction

Privatization was not a central aim of the incoming Conservative Government in 1979. When it was launched, observes Ian Gilmour,[1] 'it was only a small vessel, and it was some time before it ventured out to sea. In the 1979 manifesto, apart from the recently nationalised aircraft and shipbuilding industries, only the National Freight Corporation was earmarked for the private sector.' At first there was no great desire to decimate the public sector. Gilmour records that Gerry Grimstone, the civil servant in charge of privatisation, called it 'the unexpected crusade'.[2] From these beginnings it developed into one of the flagship policies of the government, and came to cover a wide variety of issues. First there was the right of council tenants to buy their homes from the Local Authority, then came the contracting out of central and local government services to private contractors. Only then came the central plank of the policy, the sale to the private sector of state shareholdings, nationalised industries and other public corporations. Finally, and most hesitantly, there were attempts to boost the small private component in largely public services such as education, health and social services.[3]

Privatization aroused uneasy feelings about the way everything seemed to be up for sale. In particular, privatizing the public utilities providing services essential to life, namely the gas, water and electricity industries, which were all to some extent natural monopolies, aroused widespread opposition (as well, it has to be said, as considerable popular support) based on moral as well as political and economic considerations. Quite simply, there seemed to be something wrong in handing over natural monopolies to private ownership. If monopoly needed special controls what justification could there be for creating huge private monopolies outside the reach of public, democratic accountability? Water, for which there is literally no alternative, seemed to be - to coin a phrase - a privatization too far; morally and economically it was a limiting case. Had economics finally cut loose from all ethical restraint?

This study examines the relationship between economics and ethics with reference to the privatization of three utility industries with marked natural

[1] *Dancing with Dogma* (London: Simon & Schuster, 1992), p.116.
[2] *Op. cit.* p.117.
[3] The term 'privatization' has come to be associated solely with the sale of state assets, and it is often forgotten that originally it had wider connotations.

monopoly elements,[4] over the period from privatization to the end of 1998. The plan of the study is as follows:

Chapter I establishes the special character of the utility industries and examines the privatization of them within a four-fold context: the law regulating competition and monopolies; the development of the privatization programme; the politics of the New Right; and the questions posed by Christian ethics. Five ethical issues are identified: the proper role of the State, controlling the use of power, incentives, stewardship, and the balance of benefits. These issues are set within three basic ethical tensions: revelation *v.* reason; conservation *v.* exploitation; and the individual *v.* the community.

Chapter II sets out to establish ethical criteria for judging the rightness of economic and political issues. An answer is adumbrated through an analysis of biblical teaching, and four basic criteria are identified: that the 'person-in-community' is the basic social and economic unit; that economic activity should be integrated within the moral and social life of the community and be subject to the demands of justice; that some goods are to be received as gifts and lie outside the category of tradeable commodities; that the rich have a duty to help the poor. The progress of these criteria is then traced up to the end of the 19th century; they form a linking theme throughout the study.

Chapter III continues the process of establishing ethical criteria by examining the development of modern Christian social doctrine, concentrating on 'official' statements. The development of the four biblical criteria in the social encyclicals beginning with *Rerum Novarum* in 1891 is traced and important themes noted: the subordination of economics to ethics, the primacy of labour over capital, the preferential option for the poor, and the sharp critique of liberal economic theories. The teaching of the social encyclicals is seen to be broadly reflected in the statements of the World Council of Churches. There is significant agreement on a major role for the state in economic management.

Chapter IV examines the ethical and political arguments for and against privatization through a discussion of the Parliamentary debates. On the surface the clash of values represents the familiar right/left political divide, the proponents stressing economic efficiency, managerial freedom and monetary incentives; the opposition social justice, accountability and public service. But underneath this familiar argument a more fundamental argument was being conducted about the source of value in our society: the individual, the community or the planet.

[4] Telecommunications and Railways might also have been included as both exhibit natural monopoly elements. They have been excluded: (1) because they lack the 'essential to life' characteristic; (2) in the case of telecommunications because the natural monopoly element has been much reduced by new technology (see further pp.8 & 9), and (3) to keep the study within manageable length.

Chapter V examines the economic context of privatization. The first part looks at the role of the state in economic management, particularly the change in economic theory from Keynes to Friedman, and identifies the ethical values implicit in their ideas. The second part considers the economic case for privatization and concludes that it was of marginal importance in the decision to privatize the utilities. In particular, from an economic perspective, it is clear that a change of ownership and incentives is far less important than introducing effective competition.

Chapter VI surveys the performance of the utilities over the review period, and provides the basic data for assessing the case for privatization against the criteria developed in the preceding chapters. The first part examines company performance under six criteria: customer service, social justice, price control, competition, energy efficiency and environmental protection. The second part assesses the balance of benefits between customers, shareholders and the environment, and the third part considers whether and to what extent the political and economic aims of the privatization programme have been met in the case of the utilities. While there have been significant improvements over the performance of the nationalised industries, the benefits have been unevenly distributed, the most serious problem being the failure to secure major advances in energy efficiency and environmental protection.

Chapter VII offers an ethical assessment of utility privatization and brings together the themes of the study. The five ethical issues are examined against the evidence assembled in chapter VI. In particular the New Right idea of the limited state is shown to be contrary to Christian criteria and inappropriate to modern conditions, and major questions are raised about the stewardship of natural resources, and about the appropriateness of water privatization. The study concludes with a reflection on the three tensions, discussing in particular what the study has to say about the assumptions underlying economic theory. The acid test of utility privatization is not economic efficiency, understood as better value for money, but better stewardship of the environment.

I

From Public to Private

From the earliest times trade has been a route to both wealth and power and thus both kings and priests have sought to control it - initially in order to preserve their own power, later also as a means of improving the general welfare. Rights to trade were subject to royal approval, as for example in the establishment of the mediaeval guilds and the charters granted to the great trading companies, *e.g.* the East India Company, and agreements in restraint of trade, *i.e.* which aimed to restrict competition, were outlawed. Religion has generally recognised the spiritual dangers inherent in the exercise of power, particularly in the Judaeo/Christian tradition the temptation of the wealthy and powerful to oppress the poor. Accordingly both prophets and priests have sought to impose their own controls on the conduct of trade. Isaiah and Micah uttered dire oracles against the rich and the fraudulent merchants for grinding the faces of the poor and using false weights and measures,[1] so too the mediaeval Church insisted upon both the just wage and the just price. Trade too, is a prime means of contact between peoples, and has been a powerful means of breaking down religious, class and national barriers, not all of which has coincided with the interests of established power and religion. Thus the conduct of trade, like any exercise of power, inevitably raises both political and ethical issues, causing a continual tension and friction between the parties: Church and Government waging their separate battles against merchants and entrepreneurs, and against each other, with the traders fighting back, all attempting to secure their position and interests. Within this conflict the attempts to control monopolies have raised special problems.

1. Competition Policy & Regulation

Only recently has the United Kingdom had anything approaching a co-ordinated competition policy, but for a thousand years previously English law had sought to control monopoly and cartel power. In the manner typical of the common law tradition the controls developed piecemeal in response to particular economic and political events, giving the law a rudimentary and haphazard character. Even so, three main themes are discernible: price control, monopoly, and restrictive agreements.[2]

[1] See, *e.g.*, Isaiah 3.12-15; Micah 6.9-12. This theme is developed in chapter III.
[2] R. Merkin & K. Williams, *Competition Law: Antitrust Policy in the United Kingdom and the EEC*, (London: Sweet & Maxwell, 1984), p.5.

❑ PRICE CONTROL

From at least Saxon times up to the eighteenth century the law sought to ensure that no more than a 'just price' was charged for basic goods and services, especially food. There was no single system for doing this, but in a simpler society there was more general agreement on what things 'should' cost. In some cases prices were fixed locally, in others centrally, the Tudors and Stuarts using Royal Proclamations to regulate prices. Central to this system was the belief that price was a moral matter, *e.g.* that goods and services had an intrinsic worth which the price should reflect, or that the price of necessaries should be such that all could afford it, or that the price should be sufficient to enable the workman to survive. A change came about in the eighteenth century with the development of liberal economics: the just price was replaced by the market price, determined by a free bargain between buyer and seller. In 1776, when Adam Smith published *The Wealth of Nations*,[3] only bread and fuel prices remained controlled, and these controls were removed in 1836 and 1867 respectively. Since then price controls have operated only in war-time.[4]

❑ MONOPOLY

Merkin and Williams comment[5] that the mediaeval price controls just outlined are best regarded as attempts to regulate local trading monopolies, and in addition pre-conquest custom imposed fines for profiteering. Royal monopolies were granted to individuals and guilds to encourage the development of new trades, but in later Tudor times the grant of monopoly became more a matter of political expedient than a reward for enterprise, and this led to a battle between the monarch and the courts, which like other issues involving the Royal Prerogative, was only resolved by the constitutional changes of 1688. The Bill of Rights 1689 finally established that only Parliament had the power to grant monopolies. The victory of Parliament meant that the courts had little opportunity to intervene, and until 1948 the legal control of monopolies was virtually non-existent.

❑ RESTRICTIVE AGREEMENTS

Agreements in restraint of trade have from the earliest times been controlled, originally being subject to the criminal law. The criminal jurisdiction lapsed before industrialisation, the courts preferring simply to refuse to enforce a contract in restraint of trade unless it could be positively shown to be reasonable both as between the parties and in the public interest. Originally this doctrine gave the courts power to formulate a competition policy, but with the rise of economic liberalism it became accepted that the public interest

[3] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776; reprinted R.H. Campbell & A.S. Skinner (eds), Oxford: Clarendon Press, 1976).

[4] In the 1960s the Labour Government introduced an administrative scheme in the form of the Price Commission, but it was not a success.

[5] *Op. cit.*, p.7.

merely required that the contractors adhered to their contracts, so that an agreement reasonable between the parties would automatically satisfy both limbs of the test. 'On this basis the courts upheld price fixing agreements and market division, including covenants not to compete....'[6]

This brief history demonstrates the effect of liberal economic ideas on competition policy: fairness was replaced by scarcity as the determinant of price; monopolies became virtually uncontrolled, and the doctrine of restraint of trade was effectively deprived of any economic meaning. Not surprisingly, cartels began to flourish, particularly in the 1920s and 1930s, and despite much unease governments were reluctant to intervene, again acting on the *laissez-faire* principle that intervention would inhibit growth. However, the result was not growth but recession, and the upheaval of the second world war provided the impetus for change. The 1944 White Paper on Employment Policy committed post-war governments to full employment, industrial expansion and stable prices to be achieved by preventing the artificial dampening of demand by profiteering and restrictions on output. Legislation resulted in 1948, the Monopolies and Restrictive Practices (Inquiry and Control) Act which gave the government power to investigate and control both cartels and monopolies. Notably, in addition to purely economic factors, the Act prescribed that effects on employment, export performance, the mobility of labour, and profiteering should be taken into account when determining the public interest implications of agreements and monopolies. 'While the legislation has been expanded and refined on several occasions since 1948, social and political objectives have remained as important as purely economic considerations.'[7]

The policy of the Act is now administered by three agencies, *viz:* the Monopolies and Mergers Commission (MMC), the Restrictive Practices Court (RPC) and the Office of Fair Trading (OFT), and over the years there has been a marked change in the focus of their activity. Originally cartels were seen as the major problem, but within a relatively short period the price-fixing structures had been dismantled and attention turned to market dominance and the problem of large scale mergers. The OFT has general responsibility for monitoring and initiation functions, its primary duties being to keep under review evidence of abuse of market power, to inform the government of its findings, and to initiate remedial proceedings.[8] The main task of the MMC is to investigate the existence and public interest aspects of monopoly situations, specified practices, or mergers. It can also be required to investigate the conduct of nationalised industries. It reports to the Secretary of State who decides on the

[6] *Ibid*, p.8.
[7] *Ibid*, p.11.
[8] These are (1) referring monopoly situations to the Monopolies & Mergers Commission (the decision on the outcome of the MMC's report lies with the Secretary of State); (2) referring mergers to the MMC; (3) referring horizontal agreements to the Restrictive Practices Court; (4) acting against resale price maintenance agreements either in the ordinary courts or before the RPC.

action to be taken. The RPC has jurisdiction to determine whether horizontal agreements and individual price maintenance agreements are in the public interest. The number of institutions involved, the combination of administrative and judicial procedures, and the retention of political control in some important matters has meant that UK competition law has lacked both a clear focus and consistency of implementation. This lack of clarity has now been muddied further by the establishment of separate regulatory bodies for each of the privatized utilities, adding a further five competition authorities to the three described here.[9]

Competition policy is a major concern of the European Union. Article 3(f) of the Treaty of Rome requires 'the institution of a system ensuring that competition is not distorted'; thus competition policy is an integral part of the overall economic and political structure of the Union. The policy seeks (1) to maintain a true common market across member states; and (2) to prohibit agreements and practices which divided up the market. The second element is now the more important, and 'overrides all other considerations including traditional economic efficiency arguments.'[10] Among the specific aims of EU law is the prevention of abuse of dominant position by major firms in the market.

2. From Nationalisation to Privatization

Monopoly, of course, means an absence of competition and therefore the presence of greater power than that involved in normal trading activity, and as a result monopolies generally have been subject to special controls (as outlined above) designed to prevent the abuse of market power, in particular the creation of monopoly profits. One means of control has been to take monopolies into public ownership, and this means was developed in the United Kingdom after 1945 through the nationalisation programme of the post-war Labour Government. But control of monopoly power was not the only object of the nationalisation programme, it had other clear political and ethical objectives. Nationalisation was basically a policy of social justice. Until the birth of *New Labour*, the British Labour Party had equated socialism with some form of public ownership of the means of production, reflecting two deeply held socialist convictions, *viz:* (1) that it is in some way immoral or ethically unjustifiable for private owners to make a profit out of selling resources like gas or water which exist in nature and upon which everyone depends, and (2) that capitalism is an inherently chaotic and anarchic way of organising production in society and that things could be produced and distributed more rationally if all key resources were under the control of the State. Thus the chosen method of controlling monopoly power itself involved clear political and moral choices. The

[9] There are also regulatory bodies for other industries, *e.g.* Independent Television and Radio, and the National Lottery. In 1998 two of the Regulators, Ofgas and OFFER, were merged, and in 1999 the Secretary of State for Trade and Industry announced virtual independence for the MMC. Both these developments have improved the administration of competition policy.
[10] Merkin & Williams, *op. cit.*, p.14*ff.*, where the operation of the rules is fully examined.

basis upon which these choices were made became more complex over the next three decades. Originally nationalisation aimed to secure the public ownership of the 'commanding heights' of the economy, although the way the policy was implemented showed a more pragmatic vision than that implied by the rhetoric.[11] As changing economic conditions caused problems for other major industries, for example shipbuilding, aircraft and automobile manufacture, nationalisation came to be used as a means of economic salvation. Thus when the Conservative Party came to power in 1979, nationalised industries and public corporations accounted for over 11% of the gross domestic product; they employed over 8% of the work force, and represented over 13% of the total investment in the economy. This muddying of the waters of nationalisation undoubtedly had an effect in the genesis of the subsequent privatization programme and the moral and political choices which it represented.

The immediate post-war period also brought a change in public mood; expectations increased, including that of a right to basic services. Some services were regarded as so essential that it was unacceptable to provide them on the basis of profit and individual ability to pay. This expectation was taken up by the newly nationalised industries which adopted the goal of providing a national service at a uniform charge. Health care and education were clearly among these services, but so were the basic utilities of water, gas and electricity. These utilities were not only monopolies, in some respects of their business they were natural monopolies, and this characteristic provided an extra justification for taking them into public ownership. An industry is said to be naturally monopolistic if supply by one firm involves lower costs than supply by more than one firm.[12] The characteristic which marks them out from other industrial activity is a network which it would be uneconomic to duplicate.[13] To suggest, for example, that each house and business be provided with as many water or gas pipes as there are water or gas companies operating in the market is clearly nonsense: it would be hugely expensive and a very wasteful use of resources. The very nature of the undertaking requires an element of monopoly

[11] Francis McGowan, 'Ownership, Regulation, and the Labour Party', in M. Bishop, J.A. Kay, & C. Mayer (eds), *Privatization and Economic Performance* (Oxford: OUP, 1994), p.268. McGowan says that in the pre-war period nationalisation was associated with two ideas: improving efficiency, and 'to some extent' tackling monopoly abuse; 'rather less concretely' it aimed to promote economic development and incorporate the enterprises into the planning process.
[12] Simon Cowan, 'The Water Industry in England and Wales', in Bishop, Kay & Mayer, *op. cit.*, pp.113-4.
[13] Another way of defining a natural monopoly industry is one where the economies of scale are such that production can be most efficiently organised by a single agency: Vickers & Yarrow, *Privatization and the Natural Monopolies* (London: Public Policy Centre, 1985), p.4. On this basis the distribution of gas, electricity and water are clearly included; but the manufacture of gas and the generation of electricity are not. Also clearly excluded are the maintenance, retail, research and consultancy aspects of all of them.

in its establishment.[14] Most, if not all, natural monopolies are also part of the basic infrastructure of the state: a failure in supply would be socially as well as economically disastrous. These two factors are the main reasons why these industries were nationalised. Nationalisation also imposed upon them a measure of democratic control and accountability, and, it was argued, made it possible for these particular commanding heights of the economy to be operated in the national interest, rather than in the interest of the shareholders.

Most of the nationalised enterprises were run as public corporations, a British solution to the problems of providing firms in public ownership with operational freedom whilst retaining a proper measure of public accountability.[15] Ministers appointed the board members and could control their capital spending, most external finance being obtained from the Exchequer, but on other matters, including commercial policy, Government and Parliament would have only an 'arm's length' relationship with them. In essence, they were trading companies for which the government was both the sole shareholder and the sole banker. With the profit motive removed it was hoped that the board members would act in the public interest. Herbert Morrison, the Labour minister and ideologue of the public corporation, explained the thinking thus:

> The public corporation must be no mere capitalist business, the be-all and end-all of which is profits and dividends, even though it will, quite properly, be expected to pay its way. It must have a different atmosphere at its board table from that of a shareholders' meeting: its board and its officers must regard themselves as the high custodians of the public interest. In selecting the Board, these considerations must be in the mind of the Minister.[16]

As Gerry Grimstone has observed, nationalisation was founded on a belief in the goodness of human nature: management and employees would be instilled

[14] The same is true of the railway network, though not of the operation of train services; and it used to be true of the telephone system when it relied solely on a network of land lines. Radio and satellite technology have now changed that situation and removed the element of natural monopoly from part of the telephone system. However, given the huge sums required for investment in modern telecommunications technology, it is arguable that it is uneconomic for it to be duplicated. The element of monopoly driven out of the front door re-enters by the back door. (The same could be said of the franchise arrangements for railway passenger and freight services.) The element of competition introduced into the telephone system by the establishment of Mercury Communications did not mean the duplication of the land line network as it uses the existing BT lines. Opening up the existing network to rival suppliers has also been the means of introducing competition into the gas and electricity industries.

[15] Elsewhere in Europe it has been more usual for public ownership to be achieved through Government shareholdings in commercial enterprises. The theory behind the British preference for establishing public corporations rested an the assumption that managerial matters could be distinguished from policy questions and that a successful combination of political control and managerial freedom could be achieved by reserving certain powers of decision in matters of major importance to Ministers answerable to Parliament and leaving everything else to the discretion of the public corporation acting within its legal competence. (See W.A. Robson, *Nationalised Industry and Public Ownership*, (London: George Allen & Unwin, 1960). The practice, however, turned out to be rather different from the theory.

[16] Quoted by J. Vickers & G. Yarrow, *Privatization: An Economic Analysis*, (Cambridge, Massachusetts: The MIT Press, 1988), p.127. Original source not given.

with a sense of the public good - productivity and efficiency would increase, wage demands and price increases would be moderated - and because of this the industries were given a light legal framework in which to operate. 'It was generally thought sufficient to provide for a body of honourable men to run the industries, to place some overall controls on borrowings and investment, and to require the industries to break-even taking one year with another.'[17]

It is a scarcely a matter of dispute that the reality fell far short of the hopes. The public interest almost always turned out to be the party political interest of the government, and ministers found it much more effective and convenient to exercise informal control rather than use their powers to issue formal directives.

> Politicians leaned on nationalised industry chairmen to pursue policies which were politically expedient, trade unions used their monopoly power to secure higher wages and to resist modernisation strategies, and management generally opted for the quiet life and took the path of least resistance. Removal of the need to make profits and of the threat of possible bankruptcy in the event of failure resulted in an absence of effective incentives for those who ran these industries, and the principle of 'arm's-length regulation' meant in practice that ministers were vague about setting and enforcing targets.... Pricing policies were chaotic, often with seriously deleterious effects for consumers.... Nationalised industry boards proved in practice to be largely unaccountable either to Parliament or to their customers, with the result that the industries were generally run inefficiently and with mounting and staggering levels of losses.[18]

From almost every point of view the performance of the nationalised industries was unsatisfactory. They were making large claims on the Exchequer for capital finance and to cover their operating losses, efficiency checks were few and ineffective, their managements felt constrained and complained of too much *ad hoc* interference, accountability was muddled, and productivity was low with a consequent adverse effect on the UK economy and its capacity to compete in world markets.[19] Vickers and Yarrow have shown[20] that between 1968 and 1978 productivity in UK manufacturing rose by an average of 1.7% per year, but the state-owned industries performed far less well. In the electricity industry productivity rose by only 0.7%; in steel it fell by 2.5%; and in coal it

[17] G.Grimstone, 'The British Privatization Programme', in *Privatisation and Deregulation in Canada and Britain*, J. Richardson (ed) (Aldershot: Dartmouth, 1990), p.4.
[18] P.R. Saunders & C. Harris, *Privatization and Popular Capitalism* (Buckingham: Open University Press, 1994), p.9.
[19] See Estrin & Whitehead's Introduction to *Privatization and the Nationalised Industries*, (S. Estrin & C. Whitehead, eds.), (1988, London School of Economics, ST/ICERD Occasional Paper No 13.), p.4.
[20] Vickers & Yarrow, *op. cit.* chapter 5. See also Saunders & Harris, *op. cit.*, p.9, and the authorities there cited.

fell by 4.4%. Overall they achieved a rate of return on capital of minus 0.86%.[21]

The widespread complaints about standards of service are a matter of common knowledge, and contributed to the general feeling that these commanding heights of the economy were being operated neither in the national interest nor for the benefit of their customers but in the interests of those who worked in them. Again the figures bear this out: in 1980 90% of all employees in the nationalised industries were members of trade unions compared with 75% of white-collar workers and 30% of manual workers in the private sector. This industrial muscle was used to resist the restructuring of work practices and to achieve pay awards well above those merited by increased productivity. Attempts to raise efficiency were unsuccessful because the overall system of accountability and control left the way clear for the displacement of economic efficiency objectives by managerial and political goals, and, not surprisingly, managers and politicians took full advantage of the discretion that was allowed them.'[22] After the oil crisis of 1973 the principle of 'arm's-length' control was abandoned as the Conservative Government took more direct control of the nationalised industries as part of its new industrial strategy.[23]

In 1976 the National Economic Development Office reported that there was no longer any proper framework for nationalised industries to make long-term decisions and there was no effective system for monitoring their performance. The response was to impose a financial target for each industry of a 5% real rate of return on all its investments, leaving the board free to pursue its own investment and pricing policies. Within a month the Government had breached this new arrangement by imposing a freeze on electricity prices. Political intervention also forced commercially disastrous decisions on the industries, for example the insistence that the Central Electricity Generating Board (CEGB) buy British coal even though cheaper supplies were available on the world markets.[24] The result was, even on the left of the Labour Party,[25] a widespread

[21] After examining the financial record Vickers & Yarrow conclude that low rates of return are not the result of pursuing allocative efficiency objectives, *e.g.* trying to match prices to marginal social costs, but are the result of 'some combination of over-investment and internal inefficiency, phenomena which have resulted from deficiencies in the overall framework of control.' *Op. cit.* p.147.

[22] Vickers & Yarrow, *op. cit.* p.133. Thus the 1967 White Paper, *Nationalised Industries: A Review of Economic and Financial Objectives*, set coherent economic and financial targets for the industries, but failed (1) to put in place a an adequate structure of incentives to encourage managers to act in accordance with these targets, and (2) to address the problem of informal control by ministers. Vickers & Yarrow describe the result as '*recommendation without regulation* in which, because of divergences between efficiency goals and short-run political objectives, the recommendation itself lacked credibility.' *Ibid.*

[23] The problems are illustrated by Catherine Price, 'Gas Regulation and Competition: Substitutes or Complements? in Bishop, Kay & Mayer (eds), *op.cit.*, pp.136-145.

[24] *Ibid*, pp.10-11. While it may have been economically disastrous to insist on the purchase of British coal, it would have been socially disastrous not to have done so - an example of the discrepancy between the economic model and the underlying social model pointed out by Nankivell: see p.23 below.

[25] See Francis McGowan *op. cit.*, p.285: 'Morrisonian nationalisation was regarded as over-centralized, inflexible, and unresponsive to consumer preferences.'

disillusionment with the existing system of public ownership. As Saunders and Harris observe, gradually the implications of this sorry history began to surface in political debate and argument. Rather than continue the vain attempt to make the nationalised industries operate like private sector firms by subjecting them to surrogate market forces, why not do the logical thing and turn them into actual private firms?[26]

This was originally too radical even for the Conservative Party, and John Redwood, who later emerged as a leader of the party's Right wing, in 1980 argued simply for improving performance through better controls.[27] Strict financial targets were rigorously imposed, and the two main nationalised corporations earmarked for return to the private sector, British Aerospace and British Shipbuilders, were 'ordinary' companies operating in competitive industries which had been nationalised by the previous Labour administration to save them from commercial collapse.[28] The free market philosophy of the new government did not sit easily with such philanthropic motives. During the first period of Conservative government a series of other sales followed, but they raised less than 4% of the amount collected during its next two terms of office between 1983 and 1992. The sale which changed both the pace and the philosophy of the privatization programme was that of British Telecom (BT) in 1984.

3. The Genesis of Popular Capitalism

In retrospect the sale of BT is generally seen as the watershed in the development of the privatization programme. Gerry Grimstone has described it as marking 'the emergence of popular capitalism in the UK.'[29] However, it was the pressing need to raise the huge sum of money required for investment in new telecommunications technology without increasing the PSBR rather than a desire to create a culture of popular capitalism which lay behind the decision to privatize BT. It was risky venture - the previous biggest sale had been that of half of Britoil for just over £500 millions when three-quarters of the shares had been left in the hands of the underwriters - but it succeeded beyond all

[26] *Ibid*, p.11.

[27] John Redwood, *Public Enterprise in Crisis* (Oxford: Blackwell ,1980). He described the 'overall intention' of his proposals as not to bring about a shift in the balance of ownership 'since ownership is not the most important question at issue. The intention is to find ways of stimulating greater factor productivity.' (p.31.) *Inter alia*, Redwood proposed the elements of natural monopoly, *e.g.* the gas pipeline system and the national grid, remain under the control of a central [public] authority (he specifically mentions need for the continued existence of the CEGB), with competition introduced into gas and electricity supply through rights of common carriage. He believed that much could be achieved by giving the nationalised industries greater financial independence, especially in setting rates of pay, and setting clearer political objectives. He concluded by saying that his proposals were less problematic than de-nationalisation. (p.203.)

[28] British Aerospace was denationalised in 1981 with the sale of 51% of its shares on the Stock Exchange (the remaining 49% were sold in 1985); the sale of British Shipbuilders was postponed until 1985, and was only achieved through a series of trade sales and management buyouts.

[29] G. Grimstone, 'The Financial Processes of Privatization' in V. Ramanadham (ed.) *Privatisation in the UK* (London: Routledge, 1988), p.33.

expectations, the offer of shares being 9.7 times oversubscribed. On the first day of trading in the new shares sellers made a profit of 33% on the fully-paid price. Saunders and Harris comment: 'Everybody, not least the Government was taken aback by the enormous popularity and enthusiasm which the sale had provoked. As a result of this one privatization, the number of shareholders in Britain had been swollen to over 3 million. Inevitably it was not long before ministers got around to increasing it still further.'[30] In the following year British Gas was sold (preceded by a massive advertising campaign, including the 'tell Sid' television commercials) with twice the number of applications for shares as for the BT sale, and with good profits on the first day of trading in the shares. The success of the British Gas sale led to a steady stream of privatizations as the 'family silver' was progressively sold off; popular capitalism had found its bandwagon.

It may sound pejorative, but it is not inaccurate, to describe the later privatization programme as something of a crusade. This seems to have resulted from the change in the basic motivation from economic to political considerations. The Conservative Government never gave a definitive list of the policy objectives of the programme, and piecing them together from ministerial statements, speeches and White Papers, analysts have arrived at different lists, to some extent coloured by their own political viewpoints. A relatively detached view is that of Christopher Johnson, who gives seven objectives:

1. to reduce the role of the state in the economy and restore powers of decision to the individual;
2. to implement the ideal of the property-owning democracy, partly as a way of increasing political support for the Conservative Party as the champion of private ownership;
3. to improve productive efficiency by promoting better management of public assets, whether in industry or in housing;
4. to introduce allocative efficiency by substituting competitive free-market pricing for administered prices and controlled rents;
5. to finance the PSBR and at the same time to remove claims on it arising from public corporation deficits or investment programmes;
6. to promote wider share ownership so as to spread wealth and subject company management to more democratic control;
7. to encourage employee share ownership so as to bring about better industrial relations.[31]

[30] *Op. cit.*, p.15.

[31] Christopher Johnson, *The Economy Under Mrs Thatcher 1979-1990* (London: Penguin, 1991), p.145.

The mixture of motives is apparent from this list and is echoed by those of other analysts;[32] as Veljanowski comments, 'privatization did not start from a coherent set of objectives. It was an idea stirred by the Conservative Party's traditional support of private property and a growing disillusionment with the performance of the nationalised industries.'[33] However, all lists include reducing the level of public sector borrowing, increasing efficiency, and widening the level of share ownership among the major objectives. As the programme developed the relative importance of these three 'cardinal virtues' changed. As has been noted in relation to the privatization of BT, the chief motive in the early years was the need to reduce the PSBR together with increasing efficiency through introducing competition. Not only was the monopoly of BT broken by licensing Mercury Communications to provide a rival telecommunications service, but compulsory tendering and contracting-out was introduced into local government, and the National Health Service was re-organised to incorporate an internal market. John Moore, the first minister to have responsibility for the privatization programme, made it clear in a speech in 1983 that the state industries were being privatized to force them to become more efficient by having to compete in the private sector:

> The long-term success of the privatization programme will stand or fall by the extent to which it maximises competition. If competition cannot be achieved, an historic opportunity will have been lost.[34]

Moore's 'historic opportunity' faced a crucial test with the privatization of British Gas: would it be sold as a single unit or as a number of separate companies? Any serious attempt to foster competition would have meant following the latter course, but that was not done. British Gas was sold intact as a monopoly, and a new regulatory agency, Ofgas,[35] was set up to monitor its pricing policies to ensure that it did not abuse its monopoly position. While the electricity industry was broken up prior to being sold, the regional electricity companies were not in competition with each other, and electricity generation was changed only from a monopoly to a duopoly, hardly a dynamic competitive arrangement, and competition in water supply and in sewage and other services was not even attempted.

[32] Grimstone gives six points ; increasing efficiency; raising finance; encouraging employee shareholding; boosting the general level of share ownership; strengthening the capital market; gaining domestic and international prestige. Vickers & Yarrow list seven points: improving efficiency; reducing the PSBR; increasing managerial freedom; easing problems in public sector pay determination; widening share ownership; encouraging employee share ownership; gaining political advantage. Their fourth and seventh points are worth noting; the last they describe as implicit, but none-the-less real.

[33] Cento Veljanowski, *Selling The State* (London: Weidenfelt & Nicholson, 1987), p.7.

[34] John Moore, *Why Privatize?* (London: Conservative Political Centre, 1983), p.13.

[35] Office of the Director General of Gas Supply. The regulators are described in the White Papers as 'autonomous government departments.' (*Q*: When is the government not the government? *A*: When it is a regulator.) The later introduction of competition into gas supply does not alter the argument developed above which is to do with the Government's objectives at the time.

The reasons for this change of tack seem to a large extent to be matters of political expediency, and the government adjusted its dogma in line with the political realities.[36] In 1986 John Moore declared that 'Privatization increases productive efficiency whether or not a monopoly is involved.'[37] There is some truth in this because private companies must compete for finance in the capital market, and their ability to attract funds depends upon their performance. However, the general consensus is that the decisive factor in improving efficiency is competition rather than ownership. The privatized firms operating in a competitive market have shown the most impressive gains in productivity; the evidence that monopolistic firms have performed more efficiently since they have been privatized is much less clear cut.[38] The change of tack is best explained by a change in priorities in the Government's objectives for the programme, a change from basically economic considerations to aims more political and sociological: building popular capitalism had displaced improving economic efficiency.[39]

The Conservative Party manifesto for the 1987 election signalled a new agenda for privatization, promising to privatize more industries in order to bring about a 'historic transformation' of British society in which share ownership 'would become the expectation of the many.' The new agenda for privatization was remarked on by the *Financial Times*:

> The programme began as a halting ill-defined attempt to realise easily saleable assets, the receipts from which could be written off against public spending and cut the public sector borrowing requirement. It grew into...what the government hopes will be one its most enduring contributions to British society, that is the rebirth, or some would say birth, of popular capitalism in the UK. *(5.11.1988)*

John Moore also spelled out the new vision, describing the Government's aim 'to build upon our property-owning democracy and to establish a people's capital market, to bring capitalism to the place of work, to the high street, and even to the home.'[40] The pursuit of this new vision was fundamentally a venture of faith with a strongly moral edge. Unlike the other aims of the programme, *e.g.* improving efficiency and reducing the PSBR, there had been no prior research programme to support it, and indeed none since to discover

[36] *E.g.* the trenchant opposition to dismembering British Gas by the then Chairman, Sir Dennis Rooke, and the need simply to maintain the momentum of the programme.

[37] J. Moore, 'The Success of Privatization' in J.A. Kay, C. Mayer & D. Thompson (eds.) *Privatisation and Regulation: the UK Experience* (Oxford: Clarendon Press, 1986), p.95.

[38] See Saunders & Harris, *op. cit.*, p.22 and the sources there cited, and the discussion of Vickers & Yarrow's work in ch.V, below.

[39] This conclusion is reinforced by the argument of Vickers & Yarrow that privatization was not essential to achieve the three cardinal aims of the privatization programme (improving efficiency, reducing the PSBR, and extending share ownership); all three could have been achieved in other ways. *Op. cit.*, pp.158-60.

[40] Quoted by Aharoni, 'The United Kingdom: Transforming Attitudes' in R Vernon (ed.) *The Promise of Privatization* (New York: Council on Foreign Relations, 1988), p.41.

whether in fact attitudes had changed.[41] As has been observed, 'the crucial link between ownership of shares and changed attitudes and behaviour' was "simply assumed", yet it rests on an extremely crude materialist premise which few sociologists would uncritically endorse...'[42]

Popular capitalism is, maybe, the best practical expression of Lady Thatcher's moral crusade: 'Economics is the method; the aim is to change the soul.'[43] As a political programme it had four basic elements:

1. The creation of industries which are more consumer oriented: the nationalised industries were thought to be too influenced by the interests of management and employees;
2. Breaking down the class-based divisions between management and workers: in the privatized utilities both groups would be shareholders;
3. Destroying the 'worm of socialism': increasing the financial stake that ordinary people have in private enterprise would weaken the appeal of collective ideologies;
4. Improving the popular understanding of the capitalist system: the ambivalence towards profit in British culture would be transformed as people saw the value of their shares increase.

Popular capitalism was intended to bring about a cultural revolution. As Thomas Sharpe has observed there is in Britain a long tradition unsympathetic to competition, deriving from the structure of English social life as a series of close groups.[44] Popular capitalism challenged this inherited structure, and by creating a property-owning democracy it was designed to have a significant effect on attitudes: 'By enabling people to share in the success and failures of the economy more directly it [would] foster a nation of entrepreneurs and wealth creators.'[45] Clearly privatization had an express moral purpose.

❑ SUMMARY

The privatization programme had three phases: the first from 1979 to 1984, saw the sale of enterprises operating in competitive markets; few new shareholders were enlisted, and the purpose of the sales was essentially to

[41] The election of the Labour Party in 1997 suggests that at best the programme had only been partially successful in changing the hearts and minds of the people. While New Labour took over some of the market rhetoric and did not promise to reverse the privatization programme, the fact that they were elected at all indicates that the vision offered by the left remained attractive.

[42] Saunders & Harris, *op. cit.*, p.27.

[43] This remark is often quoted, but I have been unable to trace its source.

[44] Thomas Sharpe, 'British Competition Policy in Perspective', *Oxford Review of Economic Policy*, Vol 1 (1985), p.81. Sharpe quotes the view of M. Keller: 'The traditional structure of English life seemed to foster catelisation: combination has been accepted without regulation in England because the entire English social system is a series of close groups.... English society is stratified and cellular.' M. Keller in T. McCraw (ed), *Regulation in Perspective* (Cambridge: CUP, 1981).

[45] Cento Veljanovski, *op. cit.*, p.106.

raise revenue to reduce the PSBR. The sums raised, however, were relatively small. The second phase, 1985 - 1988, saw the sale of large and often monopolistic enterprises; the number of new shareholders was very considerable. Huge sums were raised. This continued to be a main purpose of the programme, but a new purpose began to emerge, namely the creation of a culture of popular capitalism, and the concern to foster increased competition was 'quietly forgotten.'[46] The third phase from 1989 onwards saw the sale of industries which ten years earlier nobody would have thought of privatizing: water, electricity, coal, and the railways; plans to sell the Post Office were even drawn up. Privatization had become 'almost an end in itself, a self-evident good that was pursued even against widespread public opposition and which was applied even to the most basic and traditional of state services....the momentum which had been built up proved unstoppable.'[47]

4. The Politics of the New Right

An important influence underlying the privatization programme was the marked move to the right in Conservative politics after 1979. The move characterised conservative thinking in both the United Kingdom and the United States of America, and followed the collapse of the post war consensus on economic management. The new thinking was presented as a new radicalism, hence the epithet 'New Right', and brought together a disparate coalition of libertarian, liberal and conservative political and economic philosophers and groups. At one level the movement reflects the new monetarist ideas in economic management, but at a deeper level it reflects much more fundamental convictions about the way human society should be organised. The connection with economic theory is significant, a reminder that today so much else follows from economic judgements, including the framework of values which govern modern life. As Jane Collier has said, our modern culture is *economic* culture: 'The language of economics is the language through which the world is understood, the language by which human and social problems are defined and by which solutions to those problems are expressed.'[48] Economic theory validates value judgements, and one of the reasons for the rise of monetarism was that it provided an economic validation for the views of the New Right. The privatization programme was inspired by these views, and it is appropriate to examine them briefly.

The economic arguments are examined more fully in chapter V, but it is helpful to give their broad outline now. From the end of the second world war until the mid 1970s the dominant ideas in economics were those of John Maynard Keynes. Responding to the persistent high unemployment of the 1930s, Keynes offered a new analysis which gave governments responsibility for

[46] *Ibid* p.17.
[47] *Ibid* p.19.
[48] Contemporary Culture and the Role of Economics', in Montefiori (ed), *The Gospel and Contemporary Culture* (London: Mowbray, 1992), p.103. (Emphasis added.)

managing the economy with the object of securing full employment. The chief means of doing this was to increase the level of demand, for example by public investment in major projects. Initially, Keynes' ideas worked well, but in time persistent high inflation set in, and during the 1970s the post-war consensus about how to manage the economy began to break down. The new ideas in economic management which gained ground rejected the idea of a managed economy and gave prominence not only to monetary policy, but also to the free operation of market forces and the private provision of welfare needs. This was a return to classical liberal economics which, ironically, had been found wanting in the first decades of this century. Adopting the theories of Milton Friedman, the New Right contended that growth in prosperity had been hampered by distortions introduced into the market by Government intervention and the activities of powerful groups like trade unions. By eliminating, or at any rate reducing, these distortions, the market would be able to operate more freely and more efficiently. The New Right also rehabilitated the classical view that the market is an automatic mechanism, impartial in its operation between different interests and moral claims. Thus in place of the managed economy, depending for its effective operation on man-made discretionary judgements, the New Right offered a return to the seductive idea of a free economy working according to the operation of natural laws. It is one of the achievements of the New Right that this idea gained wide acceptance despite the major question whether any mechanism which is driven by ordinary human desires can be impartial in its operation. Closer examination suggests that New Right ideas, far from being impartial, seek to replace certain collective values which were part of the post-war consensus, with more individualistic values.

The New Right's progenitor is the classical liberalism of the 18th and 19th centuries. 'Strict liberalism', as it is called by Anthony de Jasay,[49] seeks to return to its original principles: limited government, the free market, the limitation of human rights to traditional civil and political rights, freedom of contract, and above all the sanctity of private property. As this list suggests, strict liberalism is associated with a thoroughgoing individualism; it believes that people should be left to make their own choices in life, and that collective provision should be limited to providing only those goods which people cannot provide for themselves, e.g. defence, sound money, and the administration of justice. Indeed, strict liberalism does not really have a concept of the state; the liberal perception is that the highest political good is the peaceful enjoyment of one's own prosperity and the free pursuit of one's own ends. The political process is regarded as having only a limited usefulness.

Maximisation of choice is the essence of liberalism, and freedom is its primary value. F.A. Hayek defined freedom quite simply as the absence of coercion. It

[49] Anthony de Jasay, *Choice, Contract, Consent* (London: Institute of Economic Affairs/Hobart 1991).

is thus seen as a negative concept, the invariable way liberals formulate rights; the crucial element is, therefore, the definition of coercion. Hayek defined coercion as 'such control of the environment or circumstances of a person by another that, in order to avoid a greater evil, he is forced to act not according to a coherent plan of his own but to serve the ends of another.'[50] Coercion, or the absence of freedom, only exists through the *intentional* act of another person. Liberals do not see freedom curtailed when a person's capacity to act is constrained by impersonal forces like the market, or when the range of options open to him is reduced by poverty, lack of education, social position or physical disability. As Stephen Newman points out, 'all that this conception of freedom requires is that one be allowed to act for a purpose of one's own choosing; whether one achieves one's goal, or even has a selection of realisable goals from which to choose, is irrelevant from the standpoint of liberty.'[51] This conception of freedom is opposed to measures designed to remove inequalities from society because such measures, especially redistributive taxation, would amount to coercion. Inequality is accepted, indeed required, as a necessary condition for the operation of the market, because inequality produces the incentive to innovate, and the market thrives on innovation and competition. In New Right thinking it is inevitable and acceptable that rewards should be distributed unequally; but it is also believed that through the market everyone will become better off, though by no means all at the same time, nor to the same extent. The gap between rich and poor is thus justified by the fact that the poorest are better off in a free market system, where they benefit from all the improvements in the quality of life that it makes possible, than they would be in a planned economy.[52]

Strict liberalism is markedly anti-egalitarian. It believes that the present range of welfare services and benefits would be better provided through the market. The welfare state is opposed not only because it limits the operation of the market but also because the level of state intervention reduces individual freedom and encourages dependence. Accordingly the New Right denies the validity of the concept of social justice. Hayek maintained it was meaningless because of the difficulty of establishing standards by which such judgments can be made. A free society, he argued, does not generate a consensus about what is a fair distribution of wealth and property. Freedom for the New Right is essentially market freedom; and because the market is an impartial mechanism, it does not generate unjust outcomes.

The liberal view of freedom as market freedom leads inevitably to a conception of justice based on the procedures for distribution rather than on the

[50] *The Constitution of Liberty* (London: Routledge, 1960), p.20.
[51] Stephen Newman, *Liberalism at Wits' End* (Ithaca, New York: Cornell University Press, 1984), p.129, quoted by D.S.King, *The New Right: Politics, Markets and Citizenship* (Macmillan; 1987), p.31.
[52] The so-called 'trickle down' theory held that the increase in wealth of the rich would trickle down to the poor. Events have shown the theory to be no more than wishful thinking.

consequences of that distribution. It has no conception of justice as equality. 'Entitlement to what is produced stems from property rights in labour or capital and factors of production.'[53] The New Right would not accept, therefore, the view of Pope John XXIII: 'Our predecessors have time and again insisted on the social function inherent in the right of private ownership, for it cannot be denied that in the plan of the creator all of this world's goods are primarily intended for the support of the whole human race.'[54] Central to liberal thought is the proposition that welfare is not owed to individuals as a matter of justice. Government may be said to have a duty to relieve obvious cases of indigency, but the discharge of that duty will depend on particular circumstances: no person has a universal claim to welfare benefits in the way that he has such a claim to free speech or equality before the law. This concept of justice allows the inequality to exist which is essential to the proper operation of the market; it has nothing to do with the imposition of any kind of 'end-state' on a spontaneously developing process.[55]

The liberal emphasis on liberty, understood as freedom from constraint, meant in economic terms, as noted above, sweeping away anything which operated as a restraint on trade. Liberals assumed that most people agreed on the ends of prosperity and liberty, and therefore free market morality developed in a way that enabled these ends to be maximised. It was inevitable that these moral values supported the interests of those able to operate most effectively in the market, and obstructed the interests of those who were not. Those who argue that the processes by which wealth is created and distributed operate in a mechanically impartial way generally do so because they are the principal beneficiaries of the system. There can scarcely be an elite in history that has not defended the status quo as part of the natural order. To the New Right liberal economics appears impartial because it does not threaten their values; the result is a certain moral blindness. For example the New Right is very aware of the way Trade Unions can distort the market, but it seems blind to the distortions caused by the power of monopoly suppliers and multi-national corporations. In much the same way it does not notice that the classical assumption about equal access to the market simply does not reflect how things are in the real world. The worker is generally in a weak position, and consumers are often powerless in the face of price-fixing cartels and the manipulation of the market by advertising and planned obsolescence. It is also true that in a free market goods will not be produced unless it is profitable to do so. This means, argues Alan Suggate, that 'the weighting of the market is towards the production of consumer goods for private consumption by the affluent. In the meantime, the more basic requirements may well not be

[53] Collier, *op. cit.*, p.118.
[54] Pope John XXIII, *Mater et Magistra*, para 11. This point is developed further in chapter III.
[55] N.P. Barry, *The New Right* (London: Croom Helm; 1987), p.82.

satisfied, because the impoverished cannot constitute a market.'[56]

The New Right influence on the privatization programme is clear, particularly in its aims of reducing the role of the state, establishing a property-owning democracy, substituting free-market pricing for administered pricing, destroying the 'worm of socialism', and improving the understanding of capitalism. It also challenged the received wisdom of the post-war years that the machinery of economic life could no longer be viewed as self-regulating.[57]

5. Privatization as an Ethical Issue

All of the aims of the privatization programme given by Christopher Johnson and others represent political choices about managing the economy; but a political choice is no less a moral choice, even if we prefer to describe it otherwise.[58] The moral element is clear in wishing to change the balance of power between the state and the individual in order to bring about a 'property owning democracy'; there is no *a priori* criterion by which such a choice can be made except that of the sort of society one believes most suited to produce human flourishing. (And, of course, to identify human flourishing as the goal of political action is itself to make a moral choice about the object of political association which is logically prior to politics.) But moral choice is no less involved in preferring 'competitive free-market pricing' or in devising new methods of financing the government's debt, because these objectives are also related to the goal of promoting human flourishing, or whatever the chosen goal may be. It is, I believe, axiomatic that both political and economic choices imply more fundamental moral choices, often assumed and unarticulated. For the most part these more fundamental moral choices do not trouble us; they intrude only when the choices are controversial.

Much of the privatization programme was uncontroversial, involving the return to the private sector of companies which had only been nationalised as a means of saving them from bankruptcy, as with the aircraft and shipbuilding industries, or where the reasons for nationalisation had been more Party political than economic, as with the steel industry. Controversy arose with the proposal to privatize the utilities, huge industries providing essential services, immune from normal competitive pressure, and in important respects natural monopolies. Here five particular ethical issues arise:

❖ *THE PROPER ROLE OF THE STATE*

Privatization means essentially a change of ownership; public assets are sold into private control, and the idea that the state has a role to play in the

[56] Alan Suggate, 'The New Right', *Crucible*, Oct-Dec 1988, p. 154. See also King, *op. cit.*, p.33, and Plant, *Equality, Markets and the State*, (Fabian Society, Tract No.494;1984), p.4.
[57] See *e.g.* J. Philip Wogaman, *Christians and the Great Economic Debate* (London: SCM Press, 1977), p.3.
[58] The terms moral and ethical are used interchangeably in this study.

economy as a participant in industrial enterprise is rejected. Transferring assets out of public ownership has also meant giving more scope to market forces in deciding the allocation of economic resources. Does this mean that the state has no role in, say, ensuring security of supply or in the rate of depletion of natural resources like coal or gas? Does it also mean that the state has no role in setting social objectives for these industries, despite the fact that they are, literally in the case of water, essential to life? Can the New Right view of the limited state be maintained in today's complex society?

❖ *CONTROLLING THE ABUSE OF POWER*

Privatization also aims at liberalisation - opening up the utilities to competition, but in some respects they are natural monopolies, and here competitive forces simply do not exist. Is it right to establish private monopolies? And how are they to be prevented from abusing their market position? In particular, is it right that in the case of the water industry public regulatory powers should be given to a private monopoly outside the system of democratic control?

❖ *INCENTIVES*

Privatization allows private sector management practices to determine the way the utilities are run, and will expose them to the normal disciplines of the capital market. Economic efficiency, profitability, and financial incentives for management and employees displace public service as the motivating force. What effect will this have on prices and investment and on the provision of services for the poor and vulnerable, whose needs might be more expensive to meet than those of other customers?

❖ *STEWARDSHIP*

All three utilities involve the exploitation of natural resources, and in the case of water the ownership of large areas of land which form part of the national heritage, and over which the public have enjoyed rights of access. Will the transference to private ownership mean that these assets will be exploited simply for private gain? All three utilities have a substantial impact on the environment: Will there be a proper concern for environmental protection, for example in the control of pollution caused by electricity generation and sewerage discharge?

❖ *WHO BENEFITS?*

Privatization creates shareholders who will expect at least a reasonable return on their investment. Will this mean that the interests of the shareholders will take precedence over those of the customers and, indeed, that of the environment? Who will really benefit from privatization?

These five issues underlie the deep-seated feeling that it is, quite simply, wrong to create private monopolies out of utilities providing essential public services. And maybe part of this deep-seated feeling is that this part of the privatization programme went beyond the area where people generally feel that economic considerations are dominant to one which affects deeper social considerations about the sort of society we live in. Important moral questions are involved not only when deciding how to use the capital receipts from the sales, for example, but also in determining the boundary between public and private enterprise, the proper stewardship of natural resources, and whether competition or co-operation should be the basic motivation of human society. In contrast to former times, in the privatization debate these questions have not been argued out as the *a priori* choices upon which economic decisions should be made; rather, the tendency has been to put the cart before the horse and to allow economic doctrine to determine basic moral and political questions. Owen Nankivell has argued this point persuasively.[59] Identifying the drive for more and more material goods as the pre-occupying concern for economic activity in western culture, he argues that it has justified 'acceptance of ways of doing things, of particular lifestyles, which, *prima facie*, conflict with logic or a sensible view of wider social goals. It leads to an acceptance of value systems which dictate action, or impose subservience, in a way that conflicts with wider perceptions of social behaviour.'[60] The value system is one of the 'heavy structures' of society (so called because they are slow to change), and at times of great technological change these structures are subject to attack, which, whilst emanating principally from economic causes, will instigate and set in train similar forces in the wider social context. 'Where it does so,' Nankivell says, 'an issue of the relative importance of the economic and social models is intensely raised. Which is the dominant model? The narrow economic model or the wider social model? Logic says the latter but experience suggests the former.'[61] Today economic arguments are used as a surrogate in a much more fundamental social and moral argument, and because they are used in this way by politicians to argue ideological points, economic arguments have acquired much more importance than they deserve. This essentially is the context for the ethical analysis presented by this study. As Nankivell puts it:

> Society as a whole provides an over-arching context in which to set economic activity. If the consequences of the latter or the practice of particular values in the latter, conflict with wider social aspirations it is clear which should yield. The plea 'it's not fair' has to be heard and addressed against wider values than simply those supporting and serving the economic model.... Nevertheless, the presumption in western market capitalism appears to be that the economic model, to

[59] Owen Nankivell, *Economics, Society and Values* (Aldershot: Avebury, Ashgate Publishing, 1995).
[60] *Ibid*, p.73.
[61] *Ibid*, p.75.

a large extent, drives and dominates peoples' lives to the point where the logic that says that society will offer protection through the application of wider values, has to be abandoned.[62]

An important element, one might even say the bedrock, of the more fundamental social model are the predominant religious ideas about the nature of human society and what binds it together. The basic questions which confront men and women - Where did we come from? Where are we going? How can we know what is right? How are we to live together in peace? - are *religious* questions. All the major religions answer them and provide a system of social ethics. In this so-called post-Christian age it is easy to overlook the formative influence of Christian doctrine and ethics on our social institutions. Even so, the Christian ideas remain in the background, sometimes as an unarticulated ideal, sometimes more explicitly, but in either case offering a reference point against which to measure the effectiveness of social ideas, behaviour and institutions. The Church is, of course, as part of its prophetic role, concerned to set the challenge of the faith before the world, and since the Industrial Revolution has done this consistently in matters of economic and social policy. This is examined in chapters II and III, but it is helpful at the outset to identify the kind of questions which Christian ethics raises for the policy privatizing the natural monopolies. A useful context is provided by the six tensions within which J. Philip Wogaman presents his historical account of Christian ethics:[63]

> *Revelation v. Reason*: Is the basis of moral judgements a special revelation given to those within the community of faith, or the knowledge available to any person of intelligence reflecting on common human experience?
>
> *Materialism v. The Life of the Spirit*: Is God to be known and worshipped primarily through his material creation, or through interior spiritual experience?
>
> *Universalism v. Group Identity*: Is salvation available to all people, or just to the members of a particular group?
>
> *Grace v. Law*: Is the righteous life -the life that is pleasing to God, achieved by a strict adherence to the moral law, or by believing in the free gift of God's redeeming love?
>
> *Love v. Force*: Is it permissible to achieve moral and social objectives by the use of coercive power, or only by the power of love?

[62] *Loc. cit.*

[63] J. Philip Wogaman, *Christian Ethics: A Historical Introduction*, (London: SPCK, 1994), ch. 1.

Status v. Equality: Is the righteous outcome of a moral system social and economic equality, or are differences in wealth and position acceptable?

Three of these tensions focus the moral concerns of this study:

❖ *VALUE & TRUTH*

Economists have striven to have their discipline accepted as an objective science, maintaining that its truths are discernible by objective analysis of 'the way things are', and must be accepted, therefore, as part of the natural order. This is to elevate reason over revelation as the source of truth; indeed for many economists the idea that there may be 'given' values that an economic system should reflect would be regarded as an atavistic irruption from a pre-scientific age. On the other hand economics is also a human science drawing its conclusions from the study of human choices, which in turn reflect human motivations, and it is clear that these motivations are determined by 'given' values as much as by rational calculation. It is precisely this conflict about the source of value and truth which is encapsulated in the first tension.

❖ *EXPLOITATION & CONSERVATION*

Privatizing the natural monopolies raises questions about the use and reverence of the material world and the natural resources which Christians see as God-given. There are issues here not only about stewardship and ecological concern, but also about the nature of the land and worship which the second tension reflects.

❖ *INDIVIDUAL & COMMUNITY*

Privatizing the gas, water and electricity industries means the use of private capital to finance utilities providing basic services which have an inescapably public character because they are part of the infrastructure of the nation and affect the life of everyone. This raises questions about the distinction between both public and private property and public and private enterprise which derive from our understanding of the interests towards which economic activity is directed: the individual or the communal? While there is an issue here about the use of wealth,[64] the more basic questions are: Whether a 'public' monopoly should be a means of private enrichment, *viz.* should the profits of such a monopoly go to shareholders or to the public purse? And whether the administration of the utilities should be directed towards correcting social inequality? These concerns are reflected in the sixth tension.[65]

[64] There are two basic questions: (1) the basic moral or spiritual attitude of the rich towards their wealth, *e.g.* Is there an element of trust involved in the possession of wealth? and (2) assuming the Biblical injunction that the wealthy should help the poor, how precisely is that help to be given?

[65] The privatized utilities are also subject to regulation which controls the way they use both their power and their profits. There is here an echo of the fifth tension.

Privatization is not just a political or economic matter, it is also an ethical matter - precisely because it raises basic questions about fundamental issues: What is the source of value? To whom, or what, are we accountable? How shall we live together? These are religious questions *par excellence*, and within the privatization debate they are part of the wider debate about the relation of economics to ethics.

II

Christian Ethics and Economic Life

The ethics of privatization are influenced not only by the political and economic ideas discussed in chapter I, but also by religious and moral ideas about the nature of human society and the forces which bind it together. Of course these two contexts are connected through a single symbiosis, but religious and moral ideas have their own distinctive roots, and they need to be examined in order to establish some Christian criteria for assessing the five ethical issues of the privatization programme identified for discussion. This chapter considers the Biblical foundations of Christian social ethics and their development from the Early Church to the end of the nineteenth century, and four criteria are suggested. Chapter III discusses the Church's modern social teaching beginning with the Papal Encyclical *Rerum Novarum* in 1891.

1. The Bible and Ethics

'Bringing Christian insights to bear on the ongoing issues in the modern world, not least in the economic order, is not easy.'[1] Ronald Preston's caution arises, in part, out of the difficulties of using the Bible as a source of social ethics. The context of its writings and of the social and economic institutions they describe, is so far removed from our own day that it is impossible to move simply from the one to the other. There is the further problem that religious and moral thought, like economic and political thought, is shaped by social conditions and thus changes through the ages. It is, therefore, difficult, and may be impermissible, to make direct applications of the thinking of the agrarian, peasant society of the Bible and the earlier years of the Christian era to the conditions of the modern technological age.[2] That said, it also has to be acknowledged that basic human needs and aspirations remain much the same from age to age, and so, therefore, do the tensions implicit in social thought. The six tensions identified by Wogaman have already been listed. Whilst they are ultimately unresolvable - because they lie at the heart of human creativity, it is the argument of this section that it is possible to identify in the economic and social sphere certain preferences which Christian teaching has developed for the way they should be worked with to model human society upon the values of the kingdom.

[1] R.H. Preston, *Religion and the Ambiguities of Capitalism* (London: SCM Press, 1991), p.107.
[2] *cf.* Andrew Britton, *Is There a Distinctively Christian Approach to Economics?* (Audenshaw Paper AP 147, 1993; The Hinksey Centre, Oxford), who argues that direct application may be possible.

In *Christianity and the Social Order* William Temple said there were no Christian answers to economic problems, because 'Christian faith does not by itself enable its adherent to foresee how a vast multitude of people, each one partly selfish and partly generous, and an intricate economic mechanism, will be affected by a particular economic or political innovation...'[3] While this is true, the Church can point to features in a society which obstruct human flourishing, and to values which promote it; it may also at times be able to say that a specific policy or course of action is required, as in the campaigns against slavery and apartheid, but usually it will have to be content with a more general policy, as with the campaign to cancel unpayable third world debt; the problem is how to work out what that policy should be. Temple's own approach was to identify what he termed 'primary' and 'derivative' principles. His primary principles are the overarching themes of Christian theology: God and his love; creation, fall and redemption; and as derivative principles he identifies freedom, social fellowship and service.[4] From these he proceeds to more specific principles, *e.g.* 'the family as the primary social unit' and 'the sanctity of personality' which enable him to offer criticisms of, *inter alia*, housing policy, education policy and industrial working conditions. From this discussion he derives six points which form a kind of Christian manifesto, *e.g.* 'Every child should find itself a member of a family housed with decency and dignity, so that it may grow up as a member of that basic community in a happy fellowship unspoilt by underfeeding or overcrowding, by dirty and drab surroundings or by mechanical monotony of environment.'[5] This principle enshrines certain values which can be used to measure the morality and effectiveness of economic and social policies.

It is, clear, however, that such principles can be no more than provisional, and that their Christian authority largely rests either on the authority of those who pronounce them, or on the measure of consent they obtain within the Church. This is an inevitable part and parcel of doing social ethics, and the personal political and religious convictions of the ethicist are bound to play a large part in the process of deriving ethical principles. It is apparent in the Bible itself. From the Exodus and the Covenant made at Sinai the Israelites knew Yahweh as Lord and Saviour, the giver of life and freedom, who had bound them into a community in which to lead was to serve. The basic laws of the community were set out in Ten Commandments. From these foundations the community had to work out more detailed laws and institutions for living in the world in a way that both honoured, and witnessed to, the character of the God who had delivered them. The Pentateuch is the result, and it took many centuries to reach its final form - a time-scale which suggests not only that the will of God was not disclosed in a single event, but also that its discernment was not free

[3] William Temple, *Christianity and the Social Order* (London: Shepheard-Walwyn / SPCK, 1976), p.59.
[4] *Ibid*, chs. 4 & 5.
[5] *Ibid*, pp.96-7.

of the personal religious and political views of his ministers. It is inevitable that the same influence is present in the analysis in this chapter, and for this no apology is made.

A particular aspect of the difficulty of using the Bible in social ethics is respecting the context of the Biblical writings. This is a major factor underlying Preston's caution,[6] and it is well illustrated by David Mealand in *Poverty and Expectation in the Gospels*.[7] Mealand describes the economic background to the Gospels as a peasant society in which most people were poor or very poor. On top of taxation religious obligations added two tithes plus the first fruits and other offerings, the total exaction amounting to between 30% and 40% of income; in time of famine the suffering of the poor was acute. It was against this background that Jesus worked and the Gospel writers wrote, and Mealand argues that some of the more extreme pronouncements against wealth are likely to reflect the outlook of impoverished Christians during the period of the famine. For example, he dates the Woes *(Matthew 23)* to the period between the time of Jesus and the compilation of sources such as *Q*, a 'particular' period in the development of early Christianity. They describe a situation in which Christians are poor, hungry, miserable, excluded and abused *(Luke 6.20-22)*, and their opponents are highly regarded, happy, well-fed, and rich: 'Such a time existed in the early years of Palestinian Christianity.... This was a time when the rich would have been especially a target for bitter resentment.... The woes on the rich may well reflect that [resentment].'[8] On this basis he argues that although it shows that 'one branch at least of early Christianity taught that to live a life of luxury and affluence was incompatible with salvation', their attitude was not in keeping with the spirit of the Gospel:

> Jesus certainly taught the pressing need for decision to accept the Kingdom. He and his disciples treated earthly possessions with carefree abandon, and perhaps also saw them as hindrances. Here, though, we see the transformation of a joyful acceptance of the demands of the Kingdom into an attitude of severity and even harsh resentment. This last is the mark of a sect rejected by its parent society, faced with pressing economic need, and hostile to the heedless affluence of the wealthy.[9]

Discriminating in this way between the different layers of the gospel sources, Mealand suggests that they reflect the changing economic and social circumstances of the period, especially the economically precarious circumstances of

[6] See, *e.g.*, R.H. Preston, *Church and Society in the Late Twentieth Century: The Economic and Political Task* (London: SCM Press, 1983), esp. ch.5.

[7] David L.Mealand, *Poverty and Expectation in the Gospels* (London: SPCK, 1980).

[8] *Ibid*, pp.45-46.

[9] *Ibid*, pp.48-49. Mealand also argues that the Magnificat (Luke 1.46-55), which is clearly not dominical, expresses the feelings and hopes of the impoverished early Christians: p. 49.

the first Christians in Jerusalem.[10]

Preston's way around the problem of context is to use the approach of 'middle axioms'.[11] This approach, as Donald Hay and other critics[12] have pointed out, is not free of problems, Hay himself believing that it is not sufficiently grounded in scripture,[13] and that the problems of cultural relativity, while real, are overstated. But this is not enough to dismiss it. Its strength lies in its insistence that empirical evidence must underlie the formulation of moral rules; there is no point in saying what should be done if it is contrary to the way things are.[14] It requires us to accept that creation is also a source of revelation, which those on the evangelical side of the church, like Hay, are more reluctant to do because it detracts from the Bible as the supreme authority.[15] Hay's approach 'is to search for universal principles which govern the particular applications described in the Biblical material... [i]n a belief that God's order and justice in relation to human nature and affairs have a timeless quality.'[16] But even if, middle axioms have problems, so do all other approaches including Hay's,[17] and some sort of intermediate principle is required as Hay's search for universals acknowledges. He derives eight social principles from scripture and uses them to present a critique of modern economic theory and institutions.[18] The approach taken here is similar, though the four ethical criteria offered are, perhaps, more akin to

[10] Mealand's ideas are considered further in section 3.

[11] Preston, *Church & Society*, Appendix 2, where he gives a good defence of the approach.

[12] *E.g.* Duncan Forrester, 'What is Distinctive in Christian Social Theology?', in *Christians and the Future of Social Democracy*, M.H. Taylor (ed) (Ormskirk: Hesketh, 1982).

[13] Brian Griffiths is another who takes this line: see his *Morality and the Market Place* (London: Hodder & Stoughton, 1982).

[14] A good example is the way medical research has enabled the reproductive process to be better understood. The discovery that within the first few weeks of pregnancy a foetus can spontaneously abort has had an effect on the ethics of abortion: see John Mahoney, *Bioethics and Belief* (London: Sheed & Ward, 1984) ch.3. Economics being a less exact science, affords less clear examples, but the necessity of profit if wealth and therefore welfare is to increase is perhaps in point.

[15] For example Peter Sedgwick argues that wealth is not to be confined to material goods, it includes social and environmental assets, and therefore in creation we see the creation of wealth. Peter Sedgwick, *The Enterprise Culture* (London: SPCK, 1992), 176.

[16] Donald Hay, *Economics Today* (Leicester: Inter-Varsity Press, 1989), p.65.

[17] Preston is rather dismissive of Hay: Preston, *Ambiguities*, p.100. Their difference illustrates well the effect of theological perspective referred to in the text. Hay's evangelical bias is apparent in his criticism that the middle axiom approach seeks another basis apart from the Bible and Christian doctrine for doing social ethics - a point not entirely fair to Preston who takes a proper, if critical, account of both. Preston's liberal bias is equally clear in his attack on biblicists. For a general critique see Andrew Kirk, *God's Word for a Complex World* (Basingstoke: Marshall Pickering, 1987), ch.6.

[18] Hay's eight principles are: (1) Man must use the resources of creation to provide for his existence, but he must not waste or destroy the created order. (2) Every person has a calling to exercise stewardship of resources and talents. (3) Stewardship implies responsibility to determine the disposition of resources. Each person is accountable to God for his stewardship. (4) Man has a right and obligation to work. (5) Work is the means of exercising stewardship. In his work man should have access to resources and control over them. (6) Work is a social activity in which men co-operate as stewards of their individual talents, and as joint stewards of resources. (7) Every person has a right to share in God's provision for mankind for their basic needs of food, clothing and shelter. These needs are to be met primarily by productive work. (8) Personal stewardship of resources does not imply the right to consume the entire product of those resources. The rich have an obligation to help the poor who cannot provide for themselves by work. *Op. cit.*, pp.70-76. Griffiths offers seven 'guidelines' - different from, and generally much less prescriptive than Hay's, *e.g.* 'Sixth, there is the constant warning of materialism.' Griffiths, *op. cit.* p.91ff.

Temple's derivative principles, being less prescriptive than Hay's.[19] However, something like middle axioms emerge from their application to the circumstances of privatization (discussed in chapter VI), for example the assertion that customer interests should be the first priority in the distribution of the benefits of privatization, and the preference for law rather than discretion as the basis of the arrangements for restraining the abuse of power. The method adopted, therefore, is first to identify the basic values which lie behind the Biblical view of the socio-economic dimension of life, and then to consider specific issues, like the symbolism of water, which have a direct bearing on this study.

2. Biblical Foundations

As the foregoing section noted, the Biblical world is far removed from modern conditions and therefore it is not possible to address each of the five ethical issues directly from the Bible. In particular, the state today is a much clearer entity than it was in Biblical times, and the scriptures are unlikely to have anything to say about its proper role in economic management. On the other hand power has always been a characteristic of human society, and we may expect to find useful guidance on the way it should be both exercised and controlled. In identifying ethical criteria the basic assumption of continuity between the Testaments has been made, taking Jesus' claim that he came to fulfil the Law and the prophets at face value. *(Matthew 5.17)*

❑ THE OLD TESTAMENT

It is possible to read the Gospels as teaching a purely individualistic faith in which the main concern is for personal salvation at the Day of Judgement, but such a reading is a partial understanding, particularly because it fails to take into account the Old Testament tradition which underlay Jesus' teaching and which was assumed by it. T.W. Manson points to a basic difference between the Hebrew understanding of the relation between man and society and those prevalent in the other cultures. In Athens, he says, a man would would be proud of his cultural and political heritage, and property, rights and privileges would be jealously guarded. 'The Israelite's attitude to Israel was different. The outstanding feature in it is the intense awareness of corporate solidarity. The members of a clan or tribe in Israel feel themselves as parts of a single living whole.' Compared to Roman law, Hebrew law was much less concerned with

[19] Wogaman presents another approach by framing his five ethical criteria as questions: 1. Does the ideology take material well-being itself seriously as a basis for human fulfilment? 2. Is it committed to the basic unity of the human family and does its view of economic life measure economic success in terms of the economic undergirding of mutual love in the life of community? 3. Does it include belief in the value of each individual human being and is it committed to individual freedom and opportunity for individual creative development and expression? 4. Does it consider human beings to be equal in a sense that is more basic than any inequalities, and does this guide the formation of economic objectives and policies? 5. Does it take the universality of human sinfulness seriously, and does it make realistic provision for the effects of self-centeredness in its proposed policies? Wogaman, *Great Debate*, pp.51-53. These criteria reflect those proposed in this study.

rights of property and much more concerned with rights of personality.[20] Thus a central element in the OT tradition was the importance of the community, and the basic unit of society is not so much the person as 'the person-in-community',[21] a point made with some force by Walter Brueggemann in his study of the land as the key element in a biblical theology: '...the land possessed or the land promised is by definition a communal concern. It will not do to make the individual person the unit of decision-making because in both Testaments the land possessed or promised concerns the whole people.'[22] This concern comes across clearly in the laws in the Pentateuch governing the way the Israelites are to live as a community, and shows clearly the social dimension of faith. A good example is *Exodus* chapters 20 to 23. This section begins with the Ten Commandments,[23] and goes on to lay down a variety of laws concerning, for example, the purchase and emancipation of slaves, criminal offences, civil injuries, duties towards aliens, lending money, and agriculture. These laws jostle with others about worship, sacrificial offerings and religious festivals, and no distinction is made between them; they are all equally part of the personal and communal duty to God. In the Biblical view, taking the person-in-community as the unit for decision-making places a high value on generosity towards the poor, and rejects attempts to separate life into separate religious and economic categories. These themes are seen clearly throughout the OT. Thus *Leviticus* has a much wider concern than laying down detailed rules about worship, *e.g.*:

> When you reap the harvest in your land, do not reap right up to the edges of your field, or gather the gleanings of your crop. Do not completely strip your vineyard, or pick up the fallen grapes; leave them for the poor and for the alien.
> *(Leviticus 19.9,10.)*[24]

[20] T.W.Manson, *Ethics and the Gospel* (London: SCM Press, 1960), pp.15-17; 35. This solidarity is evidenced, *e.g.*, in Hosea chapters. 1 & 2. In ethical terms this is seen in what Manson describes as 'the imparting of kindness' in which the strict demands of justice are surpassed by the need to show mercy to a fellow Israelite: *op. cit.*, pp.37-39.

[21] The phrase is Jane Collier's: *The Gospel and Contemporary Culture*, Montefiore (ed.), p.104; but seems to have originated with Jacques Maritain: see R.H. Preston, *Confusions in Christian Social Ethics* (London: SCM Press, 1994), p.125. It summarises Pope John Paul II's view of what it means to be human: see Ian Linden, 'People before Profit' in *The New Politics*, Paul Vallely (ed), (London: SCM Press, 1998), p.86. It needs to be said that the Bible does not present a uniform picture, as the tension between status and equality indicates. Egality is not a consistent theme. In some passages riches are taken as a sign of God's blessing, *e.g. Psalm 1* and *Job*, and Jesus accepted hospitality from persons of rank and substance without criticising them for it. 'Nevertheless, the theme of equality is emphasised to a remarkable degree in both the Old and New Testaments. It can be called remarkable because it is so at variance with the culture of most of the ancient world.' Wogaman, *op. cit.*, p.13.

[22] W. Brueggemann, *The Land* (London: SPCK, 1978), p.186. Brueggemann's thesis is considered more fully later in this section.

[23] The Ten Commandments are often said to be the foundation of religion. What is not always appreciated is that they go beyond piety into the social sphere in their prohibition of murder, adultery, theft, false witness, and covetousness. The social and economic cannot be excluded from God's concern.

[24] Biblical quotations are from the *Revised English Bible* (New York: O.U.P., 1992).

These religious rules go beyond personal charity:

> You are not to pervert justice, either by favouring the poor or by subservience to the great. You are to administer justice to your fellow-countryman with strict fairness.... You are not to falsify measures of length, weight, or quantity. You must use true scales and weights, true dry and liquid measures.
> *(Leviticus 19.15,35.36.)*

Duties towards the land are exemplified by the 'Law of Jubilee' *(Leviticus 25)*. The basic principle is the sabbatarian rest: every seven years the land is to lie fallow so that it may have a sabbatical rest, a sabbath to the Lord. In this year no work is to be done and whatever the land produces itself is to be used for food. Every fiftieth year, *i.e.* every seven sabbaths of years, is to be year of jubilee with important economic consequences. Land could not to be sold outright; a right of redemption always had to be allowed. If this right could not be exercised, the land would remain in the hands of the purchaser until the jubilee year when it reverted to the original owner. This rule was designed to prevent the permanent impoverishment of the poor, and it also regulated the price of land:

> When you sell or buy land amongst yourselves, neither party must exploit the other. You must pay your fellow-countryman according to the number of years since the jubilee, and he must sell to you according to the remaining number of annual crops. The more there are to run, the higher the price; the fewer the years, the lower, because what he is selling to you is a series of crops.
> *(Leviticus 25.14-16.)*

These rules form part of the so-called Holiness Code, and in common with the other examples cited, make it very plain that holiness is not just a matter of personal piety but includes also socio-economic relations. At the time the Pentatuech was finally compiled, namely during the exile to Babylon, the stress placed on Israel's socio-economic legislation was an important element in preserving its identity as the People of God, with a special concern for the poor, the alien and those on the edge of society. Notably, *Leviticus* reasserted the ancient prohibition against absolute human domination of persons and property, and as Israel prepared to enter the promised land the 'landless poor are redefined as brother and sister, that is, as full participants in the promises of the covenant.'[25] As Brueggemann observes, 'Brother and sister' is a covenantal phrase: 'It is a term like "neighbour", used to describe those for whom special care must be taken.... Land is for sharing with all the heirs of the covenant, even those who have no power to claim it.'[26] Land is a gift not a right; it brings responsibilities as well as freedom.

The same emphasis is to be found in the prophets. *Isaiah* opens with a series of prophecies against Judah in the course of which the contemporary practice of sacrificial offerings is denounced; instead the people are urged to 'Pursue justice, guide the oppressed; uphold the rights of the fatherless, and plead the widow's cause.' *(Isaiah 1.16)*. Moneylenders are denounced for their greed *(3.12)*, the elders are denounced for grinding the faces of the poor *(3.15)*, and unjust legislators are warned of the coming judgement:

> Woe betide those who enact unjust laws
> and draft oppressive edicts,
> depriving the poor of justice,
> robbing the weakest of my people of their rights,
> plundering the widow and despoiling the fatherless!
> What will you do when called to account,
> when devastation from afar confronts you?
> *(Isaiah 10.1-3.)*

The same theme is found in other eighth century prophets.[27] Amos inveighed against Israel just as strongly as Isaiah had against Judah. His wrath was aimed particularly at those who were concerned only for their own comfort, oppressing the helpless and indifferent to the fate of the poor, levying taxes, extorting tribute, and using fraudulent practices in the market. *(Amos 4.1; 5.11-12; 8.4-6)*.[28] Micah makes it clear that true religion encompasses what goes on in

[25] Brueggemann, *op. cit.*, p.66. The use of the Jubilee concept has been criticised by Preston who says that it 'presupposes a static economy, returning to base every fifty years.' He rejects the idea that it offers a principle for ordering modern economies. While his first point is right, it does not render the concept useless in today's world. It has a powerful motivating force for justice, *e.g.* in bringing the rich nations to face the plight of the poor nations, as witnessed in the *Jubilee 2000* campaign for the cancellation of unpayable third world debt; it also insists that solidarity needs to be built into an economic system. What it does not do is to prescribe *how* that is done today, although, it should be said, the remission of debts may be an appropriate symbolic action at a particular time, as at the turn of the millennium.

[26] *Ibid*, referring to *Leviticus* 25.25-55; *Deuteronomy* 15.1-11, 12-18; 22.1-4. This clearly has implications for the privatization of public utilities, and is examined in the conclusion to this section.

[27] The four prophets of the eighth century B.C. are *Amos, Hosea, Isaiah* and *Micah*. Their oracles were pronounced at the time of the first exile to Assyria, which they understood as the Lord's judgement on an unfaithful people.

[28] *Amos* 8.4-6 is used by Brueggemann as an example of the temptation to 'sabbathless existence': 'Hear this, you who trample the needy, and bring the poor of the land to an end, saying, "when will the new moon be over, that we may sell grain? and the sabbath that we may offer wheat for sale, that we make the ephah small and the shekel great, and deal deceitfully with false balances, that we may buy the poor for silver and the needy for a pair of sandals, and sell the refuse of the wheat?' 'Sabbathless existence is for coveting without limit because there are no...covenanted brothers and sisters.' *Op. cit.* p.65.

the market place as much as what goes on in the holy place:

> The Lord calls to the city...:
> Listen, you tribe and assembled citizens,
> can I forgive the false measure,
> the accursed short bushel?
> Can I connive at misleading scales
> or a bag of fraudulent weights?
> The rich men of the city are steeped in violence;
> her citizens are all liars,
> their tongues utter deceit.
> *(Micah 6.9-12.)*

> The Lord has told you mortals what is good,
> and what it is that the Lord requires of you:
> only to act justly, to love loyalty,
> to walk humbly with your God.
> *(Micah 6.8.)*

In a way reminiscent of the Pentateuch, these denunciations are interspersed with judgements against bad cultic practices, more usually thought of as religious. For the prophets, as for the priests who wrote the law, there was no difference between the two; prayer and sacrifice, fair trade and concern for the poor were equally part of man's duty to God, equally part of true religion.[29] The same moral concern for the poor is also found in the wisdom writings,[30] echoing traditional values in the ancient Middle East *(Ecclus 4.1-3)*, and Ben Sira reminded his readers that God does not show favouritism towards the rich in a society in which those who wished to get on had to kowtow to the rich:

> He has no favourites at the expense of the poor,
> and he listens to the prayer of the wronged.
> He never ignores the appeal of the orphan
> or of the widow as she pours out her complaint.
> *(Ecclus 35.13-14)*

In *The Land*[31] Walter Brueggemann offers a helpful perspective on the ethical themes of the OT. Protesting against 'the existential binge of contextless

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[29] Brueggemann argues that the same concern can be seen in *Ezra/Nehemiah*. On the return of the exiles, Nehemiah ensures that the rich no longer demand interest on loans to the poor, and deny them access to the land. *Ezra/Nehemiah* can be seen as parochial and legalistic, but also show a concern to return to the covenant in order to avoid future landlessness - the fate of those who do not order society in accordance with the divine law. The same imperative underlies the demand to do justice. *Op. cit.* pp. 155-8; 115.

[30] See Wayne A. Meeks, *The Moral World of the First Christians*, (Philadelphia: The Westminster Press, 1986), p.71.

[31] See note 25, p.32 above.

decision' in Biblical interpretation,[32] he argues persuasively for the centrality of Israel's relationship to the land as the key to understanding the Biblical record. It is, he says, 'rootlessness' and not 'meaninglessness' which characterises both Israel's and our own situation. His premis is that land is a gift in fulfilment of a promise. The promise of land, he says, was the promise of space for human joy and freedom, but each time land was gained, and especially under the kings, it became 'the very source of dehumanising exploitation and oppression.'[33] The reason was that Israel forgot that land is God's gift, treating it as its own, a sign of power and prosperity. Thus satiated Israel forsook Yahweh and turned to other gods 'who can function as symbolic legitimation of Israel's pursuit of satiation.' These gods 'present themselves as practical choices, usable loyalties put at the disposal of Israel as a means of securing its own existence.'[34] Brueggemann continues:

> The central temptation of the land is coveting.... Israel is a community under gift.... The introduction of self-seeking in a world of gift is an attempt to shift the grounds for security. It is an attempt to replace precarious trust with control, to substitute self-possession for covenantal assurance. Israel's memory is that land held in this way disturbs the well-being of all Israel. The temptation to private well-being is a way to death.[35]

In a later age Jesus said that 'where someone has been given much, much will be expected of him; and the more he has had entrusted to him the more will be demanded of him.' *(Luke 12.48b).* Land brings responsibilities, and Jesus' remark, made in the context of possessions, owners and stewards, challenges radically the notion that possession sets one free from caring. The law with its concern for the poor and the stranger, which has been examined earlier in this section, is, argues Brueggemann, precisely for the proper management of land, and reverses the assumption of a coercive society that possession and power enable one to sit light to the law. Caring for those without land, *i.e.* the poor and the stranger, is one of the three basic rules for those with land, and as Israel enters the promised land the landless poor are redefined as brother and sister, that is inheritors of the covenant promises along with the landed.[36]

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[32] *Ibid*, p.4
[33] *Ibid*, p.11.
[34] *Ibid*, p.57.
[35] *Ibid*, p.59.
[36] *Ibid*, pp.59-66. The other two rules are the prohibition of images, and keeping the sabbath. Brueggemann describes images as efforts to reduce to manageable and predictable form the sources of value and power in our lives. They are a peculiar temptation to the landed: '...when one is able to plan and manage everything else, one yearns for a comfortable place in life even for ultimate values which can be managed.' (p.62.) Sabbath, he says, is 'a central affirmation to Israel about the character of land and life as gift.... Sabbath is a voice of gift in a frantic self-securing world.' (p.63.) (See also p.35 above.) Brueggemann argues that establishing a different attitude towards landedness is also the purpose of Israel's battles with the Caananites: 'Israel's mandate is not to join the Caananites. It is to engage the Caananites so that the management objectives for the land can be radically transformed. *Ibid* p.70.

Two important themes emerge from Brueggemann's analysis: (1) some things are to be seen as gift, and therefore they lie outside the category of tradeable commodities, and (2) forgetting this is bound to result in the abuse of power by those in authority, in this case by the Kings, which may result in all being lost. Both themes are graphically illustrated by the story of Naboth's vineyard *(1 Kings 21)*. King Ahab, coveting his neighbour's vineyard, proposes a deal: 'Your vineyard is close to my palace; let me have it for a garden, and I shall give you a better vineyard in exchange for it, or if you prefer, I shall give you its value in silver.' To Naboth such a deal is unthinkable: 'The Lord forbid that I should surrender to you land which has always been in my family.' The exchange expresses sharply two views about land: Ahab sees it simply as a *tradeable commodity*, but to Naboth it is an *inalienable inheritance*. As the story unfolds Ahab comes into possession of the vineyard by foul means, but only to learn that his indifference to the gifted character of the land will result in the end of the dynasty and Israel's complete exclusion from the land. Underlying both Naboth's attitude and the divine judgement is the Covenant, the source of both gift and promise:

> Naboth represents traditional covenantal language in which land is not owned in a way which permits its disposal. It is 'inheritance', which means that it is held in trust from generation to generation, beginning in gift and continuing so, and land management is concerned with preservation and enhancement of the gift for the coming generations. Naboth is responsible for the land, but is not in control over it. It is the case not that the land belongs to him but that he belongs to the land. Naboth perceives himself and the land in a covenantal relation, with the relation between the two having a history of fidelity which did not begin with him and will not end with him.... Of course Ahab...had no notion of that, because kings characteristically think everything is to be bought and sold and traded and conquered.[37]

❖ *CREATION*

The opening chapter of Genesis affirms that the natural world is to be seen as the work and gift of God with its own inherent goodness. It is given to meet the needs of all creatures, but the duties of man towards the earth are formulated in two different ways. In the first account of creation man is told 'to fill the earth and subdue it' and to have 'dominion...over every living thing' *(Genesis 1.28)*; in the second account man is placed in the garden of Eden to till it *(Genesis 2.5, 8; 3.23)*. The second formulation suggests a more caring and less exploitative approach than the first, but given the overriding duty of man to God (made plain in the story of the Fall), maybe these two formulations are less opposed than they appear, both requiring a responsible stewardship related to man's needs (rather than, we may suppose, to his wants) for which man will

[37] Brueggemann, *op. cit.*, p.93.

have to give account to God - in which case we have an important principle for regulating economic activity which affects the natural world.

Land is clearly a gift, but if (following Breuggemann) rights in land are also a gift and outside the category of tradeable commodities, then maybe water is also, given its powerful symbolic nature in OT thought. Water symbolises the action of God himself: (1) in judgement and salvation - as in the stories of the Flood and the Exodus;[38] (2) in cleansing - thus Ezekiel promises that God will sprinkle pure water over the exiles so that they may be cleansed from all that defiles them *(Ezekiel 36.25)*;[39] and (3) in sustaining life - as in the wilderness where water flows from the rock *(Exodus 17)*. Water is also a sign of God's goodness to his people - after their restoration to the Holy Land, showers and rain will make the land fruitful *(Isaiah 35.6,7)*, just as in the NT it is the river of life which waters the city of God, and the tree of life flourishes on its banks *(Rev. 22.5)*. Essentially, water is a sign of the Covenant; and at a deeper level it symbolises the new life which God will give his faithful people: in the day of deliverance they will 'With joy...draw water from the wells of salvation.' *(Isaiah 12.3)*. 'Thus has the image of water in Holy Scripture been refined so that it may be used to convey pre-eminently the thought of God's activity in the world through the Holy Spirit, who as a living fountain, cleanses, quenches thirst, and refreshes the people of God.'[40] Water also must be in the category of gift.

❖ *POWER*

Power in Israel was dispersed between the charismatic and the official leaders, that is between the prophets and the priests and kings. Walther Eichrodt argues that prophetic authority, with its authentication in the direct possession of the person by the Spirit of God, was closer to the essential nature of Yahweh religion, and this was the source of the tension between them and the official leaders.[41] In particular, attempts by the monarchy to establish its legitimacy through heredity - that is without reference to the will of Yahweh - caused it to be viewed ambivalently: on the one hand as a practical necessity, on the other as a religious anomaly, and fuelled fears that the royal power would be abused with religion becoming just a means to an end. Thus after the establishment of the monarchy the prophets acted as a kind of official opposition, as can be seen from the relationship between Nathan and David and Elijah and Ahab, and in the denunciations of Amos and his successors. After the collapse of the monarchy it was the priests who assumed political as well as religious power, but following the Exile they too found that their authority was circumscribed. On the Return to Jerusalem Ezra subjected the power of the priests to the Law,

[38] An image picked up by the prophet Amos when speaking of the judgement coming upon Israel: 'Let judgement roll down as a river and righteousness like a never-failing torrent.': *Amos 5.24*.
[39] An image which is later taken up in the NT where water signifies the gift of the Spirit, especially in baptism.
[40] R.C. Walls in Alan Richardson (ed), *A Theological Word Book of the Bible* (London: SCM Press, 1957), p.281.
[41] Walther Eichrodt, *Theology of the Old Testament*, (London: SCM Press, 1960), vol.1, p.441.

and a new religious class, the scribes, were given the function of ensuring that they kept within the Law. 'The scribes were an incarnation of the community's resolve in future to recognise no authority but that of the Law, and even to allow the priesthood only so much influence as was covered by this authority.'[42] The OT shows consistently a strong conviction that power based on a foundation other than that of the will of God cannot last, and importantly, established institutions to ensure that the exercise of power was not only balanced, in the sense of being limited by interests other than those of the ruler, but also was constrained by religious and moral rules.

❑ THE NEW TESTAMENT

Harvey McArthur suggests that there are two basic principles behind Jesus' ethical teaching.[43] First, a demand for radical obedience to and trust in God: personal ties like the family *(e.g. Mark 3.31-35)*, and material ties like possessions *(e.g. Matthew 6.19-34)* were both to be subordinated to allegiance to God. Second, a demand for radical concern for the good of the neighbour, neighbour being understood in the broadest sense, crossing racial, religious and social groups, as for example, in the Parable of the Good Samaritan *(Luke 10.25-37)*, echoing the command in Leviticus: 'You shall love your neighbour as yourself.' *(Leviticus 19.18)* Jesus attacked self-centeredness, but he taught the immense value of each individual person, showing especial concern for the outcast, as in the Parable of the Lost Sheep *(Luke 15.1-7)*. Like his contemporaries Jesus took the reward principle for granted, as for instance in his teaching about the heavenly rewards awaiting those who avoided ostentation in alms-giving and prayer *(Matthew 6.1-18)*, but it is clear he understands 'reward' in a spiritual way, coming more from the grace of God than from the merit of man. McArthur concludes that the essential characteristic of the Christian ethic is 'that it is a response ethic, an ethic of gratitude. The life of joyous obedience is the normal, spontaneous response to the gifts of God in creation and in the Christ.'[44]

Although clear in essence, Jesus' ethical teaching is not free from problems. For example: Were his demands intended for his disciples or for all? Were they for all time or for the period before the expected Parousia, or for the Kingdom age - either realised through his ministry or still to come? In particular, did Jesus have any concern for the social order? Indeed, in contrast to the OT the Gospels seem to lack the socio-economic aspect of faith. The economic aspect of life is touched on mostly in the teaching that wealth is an obstacle to salvation, as for instance in the story of the Rich Young Ruler who was told to sell all that he had and to give to the poor if he wanted to enter the Kingdom *(Mark 10.17-31)*. Likewise the Lukan beatitudes, which bless the poor and

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[42] *Ibid*, p.401.

[43] 'Ethical Teachings of Jesus', in John Macquarrie (ed), *A Dictionary of Christian Ethics* (London: SCM Press, 1967), p.176.

[44] *Ibid*, p.177.

hungry in a much more direct way than the Matthean version, are balanced by a set of woes against the rich warning them that they have had their time of happiness *(Luke 6.20-26)*.[45] However, as T.W. Manson argued, Jesus' ethical teaching, as exemplified in the Sermon on the Mount, is modelled on the three pillars of Jewish ethics,[46] namely, the Law, worship, and 'the imparting of kindness',[47] and therefore it seems reasonable to assume that in his teaching Jesus presumed an understanding of the socio-economic emphasis of the Law and the Prophets; indeed, this presumption clearly underlies the advice to the Rich Young Ruler.[48] It seems also that he stood four-square within the Jewish eschatalogical tradition which looked forward to a heavenly reversal of fortunes of rich and poor.[49] The Woes on the Rich *(Luke 6.24-26)*, the parable of Dives and Lazarus *(Luke 19-31)* and the parable of the Last Judgement *(Matthew 25.31-46)*, are perhaps the clearest examples in Jesus' teaching.

Opinion is divided about to whom Jesus' ethical teaching was directed, and the time for which it was intended. Bearing in mind the expectation of an imminent End, the general feeling is that at least some of the rules have a limited application. Thus Wayne Meeks points out that Jesus' parables do not question the structures of an exploitative society: the distant landowner who sends his slaves to collect the rent from resentful sharecroppers; unemployed workers still standing idle in the town market at the end of day; the exhausted slave coming in from ploughing and ordered by his master to get cleaned up and fix his supper, no thanks expected; the beggar dying at the rich man's gate - and only in the last case is a moral judgement rendered.[50] Indeed, many of the sayings of Jesus seem to demand an ascetic detachment from the world, *e.g.* sending out his disciples charging them to take nothing with them for the journey *(Mark.6.8-11)*. This is so very much at variance with the OT tradition, that Meeks concludes that these rules were those for the itinerant prophets, and do not present 'an ethos that is demanded of the followers of Jesus as such.' 'What the followers are supposed to do if they believed the message of

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[45] *Cf. Matthew* 5.3-11.
[46] Manson, *op. cit.*, ch. III.
[47] Manson, *op. cit.*, pp.34-39; 52-56. The 'imparting of kindness' is an idea for which Manson can find no single English term.
[48] One of the claims of the early Church was that it was the new Israel, an understanding which originated in the teaching of Jesus himself. As has been argued, Israel was something wider than just a worshipping community, and, as Manson observes, the only reason the church did not develop an economic programme was that it expected the existing order 'to wind up fairly soon'. Manson, *op. cit.*, p.85.
[49] Mealand, *op. cit.*, p.28; 41-50. The theme is found in the Psalms, *e.g.* Pss. 14.4-6; and 106.9 which is echoed in the Magnificat, the NT *locus classicus* of this theme: 'He has filled the hungry with good things, and sent the rich empty away.' *Luke* 2.53. Mealand points out that although the theology of retribution on the rich appears only in one of the gospels, *viz. Luke*, it appears to rest on a number of sources, and the greater severity correlates with the harsh economic circumstances of the time of those sources: *ibid* pp.36-37. Brueggemann, *op. cit.* pp.171-4, cites *Luke* 2.53 as evidence that the coming of Jesus is to be understood with reference to new land arrangements. His ministry is to restore the rejected to their rightful possession, and it is this promise of restoration which arouses opposition to him.
[50] Wayne A. Meeks, *The Moral World of the First Christians*, (Philadelphia: The Westminster Press, 1986), p.104.

those prophets is left vague.'[51] A partial answer is provided by David Mealand who argues that over time the severe teaching about possessions was modified. Luke, who was familiar with the culture and ways of business of the more affluent, emphasised the spiritual dangers of riches, rather than express direct hostility to the rich. In Matthew the process of modification is the most advanced showing an accommodation to the values of a settled community of believers, but even so he preserves passages incorporating Jesus' 'presentation of the challenge to existing values by the supreme worth of the coming Reign of God.'[52] This challenge, Mealand believes, was subject to two principal lines of re-interpretation:

> The one was to turn it into an attack on wealth and its possessors.... The danger is that such an adaptation replaces the openness of Jesus with an exclusivist outlook governed by resentment. The opposite tendency appears when accommodation is made to the existing order of things, characterised by settled communities with an ever greater 'sufficiency' of possessions....This also eventually comes in conflict with the original vision...[53]

The process of modification is seen also in the Epistles, where the injunction to live a quiet life in expectation of the End in *Thessalonians* soon gives way to detailed advice about Christian living in *I Corinthians*, including various re-statements of customary moral rules. But nothing is added to the OT view about the nature of community or the duty of solidarity between the classes.

❖ *POWER*

The eschatological perspective also underlies the view taken of state power. The passage in *Romans* where Paul enjoins every person to 'submit to the authorities' because they have been instituted by him from whom all authority comes *(Romans 13.1-6)*, reads as a charter for the unfettered operation of all political power, but in reality it is practical advice to a small community living in expectation of the End. In the short time available Christians are to bear with the authorities under whom God has placed them.[54] However, in *Luke-Acts*,

[51] *Ibid*, p.106.

[52] Mealand, *op. cit.*, p.92.

[53] *Ibid*, p.93. Mealand agrees with Meeks that although Jesus and his closest companions left behind close family and possessions, he does not seem to have insisted that all his followers respond in precisely the same way. His teaching and activity assumed that a new era was dawning, and this may be the 'ultimate origin' of the passages which warn against the danger of riches. However, as the economic situation of the disciples worsened in the post-resurrection years, they held on to these teachings as a source of comfort and justification. 'Yet the strongest long-term trend was one of routinization. The *ad hoc* decisions of a more charismatic beginning became institutionalised, and phrases which no doubt once belonged to a situation where mendicant itinerancy was the norm, got repeated in more settled communities of believers.' *Ibid*, p.91.

[54] See J.L. Houlden, *Ethics and the New Testament* (Oxford: Mowbrays, 1975), p.81. *Cf.* Harvey Cox: 'The passage in *Romans* about respecting 'the powers that be' used to be interpreted a sacral legitimation of state power, but today it is not seen as offering any theology or metaphysic of state power, but merely answering a specific question from the church in Rome.' (*A Dictionary of Christian Ethics*, p.265.)

where time was not so pressing, there is also an uncritical acceptance of the 'powers that be'. Houlden suggests that Luke writes as he does in part to convince the Roman authorities that Christians offered no threat to the established order and could be afforded the same tolerance as the Jews, and in part to assure Christians that they can look the world in the face and claim a part within it. As he comments, 'Luke accepts political society as beneficent and stable, and life within it raises no moral issues whatsoever. [His] polemic against meanness and cruelty never leads him to raise a voice against anyone in a position of political power...'[55] Similarly, Peter urges his readers to submit to every human authority, expressing complete confidence in the Emperor's justice. *(I Peter 2.13-17)*. In contrast to these views *John* and *Revelation* take a negative view, in the latter case placing the political powers among the enemies of God. *(Rev 13)*. With the threat of persecution a reality, 'The Empire is now no beneficent guarantor of peace but...the veritable incarnation of idolatrous power.'[56] It seems safe to conclude that early Christian attitudes towards the state were conditioned by the actual conditions under which the Church existed, and provide little guidance for modern conditions, let alone any doctrine of the state. John Bennett suggests that the NT sets the outside limits of Christian thinking, warning against both anarchism and the unlimited state, but concludes: 'it is not possible to derive from these passages adequate guidance for Christian ethics in relation to the state the political structure of a nation in which Christians have the rights and responsibilities of citizens.'[57] However, within the Church Christians put forward radical ideas about the structure of power. Taking the 'slave-like self-giving of Jesus' as the model, service was to be the distinguishing mark of those who have authority within its fellowship.[58]

If Mealand advises caution in using the Gospels to construct an economic ethic, he also directs attention to the 'original vision', the goal that all human economic systems should serve. Part of this original vision is solidarity between the different classes of people, which Manson identified as one of the basic characteristics of the Israelites. It is, perhaps, significant that Matthew ends his account of Jesus' teaching on this note. In the parable of the Last Judgement those who enter the Kingdom are those who have aided the poor, *i.e.*, the hungry, the thirsty, the strangers, the naked, the sick and the prisoners. While the identity of the poor in this parable is debated,[59] behind it lies the

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[55] *Ibid*, pp.83-4.
[56] Houlden, *op. cit.*, p.87.
[57] John C. Bennett in *A Dictionary of Christian Ethics*, p.331-2.
[58] Houlden, *op. cit.*, p.88. Jesus taught the disciples that the greatness of the community is to be measured in terms of its willingness to serve *(Luke 22.25-27)*, and in the same way the ministry of oversight is linked to the image of the shepherd, the one who tends and feeds the flock, drawing on OT images of the leaders as shepherds of Israel *(e.g. Ezekiel 34 & 37.24)*.
[59] *E.g.* Mealand and others believe they are the early Christians, Fenton, *per contra*, interprets the parable as directed to Christians showing the kind of life which will receive approval from Christ on his return. (J.C.Fenton, *Saint Matthew*, (London: Pelican NT Commentaries, 1963), pp. 402-3. Others have argued that this parable sets the standard of judgement for the nations, just as the preceding parable, the parable of the Three Servants, sets the standard for the disciples.

Jewish tradition that the poor and the weak are especially the objects of God's concern and protection. But it teaches more than the importance of private charity: to care for those in dire need is not simply to reflect God's 'preferential option for the poor', it is to act on the basis that salvation is communal; an individual's eternal destiny cannot be separated from that of his neighbour.

❑ SUMMARY

This survey of the Scriptures suggests four basic criteria against which the ethics of economic activity should be assessed, and which can be used to control public monopoly power in private hands.

1. COMMUNITY The primary criterion for economic activity is the well-being of the community. The communal interest takes precedence over the individual interest, but not in a way that de-humanises the individual, as the description of the basic unit as the person-in-community makes plain. Thus the Biblical model is differentiated from both *laissez-faire* and totalitarian economic models. The primacy of the communal interest is expressed typically in a solidarity between the classes with a duty of generosity towards the poor being accepted by the rich.

2. JUSTICE Economic activity is not *sui generis*. Trade and craft are no different from praise and sacrifice; all are carried out under God and are subject equally to his laws. Economics is not exempted from the divine demands of justice and fairness, and thus a purely utilitarian approach to ethics is, from the Biblical perspective, inadequate. The divine demands for justice control the exercise of political power, for which the appropriate model is service rather than dominion.

3. GIFT Within the economy some things are to be regarded as gifts and therefore lie outside the category of what is tradeable. Land is not to be treated as property, like goods and chattels, and it looses its giftedness if it is treated simply as tradeable commodity. The gift is for the whole community to enjoy, and imposes burdens as well as benefits upon the land-holder.[60] Abuse of the land, that is failing to respect its giftedness and treating it like a private possession, leads to alienation and rootlessness, the destruction of community. Water also occupies a special category because of its uniquely symbolic character, and it too belongs to the category of gift.

4. EGALITY Riches are not wrong *per se*. The stress upon communal solidarity, while egalitarian in nature, does not issue in a doctrine of strict equality, and so differences in wealth are tolerated in the Biblical picture of human society, but nevertheless, they are subject to the demands of that solidarity. Riches bring

[60] The term 'land-holder' is used in preference to 'land-owner' because the Biblical witness is that Yahweh 'owns' the land, his people merely 'hold' it in trust.

with them an obligation to help the poor, and the tendency over time to accommodate the Biblical demands to those considered prudent in a more advanced commercial society has to be resisted.

3. Primitive and Mediaeval Christianity

❑ THE EARLY CHURCH

The first Christians, with their emphasis on the common life *(Acts 4.32-35)*, and in the harsh punishment meted out to those who indulged in deception and double standards,[61] seem to have taken to heart the communal dimension of faith and salvation. Inevitably, the early idealism proved difficult to maintain, and the appearance of social distinctions in the church was bitterly criticised:

> My brothers and sisters, do you with your acts of favouritism really believe in our glorious Lord Jesus Christ? For if a person with gold rings and fine clothes comes into your assembly, and if a poor person in dirty clothes also comes, and if you take notice of the one wearing fine clothes and say, 'Have a seat here, please,' while to the the one who is poor you say, 'Stand there,' or, 'Sit at my feet,' have you not made distinctions among yourselves, and become judges with evil thoughts? Listen, my beloved brothers and sisters. Has not God chosen the poor in the world to be rich in faith and to be heirs of the kingdom that he has promised to those who love him? But you have dishonoured the poor. Is it not the rich who oppress you? Is it not they who drag you into court? Is it not they who blaspheme the excellent name that was invoked over you?
> *(James 2.1-7, NRSV.)*

The spiritual dangers of wealth were emphasised also in other early Christian writings.[62] A recurring theme is solidarity between the classes. Thus Clement of Rome writes: 'The rich must provide for the poor; the poor must thank God for giving him someone to meet his needs.'[63] Facing the question How was this help to be given? Clement appreciated the need for wealth in society, especially if poverty was to be relieved. Discussing the parable of the Rich Young Ruler he says that we cannot take literally Jesus' command to sell all we have; instead it is to be understood as a command to 'banish from the soul its opinions about riches, its attachment to them, its excessive desire, its morbid excitements over them, its anxious cares, the thorns of our earthly existence which choke the seeds of true life. For it is no great or enviable thing to be simply without riches, apart from the purpose of obtaining life.'[64] How are we, he asks, to obey

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[61] See the story of Ananias and Sapphira: *Acts 4.5-12.*
[62] Wogaman, *Ethics*, pp.27-30.
[63] I Clement 38.2, in Cyril C. Richardson (ed), *Early Christian Fathers* (New York: Macmillan, 1970).
[64] Clement, *The Rich Man's Salvation*, in George W. Forell, *Christian Social Teachings* (Minneapolis: Augsburg Publishing House, 1971), p.54.

the Lord's command to feed the hungry, cover the naked and entertain the homeless if we have given away all we possess? And in reply he says, 'We are not then to fling away the riches that are of benefit to our neighbours as well as ourselves.... They have been prepared by God for the welfare of men.'[65] However, as Wogaman notes, the early church did not develop these ideas systematically or with economic sophistication. The church's economic ethic was more concerned with distribution than with production, and distribution was seen more in terms of the moral responsibility for acts of charity than as a matter for systematic action.[66]

Later thinkers of the early centuries developed these moral themes, continuing the emphasis on solidarity with the poor. An important development came in Bishop Ambrose's writing about justice. He understood justice as 'a profoundly communitarian concept [which] exists for the good of all and helps to create unity and society among us.' Ambrose applied this concept specifically to economic matters:

> The philosophers also believe that justice requires that public property be treated as public and private property as private. But this is not what nature illustrates, for nature has provided all things for common use. God has decreed that all things are produced so that food is available to all and the earth is possessed by everyone equally. Nature provides for everyone, but greed has restricted the supply to only a few.... When our goal is to make money and to accumulate possessions, to buy more land and to be the richest of all, we have rejected the virtue of justice and are not able to be a blessing to others. How can you be just if you attempt to add to yourself what you take from others?[67]

In forthright vein Ambrose rejected the idea that the duty of the rich to help the poor should be regarded as charity: 'You are not making a gift of your possessions to the poor person. You are handing over to him what is his. For what has been given in common for the use of all, you have arrogated to yourself. The world is given to all, not only to the rich.'[68] However, when Christianity became established as the official religion, attempts were made to accommodate the possession of wealth with the traditional Christian suspicion of riches and worldly possessions. The most important of these was Augustine's distinction between 'use' and 'enjoyment'. Wealth, he argued, was not evil in itself but only if it is enjoyed as a substitute for God. Wealth, like the rest of creation, is God-given, and is to be used for the purposes for which

[65] *Ibid* p.56.
[66] Wogaman, *Ethics*, p.28.
[67] Ambrose, *Duties of the Clergy*, I.28, in Philip Schaf & Henry Wace (eds), *Nicene and Post-Nicene Fathers*, Vol.X, (New York: Christian Literature Co., 1896), p.23. (Quoted by Wogaman, *Ethics*, p.49.)
[68] *De Nabuthe*, c.12, n.53 (P.L.14, 474). Quoted in *Populorum Progressio*, 1968.

God has ordained. Thus riches are blessed in use rather than in enjoyment. However, Augustine did not consider the co-existence of rich and poor to be a moral scandal; both are part of God's plan: he made the rich to help the poor, and the poor to test the rich - a significant reformulation of the Biblical teaching.

❑ THE MIDDLE AGES

The Middle Ages brought with them a very considerable expansion of both learning and trade, and not surprisingly this had a marked effect on Christian social ethics. However, the earlier attitude that wealth was a responsibility and not a reward was maintained, Catherine of Sienna, for example, advising the wealthy to own their riches 'humbly, not with pride, as things lent to them rather [than] as their own.'[69] Nevertheless, during this period Christian ethics begin to take on an individualistic tone, a development aided, it is argued,[70] by the practice of private, auricular confession which placed the emphasis on personal wrong-doing and which caused systemic wrongs to be overlooked. Mediaeval theology was dominated by Thomas Aquinas (1225-1274). Although his social ethic was based on the concept of the common good, which transcended the individual good of one person,[71] Wogaman observes that he 'had little to say on economic matters that would upset the wealthy, beyond reminding them that their possessions were from God and urging them to be more generous.'[72] Contrary to Ambrose he accepted the morality of private property on pragmatic grounds:

> First, because every man is more careful to procure what is for himself alone than that which is common to many or to all: since each one would shirk the labour and leave to another that which concerns the community, as happens where there is a great number of servants. Secondly, because human affairs are conducted in more orderly fashion if each man is charged with taking care of some particular thing himself, whereas there would be confusion if everyone had to look after any one thing indeterminately. Thirdly because a more peaceful state is ensured to man if each one is contented with his own.[73]

Even so, in the *use* of property he argued that 'man ought to possess external things, not as his own, but as common, so that...he is ready to communicate

[69] *Catherine of Sienna: The Dialogue*, trans. Suzanne Noffke, O.P. (New York: Paulist Press, 1980), *Dialogue* 47, p.96. (Quoted by Wogaman, *Ethics*, p.73.)

[70] Wogaman, *Ethics*, p.80. A related point is made by Weber in his discussion of the moral consequences of the Calvinist doctrine of predestination. He argues that the decline of private confession reinforced the pursuit of salvation through works because the 'periodical discharge of the emotional sense of sin was done away with.' Max Weber *The Protestant Ethic and the Spirit of Capitalism* (London: Routledge, 1992), p.106.

[71] Thomas Aquinas, *Summa Theologica*, II/2, Q.58, Art.12.

[72] *Op. cit.*, p.92.

[73] *Summa Theologica*, II/2, Q.66, Art.2.

them to others in their need.'[74] Although trade had for him a certain debasement, he accepted its necessity and the selling of goods at a profit to be in accordance with the natural law, but his discussion presupposes, although it does not define, a 'fair price'.

The doctrine of the just price, and that of the just wage, which was a particular example of it, arose out of the desire of the mediaeval church to apply a detailed system of Christian ethics to every aspect of life. Sleeman describes a just price as that which would enable the seller to receive 'a value equivalent to that of the goods and services which he provides to the buyer.'[75] In practice, as he points out this, was a market price, but determined by customary evaluation rather than the blind operation of the forces of supply and demand. Thus taking advantage of a buyer's exceptional necessity or of a temporary shortage of supply to increase the price was condemned as immoral. Similarly the just wage was the customary market rate for the job, believed to represent the value of the service provided to the buyer; in particular the doctrine was held to require equal pay for equal working capacity, and that 'in each type of occupation the the pay should be adequate to enable the worker to maintain the status associated with his position in life.'[76]

❑ SUMMARY

In the views of the first Christian thinkers we see the tension developing between the faith as received from the Apostles and the demands of living in an economically developing world. The four scriptural criteria are accepted, but assimilating ideas appropriate to the early church to the situation of a more established, richer church begins to bring about changes in the way the criteria are formulated. In terms of the three tensions discussed at the end of chapter I, reason, reflecting on the established nature of society, brings in values more concerned with stability than equality. Nevertheless, a feeling for social justice persists, and can be seen in the doctrine of the just price. Although this doctrine was suited to a society which was slow moving, where technical innovation was infrequent, and in which customary prices were known and accepted over long periods, it does speak across the centuries as a reminder of the Biblical concern that justice should be central to trade and employment.[77] In the years which followed this revising trend within the church continued until it met with a sharp rejection at the end of the nineteenth century.

4. The Reformation Retreat

The great religious upheaval at the end of the Middle Ages continued the

[74] *Loc. cit.*

[75] John F. Sleeman, 'Just Price and Just Wage', in *A Dictionary of Christian Ethics*, p.182.

[76] *Ibid.*

[77] Clearly the doctrine cannot simply be applied to modern conditions, but as Sleeman points out, the Biblical concern behind it is still around today. The idea of fairness underlies opposition to high prices charged by monopolies, resale price maintenance and low wages for 'sweated' labour.

individualist trend in Christian thinking and ushered in an economic ethic which justified trade as a divine calling. This resulted from the doctrine of John Calvin (1509-1564). Calvin's theology stressed the importance of both grace and election in the Christian life: 'By the decree of God, for the manifestation of his glory, some men and angels are predestined unto everlasting life, and others foreordained to everlasting death.'[78] These judgements had been made by God 'before the foundation of the world,' and human merit played no part in it. According to Max Weber, in those who 'surrendered to its magnificent consistency' this doctrine of predestination produced 'a feeling of unprecedented inner loneliness.'[79] However, the psychological effect was not fatalism or despair but a powerful concern for the pursuit of one's calling. Calvin, certain of his own election, advised his followers to be content with the judgement of God, but this advice was not acceptable to the mass of people; they wanted signs by which they could be sure of their election, and it was this concern for proof which gave rise to a new ethical evaluation of work, which later was called 'the Protestant work ethic'. Those anxious about their fate were advised principally in two ways. First it was an absolute duty to consider oneself chosen, and to combat all temptations of the devil. Thus, observed Weber, 'in the place of the humble sinners to whom Luther promises grace if they trust themselves to God in penitent faith are bred those self-confident saints whom we can rediscover in the hard Puritan merchants of the heroic age of capitalism.'[80] Second, it was held that the best way to attain that self-confidence was through intense worldly activity. Calvin required of his followers a life of good works directed to adding to the glory of God on earth, and success in this worldly activity was taken to be proof that one's eternal destiny was among the elect. However, although Calvin upheld the ideal of private property, he maintained that it could not be used for one's own selfish ends: all property is held in trust for God and is to be used for the glory of God. This teaching provided the basis for a very active economic life, and combined with strictures against inordinate material desire and the pursuit of pleasure, encouraged the accumulation of capital.

Richard Baxter, one of Calvin's followers, moved the puritan social teaching further away from the Biblical foundations. Baxter taught that Christians were under a duty to maximise gain, which derived from the requirement that a calling had to be useful. Although usefulness was primarily a moral evaluation, in practice the most important criterion was private profitableness. If God showed one of his elect a chance of profit his duty was to take advantage of it; 'If you refuse this,' said Baxter, 'and choose [a] less gainful way, you cross one of the ends of your calling and you refuse to be God's steward.'[81] Old Testament figures, particularly the Patriarchs and Job, were called in aid to

[78] *Westminster Confession*, ch.III, no.3.
[79] Weber, *op. cit.*, p.104.
[80] *Ibid*, pp. 111-112.
[8] Richard Baxter, *Christian Directory I*, ch.XI, p.9; quoted by Weber, *op. cit.*, p.162.

show that riches were a sign of God's blessing.[82] Puritanism placed the emphasis on individual salvation and this encouraged what today are called middle-class values. The Puritans held, for example, that a man had a duty to his possessions: they were to be held undiminished for the glory of God, and increased by restless effort; and in their repudiation of sport, dancing, public houses, romantic literature, theatre, art and gossip, Puritans gave a grey, sober, utilitarian character to life (seen clearly in the Puritan style of dress), and this in turn meant that calculating, utilitarian values became more important in determining social and political questions.

The individualising, privatizing trend of Reformation thought continued in the post-reformation years, and gained an important impetus from the enclosure movement which took the common land away from the people. This was not done without protest, but the protest did not come from the Church.[83] Enclosure was motivated by the need for greater efficiency in agriculture: farms needed to be larger (a product of the maximising teaching of the Puritans), and the private capital which financed this expansion looked for its reward in terms of property rights.[84] The eighteenth-century church largely presented a comfortable faith to its comfortable middle-class congregations, and even the notion of holding property on trust was generally lost sight of. Christianity had to conform to the spirit of the age which was rationalist and 'enlightened'. There were, however, voices raised in protest at the dire social effects of the trend, notably John Wesley,[85] but Wesley's conception of economic ethics was highly individualistic. In deciding how to spend his wealth Wesley advised that

[82] Baxter's doctrine was an important influence on Max Weber in the development of his protestant ethic thesis. Weber's thesis falls short of full proof, but despite much criticism it still retains a basic plausibility. As Ronald Preston has observed, complete verification is not possible: 'the most we can hope for is the demonstration of plausible correlations.' R.H. Preston, *Religion and the Persistence of Capitalism* (London: SCM Press 1979), p.20. It is important to understand the limits of Weber's argument. He distinguished the rise of the capitalist spirit from the rise of modern capitalism, and he accepted that other influences were also at work, indeed that the impact of Protestantism was only of transitional significance: 'Once modern capitalism became secured it no longer had need for practices such as Calvinism to break down the obstacles of economic traditionalism. The capitalist spirit would now be fuelled, as it were, from internal secular sources.' R. J. Holton, *The Transition from Feudalism to Capitalism* (London; Macmillan, 1985), p.113.

[83] The protest came from the 'Levellers' and the 'Diggers'. The best known event is probably the debates within Cromwell's army at Putney Church in October and November 1647. The central question was whether voting rights for Parliament should continue to depend on a property qualification. Those opposed to abolishing this qualification feared the undermining of property rights with all things held in common. The Levellers' egalitarianism was more political than economic: their concern was to establish the principle of government by consent, rather than to attack property rights. However, that was the aim of the more radical Diggers.

[84] See Sir David Lindsay Keir, *The Constitutional History of Modern Britain Since 1485* (London: A&C Black, 1966, 8th edn.), pp.365-6.

[85] In his essay on scarcity Wesley referred to his experience of the destitution caused by the high price of food, offering his own analysis of the structural economic problems which underlay the situation. Wesley saw a connection between poverty and unemployment (anticipating Keynes) but failed to press the point. Instead he attacks the high prices of wheat, oats, meat, dairy produce and land, ascribing them to too much of the produce being diverted to wrong uses, *viz:* distilling, horses and luxury. This produced scarcity which was driving prices beyond the means of the poor, and their plight was made worse by a high tax burden. The remedy he prescribed was to prohibit distilling, reduce the number of horses, regulate the letting of farms, repress luxury and pay off the national debt. He does not consider how to increase production. John Wesley, 'Thoughts on the Present Scarcity of Provision,' in George W. Forell *Christian Social Teachings* (Minneapolis: Augsburg Publishing House, 1971), p.285.

a man's first duty was to himself to ensure that he was provided with all that nature moderately required for preserving the body in health and strength; then to ensure that his wife, children, servants and household were similarly provided for; any surplus was to be applied to doing good to the household of faith, and then to all men.[86] The whole tenor of his advice is one with that of the reformers in encouraging both economic activity, sobriety, and stewardship. Like them he places the individual clearly at the centre with the community provided for by personal acts of charity, and, despite his social concern and his gospel proclamation, he failed to notice the real disjunction between the values of the Bible and those of his day. Weber treats him as a prime example of the ascetic Protestant spirit which unleashed the pursuit of wealth from earlier constraints while placing even greater constraints upon consumption, a combination which was highly functional in the development of modern capitalism.[87]

❑ SUMMARY

For all their concern to glorify God, and their strictures against selfishness and luxury, the Puritan teaching stands in stark contrast to that of earlier centuries. Comparison with the biblical criteria identified above is revealing:

1. COMMUNITY Gone is the communal dimension of faith, so basic to the Biblical view, and with it the idea that the well-being of the community is the primary criterion for economic activity. The special concern for the poor is no longer emphasised; indeed poverty is seen as evidence of moral and spiritual failure.

2. JUSTICE Although economic activity is not seen as *sui generis*, but as part of a man's duty to glorify God in all that he does, the foundations have been laid for freeing it from the demands of justice and fairness, and for a utilitarian system of ethics. Service, especially of the poorest, is not conspicuous as the hallmark of the exercise of authority.

3. GIFT The land has ceased to occupy a special category; it is a tradeable entity like a commodity.

4. EGALITY Riches have become a sign of God's favour, and the spiritual man pursues the increase of his riches as a divine calling, remembering as he did so that he might not use his gains for his own selfish ends. However, the injunction against selfishness did not imply any solidarity between the classes. Nor did the survival from earlier times of the insistence that property is held in trust. If the duty is, as Baxter maintained, to hold them undiminished for the glory of God, clearly the purpose of the trust is not the benefit of the community.

[86] See his sermon on *The Use of Money*, in George W. Forell, *Christian Social Teachings* (Minneapolis: Augsburg Publishing House, 1971), p.275.
[87] Weber, *op. cit.*, p.175.

It is clear that during the Reformation the demands of a more advanced commercial society had made considerable inroads on the biblical criteria. The Puritan outlook, 'favoured the development of a rational bourgeois economic life.... It stood at the cradle of modern economic man.'[88]

5. The Protest

After Wesley thinking on social and economic questions was largely, if not wholly, carried on outside the church. It was during this period that economics began to develop as a separate discipline, Adam Smith's *The Wealth of Nations* was published in 1776, and economic thinking broke free from any residual religious restraints. The demand for free trade, and the development of *laissez-faire* doctrines, were the outworking of the values and attitudes of the Reformation cut loose from the religious restraints of the reformers. Economic activity was regarded as *sui generis*; biblical ideas of community, the giftedness of land, and social solidarity were lost in a rationalist, individualist culture. The private interest took precedence over the public interest, and the gap between the rich and the poor became gross. However, the desperate social conditions which resulted from the industrial revolution could not remain unnoticed for long. Among those whose concern was aroused was F. D. Maurice, one of the leaders of the Christian Socialist Movement, who insisted that the church respond to the massive social evil all around it. While Maurice was acutely aware of the problem and of the inadequacy of contemporary ideas to provide a solution, he was unable to suggest a remedy beyond organised philanthropy. His socialism was not at all the scientific socialism of Marx and Engels with the public ownership of the means of production, distribution and exchange, but rather a somewhat vague expression of economic co-operation born of a dissatisfaction with the results of *laissez-faire* political economy. However, Maurice does represent the re-emergence in social ethics of the Biblical concern both for the community as the basic unit of moral concern, and for the poor as the special focus of God's care. He and others who shared his concerns set the stage for a renewed and vigorous engagement by Christians with the economic ideas which were now controlling everyday life.[89]

The Christian Social Movement was one among a number of responses to the social and economic conditions brought about by industrialisation. There was a widespread call for the re-Christianising of society, generally accompanied by biting criticism of *laissez-faire* capitalism and the culture of greed that supports

[88] Weber, *op. cit.*, p.174.

[89] Maurice's main work in which his ideas are developed is *The Kingdom of Christ* first published in 1842, reissued by the SCM Press (London) in 1958. A similar outcry was heard in America from Horace Bushnell who protested that the theories of government of his day 'totally forbid the entrance of moral considerations. Government, we think, is a social compact or agreement - a mere human creation, having as little connection with God, as little of a moral quality, as a ship of war or a public road.... The false notion has taken possession of the public mind, and received the practical assent of ministers of religion themselves, that they must not meddle with politics.... It is the solemn duty of the ministers of religion to make their people feel the presence of God's law everywhere...' *Politics Under the Law of God*, (Hartford, Conn: Edwin Hunt, 1844) in Forell *op. cit.*, pp.316-7.

and is fostered by it.[90] In America particularly, the period of industrialisation which followed the civil war, with its rapidly expanding urban population swollen by immigration from abroad, brought problems of social maladjustment and poverty to which the traditional message of Protestant churches seemed remote and inept. While industrial capitalism and the crowded cities of America crushed the spirits of men *en masse*, the churches were attempting pathetically to 'save souls' one by one for a life beyond.[91] Thus, one prominent feature of these criticisms was the insistence on the systemic character of both good and evil - at the same time both a reaction against the prevailing individualism of Christian faith and a radical return to the teaching of the Bible and of the early Church. The leaders of the protest 'called the church to turn from its complacency and escapism to the social problems of industrialism, to fight the real powers of darkness, economic corruption in high places and grinding poverty in low.'[92] Christian thinkers were now heard to proclaim that humanity is not just a collection of individuals; it is a society bound together in a network of relationships and structures.[93] Another feature of these responses was the return of the prophetic tradition in Christianity with its emphasis on justice and the primacy of the needs of the poor over those of the rich. Not surprisingly some Christians also turned to the new ideology of socialism as the vehicle for expressing their criticisms; some adopted it more or less *in toto*, but most were more guarded.[94]

❑ THE SOCIAL GOSPEL

In the U.S.A. one expression of this protest against the evils of the day was the Social Gospel Movement. At the beginning of this century, William Lawrence, the Episcopalian Bishop of Massachusetts, wrote that 'in the long run it is only to the man of morality that wealth comes.... Godliness is in league with riches.'[95] He argued that Man draws wealth to himself as naturally as a tree draws the elements into itself from the earth, and that an increase in wealth was, in the long run, favourable to the morals of the people. While this might be true for

[90] *E.g.* Walter Rauschenbusch, writing at the turn of the century, believed that business life was the source of the troubles of the times. 'It is in commerce and industry that we encounter the great collective inhumanities that shame our Christian feeling.... Here we find the friction between great classes of men which makes whole communities hot with smouldering hate or sets them ablaze with lawlessness. To commerce and industry we are learning to trace the foul stream of sex prostitution, poverty, and political corruption. Just as an epidemic of typhoid fever would call for an analysis of the water supply, so these chronic conditions call for a moral analysis of the economic order....' *Christianizing the Social Order* (New York: Macmillan, 1912), p.156.

[91] W.Beach & H.R.Neibuhr, *Christian Ethics* (New York: The Ronald Press Co., 1973), pp.445-6.

[92] *Ibid*, p.446.

[93] The denial of this aspect of the human condition is one of the grosser manifestations of the New Right in contemporary society.

[94] Leonhard Ragaz is a good representative of this position. He believed 'that socialism in its basic goals provides the direction that will lead us out of capitalism to the next higher level in historical development.' Even so, he stopped short of identifying the teachings of Christ with any particular social order, even socialism. Perceiving its inner tensions, he warned it must choose between becoming 'an absolute and despotic power or...a democratic one, either...an authoritarian and coercive force or...a power of freedom.' See *Signs of the Kingdom: A Ragaz Reader*, ed. and trans. Paul Bock (Grand Rapids: Eerdmans, 1984), pp.6 & 54.

[95] William Lawrence, 'The relation of Wealth to Morals', *The World's Work* Vol.I, No.3 (Jan 1901), in Forell *op. cit.* p.331.

the illustration he used (an Irish immigrant bettering himself by hard work and education), it was not a perception shared by all protestants of the time. Thus Washington Gladden was critical of the separation of religion and industrial relations, asserting that Christians must affirm the hand of God in the industrial struggle in the conviction that 'he has a way for human beings to live and work together', and that social reform must go hand in hand with the revival of religion.'[96] Underlying his essay is the belief that the separation between religion and economic affairs was not only unfortunate in its effects but also unreal in its implied statement about God. Referring to the general assumption that business and religion are poles apart, businessmen being 'too busy to be pious and too worldly to be saints,' Francis Peabody said, ' And yet, if the Christian character is to have any place in modern life, it must be precisely where men are set, in the heat of the world's work and under the load of the world's care; and the worst of disasters, alike for religion and for business, is to separate the one from the other.'[97] The proper relation between business and religion, he argued, was symbiotic, and in a prophetic passage set out the vision of the Movement:

> Precisely as the modern miracles of intercommunication have transformed the world into an organism where the progress or decadence of one nation is felt, like pain at the extremities of a body, at the remotest parts; precisely as a new economics and a new politics have issued from this new thought of the unity of the world, - so the circle of religious experience has widened from the problem of personal redemption to the problem of a world to be redeemed; and the individual, instead of being called to save his soul from a lost world, is called to set his soul to save the world. The religion of the twentieth century must contemplate the world, not as a chaos of competing atoms, but as an organic and indivisible whole. It must socialize its hopes, and save people, not singly but together, the poor with the prosperous, the employed with the employer, the Oriental with the Occidental, the Black with the White.[98]

Walter Rauschenbusch, the main spokesman of the Movement, used the concept of the Kingdom of God as the governing idea of the Social Gospel. This concept, he believed, had been lost to Christian theology, driven out by the development of the doctrine of the Church, one consequence of which was the loss of the distinctive ethical principles of Jesus which were the outgrowth of his teaching about the Kingdom. He wrote: 'The Kingdom ideal is the test and corrective of the influence of the Church. When the Kingdom ideal

[96] Washington Gladden, *Social Salvation* (Boston and New York: Houghton Mifflin & Co., 1902) in Forell *op. cit.*, pp. 262-4.
[97] Francis Peabody, *The Approach to the Social Question* (New York: Macmillan, 1909), in Forell, *op. cit.*, p.367.
[98] *Ibid.* It is arresting to note that the modern conception of the global village was already apparent in 1909.

disappeared, the conscience of the Church was muffled.... It became possible for the most unjust social conditions to fasten themselves on Christian nations without awakening any consciousness that the purpose of Christ was being defied and beaten back.'[99] In consequence secular life was belittled as compared with religious life; the religious value was taken out of the activities of the common man, and the future life became the horizon of theology rather than the task of saving the social order. The Kingdom, he believed, was nothing less than 'the Christian transfiguration of the social order.'[100] Rauschenbusch protested against the individualism of his time, arguing particularly for a wider understanding of the concept of sin. Thinking about sin, he argued, must be socialised: 'Sin is not a private transaction between the sinner and God. Humanity always crowds the audience room when God holds court.'[101] Amplifying his doctrine, he writes:

> Sin is essentially selfishness. That definition is more in harmony with the social gospel than with any individualistic type of religion. The sinful mind, then, is the unsocial and anti-social mind. To find the climax of sin we must not linger over a man who swears, or sneers at religion, or denies the mystery of the trinity, but put our hands on social groups who have turned the patrimony of a nation into the private property of a small class, or who have left the peasant labourers cowed, degraded, demoralised, and without rights in the land. When we find such in history, or in present day life, we shall know we have struck real rebellion against God on the higher levels of sin.[102]

Among the examples he gives of these higher levels of sin are those who work against the interests of the poor by organising powerful lobbies to defeat tenement or factory legislation, or to turn factory inspection into a sham. 'Sin selfishly takes from others their opportunities for self-realization in order to increase its own opportunities abnormally; and it shirks its own labour and thereby abnormally increases the labour of others.'[103] Applying his ideas to the business of corporate government, Rauschenbusch argues for a co-operative structure. The capitalistic joint-stock company, working on the basis of 'one

[99] Walter Rauschenbusch, *A Theology for the Social Gospel* (New York: Macmillan, 1917), in Forell, *op. cit.* p.373.
[100] Rauschenbusch, *op. cit.*, in *Christian Ethics*, W.Beach & H.R.Niebuhr (eds.) (New York: The Ronald Press Company, 1973), p.473.
[101] *Ibid*, p.454.
[102] *Ibid*, p.455-6. Rauschenbusch also comments that so deeply has the concept of sin been skewed by the absence of a religious ideal of social life, that people who have been exposed to a lifetime of Christian teaching are not aware that the values and practices of commercial life which they take for granted are contrary to the ethics of the Kingdom. He continues, arguing for a wider understanding of salvation than the merely individual: 'The definition of sin as selfishness gets its reality and nipping force only when we see humanity as a great solidarity and God indwelling in it. In the same way the terms and definitions of salvation get more realistic significance and ethical reach when we see the internal crises of the individual in connection with the social forces which play upon him or go out from him.' *Ibid* at p.462.
[103] *Ibid*, p.457.

share one vote', locates power with money, allowing the rich minority, or individual, to outvote all the rest. Money thus becomes stronger than life, character and personality. By contrast a co-operative works on the basis of one-person-one-vote. Here rich and poor are equalised; what counts is not money power but character, sobriety and good judgement.[104] The fundamental step of repentance for professions and organisations, he asserts, is to give up monopoly power and the incomes derived from legalised extortion, and to come under the law of service, content with a fair income for honest work.[105] At the turn of the century the Social Gospel Movement became a more official part of the life of the church with the adoption of the *Social Creed* in 1908. Among other things this demanded better industrial working conditions, an end to child labour, shorter working hours, 'a living wage in every industry....the highest wage that each industry can afford....and the most equitable division of the products of industry that can ultimately be devised.'[106]

The Social Gospel Movement had a deep influence on one of the formative thinkers of this century, Reinhold Niebuhr. In *Moral Man and Immoral Society* Niebuhr drew attention to the common experience of people who show high moral standards in personal conduct behaving in immoral ways in institutional and group settings. Low standards of collective morality seemed to be far more tolerable, and indeed inevitable, than in personal behaviour. In this situation, he argued, it was misleading to talk about love - the selfless regard for the other, and the purest expression of the Christian ethic - when discussing social and political issues; justice was the more meaningful concept. Indeed, Niebuhr argued that justice is prior to love; without justice love is sentimental - it is not really love at all. Justice he defined as the tolerable but imperfect accommodation of life to life, with protection of human rights and liberties, and structures of justice are required to protect the weak and poor members of society. Niebuhr was realistic about the human situation, and in a memorable phrase he linked the case for social justice to the case for democracy: 'Man's capacity for justice makes democracy possible, but man's inclination to injustice makes democracy necessary.'[107] However, he separated the case for democracy from the case for bourgeois capitalism with its strongly individualist character. 'Bourgeois individualism, he felt, grasps neither the depth of human sin nor the extent of human need for community.'[108] In more recent times but in similar vein Bernard Haring argued that the fundamental purpose of moral theology is not to make concrete decisions in particular cases, but 'to gain the right vision, to assess the main perspectives, and to present those truths and values which

[104] The stakeholder concept aired in recent debate has something of the same character as Rauschenbusch's co-operative.
[105] *Ibid*, p.467.
[106] *The Social Creed*, adopted by the General Conference of the Methodist Episcopal Church: Wogaman, *Ethics*, p.203.
[107] Reinhold Niebuhr, *The Children of Light and the Children of Darkness* (New York: Charles Scribner's Sons, 1941) p.xiii.
[108] Wogaman, *Ethics.*, p.220.

should bear upon decisions to be made before God.'[109] Haring based his moral theology on the covenant, God's loving relationship with humanity as encountered in Jesus Christ. The essence of the covenant is love; its character is freedom. The Covenant cannot be expressed in terms of law because love transcends all legal standards. Thus he writes, 'One of the most uncreative approaches in the church is to stress fidelity to certain negative commandments to such an extent that fidelity to Christ and his great affirmative commandments of justice, love and mercy is seriously neglected.'[110]

❑ SUMMARY

At the heart of the protest is the search for an over-arching vision which could comprehend both the spiritual and the material. It rejected the idea that economic life was *sui generis,* and sought to subject it to basic Christian values. The Puritan depiction of poverty as a sign of moral failure is rejected, and the plight of the poor again becomes the standard by which the whole of society is judged. Also rejected is the idea that the discharge of the biblical duty of solidarity between rich and poor could be left to private philanthropy; an institutional means of achieving this was essential, and Niebuhr's stress on justice provided the theoretical justification for doing this. He wrote at much the same time as Keynes whose economics sought to achieve the same end. They were both part of the reaction to the excesses of *laissez-faire* doctrines. It would be ironic if it were not tragic, that those doctrines had been fuelled by the perversion of scriptural social teaching at the hands of the Puritans, and from a Christian standpoint it seems perverse that monetarism, the theory which displaced Keynes, was itself inspired by those same discredited doctrines. If there is a message for today in the protest perhaps it is that the conscience of mankind cannot tolerate indefinitely the existence of structural social injustice. The affirmation of the centrality of justice to social ethics is one of the outstanding features of both Roman Catholic and ecumenical teaching this century, and together with the insistence on the covenantal basis of man's relation with the natural world and the protection of human rights, has been the basis for a Christian re-engagement with the ethics of economics, and to this we now turn.

[109] Bernard Haring, *Free and Faithful in Christ*, Vol I of *General Moral Theology* (New York: Seabury Press, 1978), p.6.
[110] *Ibid.*, pp.75-76.

III

Modern Christian Social Doctrine

This chapter continues the process of establishing criteria for judging the ethics of economic activity, and carries over from chapter II and develops the four basic ethical principles. It concentrates on the official teaching of the western Church, as exemplified in Papal Encyclicals and the Statements of the World Council of Churches and other Ecumenical Assemblies, as giving authoritative guidance which can used for formulating criteria; some statements of individual Protestant Churches are also noted. Many individual authors have also contributed to the discussion; some are noted below in comments on the official teaching, and some in the concluding chapter.

1. The Social Encyclicals

The Churches re-engagement with the ethics of economics began officially, so to speak, with the publication in 1891 of *Rerum Novarum*, the first of the so-called social encyclicals, and has continued unabated until the present day.

❑ RERUM NOVARUM 1891

As the title implies, *Rerum Novarum* sought to address the new situation facing western civilisation and the Church brought about by the spread of democracy, *laissez-faire* capitalism, and the rise of communism. Pope Leo XIII was concerned to safeguard the well-being of workers and the achievement of the common good, and to restate the church's authority over economic life. The language pulls no punches; it is both forceful and striking:

> ...it has come to pass that working-men have been surrendered, isolated and helpless, to the hard-heartedness of employers and the greed of unchecked competition. The mischief has been increased by rapacious usury, which, although more than once condemned by the Church, is nevertheless, under a different guise, with the like injustice, still practised by covetous and grasping men. To this must be added that the hiring of labour and the conduct of trade are concentrated in the hands of comparatively few; so that a small number of very rich men have been able to lay upon the teeming masses of the labouring poor a yoke little better than that of slavery itself.[1]

[1] Pope Leo XIII, *Rerum Novarum*, section 2.

He condemned the exploitation of workers for inadequate wages and bad conditions of work, and restated the duty of the rich to help the poor. Indeed, Pope Leo's concern to better the condition of the workers is passionate. Both employers and the state are reminded that 'it is only by the labour of working-men that states grow rich and that the well-being of those who work must obtain favourable consideration.[2] Echoing the natural law doctrine of Thomas Aquinas, Pope Leo XIII advocated a 'just wage', that is one which would allow the worker to maintain himself and his family 'in reasonable comfort'. He did not, however, attempt to reconcile the just wage with the process of wage determination in the free market, but he did stress that Christian employers should pay the just wage. Where the worker is compelled to accept less than the just wage or to submit to bad conditions of employment, Leo asserted that he is 'the victim of force and injustice.'[3] The concept of the common good is developed as a positive duty 'to make sure that the laws and institutions, the general character and administration of the commonwealth shall be such as to produce of themselves public well-being and private prosperity.'[4] Because 'the interests of all, whether high or low are equal', it is a 'grave duty of rulers...to act with strict justice' by which Leo means *distributive* justice.[5] The state should recognise that its authority comes from God, and governments should reflect the divine concern for all its citizens, especially the poor and helpless. *Rerum Novarum* also introduced the principle of 'subsidiarity' which required that the state dealt with only those problems which cannot be dealt with by lower, more immediate levels of social organisation.

However, this social concern did not lead Leo to approve of socialism. He rejected its egalitarian character as both contrary to nature and likely to lead to various social evils including a disinclination to hard work, but his main criticism was that it would destroy the natural right of property. Leo argued that even though God had given the earth for the use and enjoyment of the whole human race, this was no bar to the owning of private property. The right to private property was inherent in the nature of human economic activity; property was established by labour:

> Now when man thus spends the industry of his mind and the strength of his body in procuring the fruits of nature, by that act he makes his own that portion of nature's field which he cultivates - that portion on which he leaves, as it were, the impress of his own personality; and it cannot but be just that he possess that portion as his own, and have a right to keep it without molestation.[6]

[2] *Ibid*, sections 27 & 29.
[3] *Ibid*, section 35.
[4] *Ibid*, section 26.
[5] *Ibid*, section 27.
[6] *Ibid*, section 7.

Socialists, by proposing to abolish private rights to property, struck not only at a natural right,[7] but removed the hope of ordinary wage-earners of bettering their condition in life. Leo also seems to reject the OT view that the land cannot be owned outright, arguing that those who maintain the contrary defraud man of what his labour has produced.[8] Although Leo accepted that inequalities between men were inevitable, and indeed had their advantages,[9] this did not lead him to approve of the liberal political and economic ideas which were current at the time. As already noted, he rejected the determination of wages by the market alone as unjust; also he advocated that the power of the state be used to remedy social injustice, reminding the rulers that the poor have a claim to 'especial consideration': 'The richer class have many ways of shielding themselves, and stand less in need of help from the state; whereas the mass of the poor have no resources of their own to fall back upon, and must chiefly depend upon the assistance of the state.[10] Throughout its pages *Rerum Novarum* reflects the Biblical view of social solidarity: the primary criterion for economic activity is the well-being of the community; the common good takes precedence over the individual interest.

❑ QUADRAGESIMO ANNO 1931 / DIVINI REDEMPTORIS 1937

Rerum Novarum had a profound effect on Catholic social thought, and in 1931 its fortieth anniversary was marked by the publication by Pius XI of *Quadragesimo Anno*. Fulsome in his praise of his predecessor's work, Pius made no bones about the inadequacy of liberal ideas averring that *Rerum Novarum* 'completely overthrew those tottering tenets of liberalism which had long hampered effective interference by the government,' and as a result there had arisen 'a new branch of law unknown to earlier times' establishing and safe-guarding employment and welfare rights.[11] He confirmed Leo's teaching on the rights of ownership and private property, but also stressed the principle of the just distribution of wealth 'in conformity with the demands of the common good or social justice' and condemned the then distribution of wealth as 'gravely defective.'[12]

[7] 'Every man has by nature the right to possess property as his own....[and because] man alone is endowed with reason, it must be within his right to possess things not merely for temporary and momentary use...but to have and to hold them in stable and permanent possession.' *Ibid*, section 5.

[8] 'They [*i.e.* those of a contrary view] assert that it is right for private persons to have the use of the soil and its various fruits, but that it is unjust for anyone to possess outright either the land on which he has built, or the estate which he has brought under cultivation. But those who deny these rights do not perceive that they are defrauding man of what his own labour has produced.' *Ibid*, section 8.

[9] 'Such inequality is far from being disadvantageous either to individuals or to the community. Social and public life can only be maintained by means of various kinds of capacity for business and the playing of many parts; and each man, as a rule, chooses the part which suits his own peculiar domestic condition.' *Ibid*, section 14.

[10] *Ibid*, section 29.

[11] Pope Pius XI, *Quadragesimo Anno*, sections 27 & 28. In a later section (30) he likens liberalism to a disease, referring to the way in which certain rulers were 'infected' by it.

[12] *Ibid*, section 58. In section 57 Pius reiterated the Biblical concern for the good of the whole community; newly-created wealth must be so distributed that the needs of all are satisfied. 'By this principle of social justice, one class is forbidden to exclude the other from a share of the benefits.'

Quadragesimo Anno was written two years after the Wall Street crash which resulted in economic recession and widespread unemployment. It insisted on the subordination of the economic order to the moral order, rejecting in forthright terms the economic ideas which had produced the problems for which Keynes had sought to find a solution:

> Just as the unity of human society cannot be built upon opposition between classes, so the proper ordering of economic life cannot be left to free competition. From this contaminated source have proceeded in the past all the errors of the economic individualist school. This school, ignorant or forgetful of the social and moral aspect of economic life, held that this must be considered and treated by the state as absolutely free and independent, because it possesses in free competition and open markets a principle of self-direction better able to control it than any human ingenuity. Free competition, however, though within certain limits right and productive of good results, cannot be the guiding principle of economic life; this has been abundantly proved by the consequences that have followed from the practical application of these dangerous individualist ideas. It is therefore very necessary that economic life be once more subjected to and governed by a true and effective guiding principle.[13]

The Pope showed an equally acute concern over the concentration of economic power, particularly since the unrestrained competition of the preceding years had meant that 'immense power and despotic economic domination' had become concentrated in the hands of a few.[14] Unemployment is also condemned for its adverse individual and social effects; communism and socialism are both rejected, although Pius does note that socialist policies 'sometimes closely approach the just demands of Christian social reformers.'[15] Particularly important is Pius' elaboration of the principle of subsidiarity, which is advocated as a means of reconstructing the social order. Accepting that in modern times much that was formerly done by small groups can now only be done by large associations, Pius writes:

> None-the-less, just as it is wrong to withdraw from the individual and commit to a group what private enterprise and industry can

[13] *Ibid*, section 88.

[14] *Ibid*, section 105. In section 107 he argues that the concentration of economic power is the result 'of limitless free competition, which permits the survival of those only who are the strongest, and this often means those who fight most relentlessly, who pay least heed to the dictates of conscience.'

[15] *Ibid*, section 113. This thawing in the attitude towards socialism is clearer in the next section (114) where Pius detects an abatement in the attack on private property. He observes that if this trend continues 'it may well come about that gradually these tenets of mitigated socialism will no longer be different from the programme of those who seek to reform human society according to Christian principles.' However, in the end he believes that socialism, however attenuated, cannot be brought into harmony with the dogmas of the catholic church because it sees the aim of human society merely as material well-being. (Sections 117-119)

> accomplish, so too it is an injustice, a grave evil and a disturbance of right order, for a larger and higher association to arrogate to itself functions which can be performed efficiently by smaller and lower societies.... Of its very nature the true aim of all social activity should be to help members of the social body, but never to destroy or absorb them.[16]

Six years later in *Divini Redemptoris* again he condemned *laissez-faire* capitalism and argued the case for Christian social justice as an alternative to collective ideologies, asserting that 'the wage-earner is not to receive as alms what is his due in justice. And let no one attempt with trifling charitable donations to exempt himself from the great duties imposed by justice.'[17] In the early social encyclicals the popes struggled to preserve an organic understanding of society in face of the pressures of industrial interests. The competitive individualism of *laissez-faire* economic theories and practices was rejected as an adequate basis for human society, and consistent with the Biblical vision, the Popes sought to formulate an understanding of workers' rights and the common good in terms relevant to the new industrial age.

❑ MATER ET MAGISTRA 1961 / PACEM IN TERRIS 1963

To mark the seventieth anniversary of *Rerum Novarum* John XXIII issued *Mater et Magistra*. While reiterating the teaching of the earlier encyclicals, John turned their doctrines towards more egalitarian outcomes. It was not sufficient to assert that the right to own property was inherent in human nature, it must be insisted that that right be extended to all classes of citizens. John argued for a more widespread distribution of property, including shares in businesses, and for a strong public sector in the economy - a requirement made necessary by the demands of the common good. Public ownership should observe the limitations of subsidiarity, the common good again being the test of what is permissible: 'public authority must encourage and assist private enterprise, entrusting to it, wherever possible, the continuation of economic development.'[18]

In *Pacem in Terris* John asserted that 'the attainment of the common good is the sole reason for the existence of civil authorities' because 'it is in the nature of the common good that all citizens have a right to share in it.'[19] The common good extends beyond the material affecting 'the needs of the whole individual, body and soul'.[20] Re-inforcing this teaching, an important Biblical theme resurfaced in this encyclical which later came to be called the 'preferential option

[16] *Ibid*, section 79. John Coleman has remarked that subsidiarity is 'neither a theological or even really a philosophical principle, but a piece of congealed historical wisdom.' Quoted by Michael Walsh in *The New Politics*, Paul Vallely (ed) (London: SCM Press, 1998), p.36.
[17] *Divini Redemptoris*, section 49.
[18] Pope John XXIII, *Mater et Magistra* (1961), section 152.
[19] Pope John XXIII, *Pacem in Terris* (1963), sections 54 & 56.
[20] *Ibid*, section 57.

for the poor.'[21] John writes: 'considerations of justice and equity can at times demand that those in power pay more attention to the weaker members of society, since these are at a disadvantage when it comes to defending their own rights and asserting their legitimate interests.'[22] He also advanced a notable extension of the doctrine of subsidiarity: if a problem could not be dealt with at a local level, the doctrine required that it be passed up to the appropriate higher level. The reason for this extension is clear enough in the context of the letter, namely the threat of thermonuclear war, but it could also have applications in the management of the economy, particularly in giving the state the duty to ensure that the market does not work against the interests of the poor - as *Pacem in Terris* implies; in some situations social justice will take precedence over economic efficiency.

❑ GAUDIUM ET SPES 1965

These themes were confirmed by the second Vatican Council in *Gaudium et Spes*, the 'Pastoral Constitution on the Church in the Modern World'. Noting the 'increasingly close interdependence which is gradually extending to the entire world,' the Council recognised the need to extend the role of the common good, defining it as 'the sum total of social conditions which allow people, either as groups or individuals, to reach their fulfilment more fully and more easily.'[23] The rights flowing from this, in the Council's view, are those necessary for living a genuine human life, including a number of 'positive' rights, *e.g.* the right to work. Notably, the Council called for greater equality. Equality, it said, is grounded in the 'rational soul' of all human beings, their common creation in the image of God and their common redemption through Christ. The Council warned that a purely individualistic morality fell short of the demands of the age; fulfilling social obligations should be regarded as a sacred duty.[24] In the same vein it insisted upon the subordination of economic activity to the social and spiritual needs of all the world's peoples,[25] and called on each country to end as soon as possible the immense economic inequalities which exist in the world, which increase daily and which go hand in hand with individual and

[21] The actual phrase originated in the Report of the Synod of Bishops, *Justice in the World*, 1971.

[22] *Ibid*, section 56.

[23] *Gaudium et Spes*, section 26. This definition of the common good has wide implications: 'The resulting rights and obligations are consequently the concern of the entire human race. Every group must take into account the needs and legitimate aspirations of every other group, and even those of the human family as a whole.' The text used is that contained in Austin Flannery OP (ed), *Vatican Council II, The Basic Sixteen Documents* (New York: Costello; Dublin: Dominican Publications, 1996).

[24] *Ibid*, sections 29 & 30. In section 32 the Council rejected explicitly the idea that God created people to live as individuals; his purpose is that they 'come together in the formation of social unity'. This communitarian character is reflected in his calling of a people to proclaim his truth, and is 'perfected in fulfilled in the work of Jesus Christ.'

[25] *Ibid*, section 64: 'The ultimate and basic purpose of economic production does not consist merely in producing more goods, nor in profit or prestige; economic production is meant to be at the service of humanity in its totality, taking into account people's material need and the requirements of their intellectual, moral, spiritual, and religious life.... Therefore, economic activity is to be carried out in accordance with techniques and methods belonging to the moral order, so that God's design for humanity may be carried out.'

social discrimination"[26] It also re-affirmed the universal destination of earthly goods,[27] implying from it a right for everyone 'to possess a sufficient amount of the earth's goods for themselves and their family,' and recognised private property as necessary 'to the expression of personality.'[28] Commenting on the description of this document as a *pastoral* constitution, Wogaman observes, that it points to a new level of understanding because 'it suggests that individual and social aspects of human existence cannot so easily be separated if the church is to minister to whole persons in their actual social context.'[29]

❑ POPULORUM PROGRESSIO 1967 / OCTAGESIMA ADVENIENS 1971

Paul VI continued to develop the church's social teaching along the now-familiar lines. In *Populorum Progressio* he insisted that man is both social and individual by nature, and, citing the opinion of Ambrose mentioned above,[30] he set limits to the notion of private property more freely advanced in *Rerum Novarum*: 'private property does not constitute for anyone an absolute and unconditional right. No one is justified in keeping for his exclusive use whatever he does not need when others lack necessities....[T]he right to property must never be exercised to the detriment of the common good.'[31] This egalitarian emphasis led him to advocate social programmes to alleviate poverty so as to avoid increasing 'still more the wealth of the rich and the dominance of the strong, whilst leaving the poor in their misery and adding to the servitude of the oppressed.'[32] He called upon governments to take the lead in addressing social injustice, stressing at the same time that the principles of free trade are not adequate to the needs of development, aware that he is questioning a fundamental principle of liberalism.[33]

In 1971 Paul VI issued his apostolic letter *Octagesima Adveniens* to mark the eightieth anniversary of *Rerum Novarum*. In it he warned of the long-term effects of environmental degradation,[34] condemned 'flagrant inequalities'[35] among the nations, and placed new emphasis on 'the preferential respect due to the

[26] *Ibid*, section 66.
[27] *Ibid*, section 69.
[28] *Ibid*, section 71.
[29] Wogaman, *Ethics*, p.241.
[30] See p.45.
[31] Pope Paul VI, *Populorum Progressio*, section 24.
[32] *Ibid*, section 33.
[33] *Ibid*, section 56ff. Paul VI accepts that free trade between equals has advantages, but not when 'economic conditions differ too widely from country to country; prices which are "freely" set in the market can produce unfair results. One must recognise that it is the fundamental principle of "liberalism", as the rule for commercial exchange, which is questioned here.' (Section 58)
[34] Pope Paul VI, *Octagesima Adveniens*, section 21: 'Man is suddenly becoming aware that by an ill-considered exploitation of nature he risks destroying it and becoming in his turn the victim of this degradation. Not only is the material environment becoming a permanent menace - pollution and refuse, new illnesses and absolute destructive capacity - but the human framework is no longer under man's control, thus creating an environment for tomorrow which may well be intolerable.'
[35] *Ibid*, section 2.

poor.'[36] He expressed a guarded openness to to some forms of socialism,[37] and criticised the renewal of liberal ideology for its 'erroneous affirmation of the autonomy of the individual in his activity, his motivation and the exercise of his liberty.'[38] Asserting the subordination of economics to politics, he asked if there was not 'a radical limitation to economics' which rendered it inappropriate to determine social structures?

> The ambition of many nations, in the competition that sets them in opposition and which carries them along, is to attain technological, economic and military power. This ambition then stands in the way of setting up structures in which the rhythm of progress would be regulated with a view to greater justice, instead of accentuating inequalities and living in a climate of distrust and struggle which would unceasingly compromise peace.[39]

❑ LABOREM EXERCENS 1981 / SOLICITUDO REI SOCIALIS 1987

These themes were developed further by John Paul II. In *Laborem Exercens* he spoke of the moral nature of work, asserting that '[t]he primary basis of the value of work is man himself, who is its subject,' and insisting on 'the principle of the priority of labour over capital,' a priority which meant it was wrong to treat labour solely on the basis of its economic function.[40] As in other matters, we see here a return to a more biblically based scale of values which is also evidenced in John Paul's teaching about private property. The right to private property is affirmed but not absolutely: 'the right to private property is subordinated to the right to common use, to the fact that goods are meant for everyone,'[41] and in some cases, he says, the socialization of the means of production cannot be ruled out.[42]

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[36] *Ibid*, section 23: 'In teaching us charity, the Gospel instructs us in the preferential respect due to the poor and the special situation they have in society: the more fortunate should renounce some of their rights so as to place their goods more generously at the service of others.' Paul is at pains to set the preferential option within the context of a mutual solidarity in which the poor also have their duty to the common good: 'If, beyond legal rules, there is really no deeper feeling of respect for and service to others, then even equality before the law can serve as an alibi for flagrant discrimination, continued exploitation and actual contempt. Without a renewed education in solidarity, an over-emphasis of equality can give rise to an individualism in which each one claims his own rights without wishing to be answerable for the common good.' *Loc. cit.*

[37] *Ibid*, section 31. Paul recognises that socialists share the Christian aspiration towards a more just and equal society, but warns that Christians part company with socialists when they offer 'an ideology which claims to give a self-sufficient picture of man.' He also notes the dialogue with Marxism but warns that even though it may present itself in new forms, at root it it based on the idea of class struggle, and urges Christians to note 'the kind of totalitarian and violent society to which this process leads.' (Section 34)

[38] *Ibid*, section 35.

[39] *Ibid*, sections 45 & 46.

[40] Pope John Paul II, *Laborem Exercens*, sections 6 & 12.

[41] *Ibid*, section 14.

[42] *Ibid*.

❑ CENTESIMUS ANNUS 1991

Three years later in the midst of the collapse of Eastern Europe, John Paul II issued *Centesimus Annus*, marking the centenary of *Rerum Novarum*. Echoing his predecessors' teaching, he was critical of both collective and liberal economic theories, and insisted upon the duty of the state to set the context for economic activity: 'The state...has the task of determining the juridical framework within which economic affairs are to be conducted, and thus of safeguarding the prerequisites of a free economy, which presumes a certain equality between the parties, such that one party would not be so powerful as practically to reduce the other to subservience.'[43] The underlying fault of both ideologies was their misconception of the nature of the human person which led to a distorted view of both human freedom and human society.[44] He criticised both communism and capitalism for their exaltation of the economic over the spiritual: when 'the affluent society or the consumer society.... seeks to defeat Marxism on the level of pure materialism by showing how a free-market society can achieve a greater satisfaction of material human needs than Communism, while equally excluding spiritual values...it agrees with Marxism, in the sense that it totally reduces man to the sphere of economics and the satisfaction of material needs.'[45]

Perhaps most telling are the Pope's strictures against capitalism. He warned the capitalist countries against triumphalism: 'it is unacceptable to say that the defeat of so-called "Real Socialism" leaves capitalism as the only model of economic organisation.'[46] The market has its limitations: 'there are collective and qualitative needs which cannot be satisfied by market mechanisms. There are important human needs which escape its logic. There are goods which by their very nature cannot and must not be bought or sold.'[47] Therefore, even in a free market economy, the state should have a significant role in regulating and enabling the market and in defending the 'collective goods' without which society cannot function. Notably, *Centesimus Annus* accepts that when an economic system ceases to serve basic human needs it is right for Christians to work against it:

> In this sense, it is right to speak of a struggle against an economic system, if the latter is understood as a method of upholding the absolute predominance of capital, the possession of the means of

[43] Pope John Paul II, *Centesimus Annus*, section 15.

[44] "[T]his error consists in an understanding of human freedom which detaches it from freedom to the truth, and consequently from the duty to respect the rights of others. The essence of freedom then becomes self-love carried to the point of contempt for God and neighbour, a self-love which leads to an unbridled affirmation of self-interest and which refuses to be limited by any demand of justice.' *Ibid* section 17. The rights to which the Pope refers are described earlier in the encyclical and go beyond 'negative' rights to include social and economic rights, *e.g.* the right to a just wage and fair working conditions. (See sections 6-9.)

[45] *Ibid*, section 19. The same point is made by Lesslie Newbiggin in his analysis of contemporary culture: see *The Gospel in a Pluralist Society* (London: SPCK, 1989).

[46] *Ibid*, section 35.

[47] *Ibid*, section 40.

production and of the land, in contrast to the free and personal nature of human work. In the struggle against such a system, what is being proposed as an alternative is not the socialist system, which in fact turns out to be state capitalism, but rather *a society of free work, of enterprise and of participation.* Such a society is not directed against the market, but demands that the market be appropriately controlled by the forces of society and by the state, so as to guarantee that the basic needs of the whole of society are satisfied.[48]

While profits are accepted as a legitimate aim of a business, being an indication that it is functioning efficiently, Pope John Paul II is clear that profits are not the sole aim, nor indeed are they the 'bottom line':

> the purpose of a business firm is not simply to make a profit, but is to be found in its very existence as a *community of persons* who in various ways are endeavouring to satisfy their basic needs, and who form a particular group at the service of the whole of society. Profit is a regulator of the life of a business, but it is not the only one; *other human and moral factors* must also be considered which, in the long term, are at least equally important for the life of a business.[49]

Again the Pope insists upon the subordination of economics to ethics; even the decision to invest in one place rather than another is always 'a *moral and cultural choice,*'[50] and ownership of the means of production becomes illegitimate when it seeks profits at the expense of the overall expansion of work and the wealth of society.[51] The *ecological question* - the excessive and disordered way in which man consumes the resources of the earth - is based on an anthropological error: human cleverness blinds man to the truth that creation is God's gift.

> Man thinks that he can make arbitrary use of the earth, subjecting it without restraint to his will, as though it did not have its own requisites and a prior God-given purpose, which man can indeed develop but must not betray. Instead of carrying out his role as a co-operator with God in the work of creation, man sets himself up in place of God and thus ends up provoking a rebellion on the part of nature, which is more tyrannised than governed by him.[52]

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[48] *Ibid*, section 35.
[49] *Loc. cit.* In the next section Pope John Paul II sharply criticises the consumerist mentality which seeks to generate new needs and desires which fail to take account of the true calling of man. The result is alienation: people become ensnared in a web of false and superficial gratifications rather than being helped to experience their personhood in an authentic and concrete way. Alienation is also experience in work in which the worker becomes a means and not an end. (See Section 41.)
[50] *Ibid*, section 36.
[51] *Ibid*, section 43.
[52] *Ibid*, section 37.

Implicitly criticising New Right thinking, John Paul is clear that economic freedom is only one element in human freedom and when it becomes autonomous it looses its necessary relationship with the human person and ends up alienating and oppressing him. The proper role of the state goes well beyond the limited role which Hayek and others have prescribed:

> It is the task of the state to provide for the defence and preservation of common goods such as the natural and human environments, which cannot be safeguarded simply by market forces. Just as in the time of primitive capitalism the state had the duty of defending the basic rights of workers, so now, with the new capitalism, the state and all of society have the duty of *defending those collective goods* which, among others, constitute the essential framework for the legitimate pursuit of personal goals on the part of each individual.[53]

❑ SUMMARY

The social encyclicals are important because they show a church on the move. The movement is on two levels: on the surface there is a movement towards contemporary relevance in addressing the human problems caused by economic progress against Christian theological and ethical standards; below the surface there is a movement in theological understanding as the formulation of those standards changes; this movement is brought about by the nature of the very problems under consideration. This deeper movement is seen in a marked return to the Biblical emphasis both on the community, and on the treatment of the poor as the basic criterion of social and economic programmes. Compared to the end of the Reformation period, the church has recovered its original voice.

1. COMMUNITY The communal dimension of faith is re-asserted, and with it the insistence that the well-being of the community is the primary criterion for economic activity. This is seen in a number of ways:

(a) in the development of the doctrine of the common good, which seeks to bring into harmony both public well-being and private prosperity;

(b) in the insistence upon the 'preferential option for the poor', developing the 'just wage' doctrine of the Middle Ages; and

(c) in the understanding of a business firm 'in its very existence' as a community of persons.

2. JUSTICE The refusal to regard economic activity as *sui generis* is re-emphasised, John Paul II insisting that the economic sector must be circumscribed within a strong ethical and religious framework. The market must

[53] *Ibid*, section 40.

comply with the requirements of 'the common good', a concept based on the biblical teaching about justice.[54] Thus the Popes

(a) deny that the free play of competition of itself produces a just economic order: free trade is not adequate to the needs of development;

(b) affirm that work has a moral nature, labour taking priority over capital;

(c) maintain that human rights include positive rights, like the right to work; and

(d) warn that excluding spiritual values from the market place reduces man to 'the sphere of economics and the satisfaction of material needs.'[55]

3. *GIFT* Limits to the scope of the free market are insisted upon:

(a) while land is not placed in a special category, the givenness of creation is affirmed in the insistence that the earth was given for the use and enjoyment of all;

(b) there are some things which lie outside the category of tradeable commodities, and some needs which cannot be satisfied by market mechanisms.

(c) although private property is basic to individual worth and well-being, it is subordinate to common use, and proper care for the environment limits freedom in its use.

4. *EGALITY* Whilst no doctrine of strict equality is advocated, there is a marked concern about the use of wealth:

(a) the growing disparity between rich and poor is unacceptable: justice requires a 'preferential option for the poor' to ensure that economic inequality is reduced;

(b) earthly goods have a universal destination, and this must be respected.

These demands represent the re-emergence of the biblical stress on communal solidarity, and its requirement that riches bring with them an obligation to help the poor.

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[54] The doctrine of the common good was brought to public attention before the 1997 General Election in the UK. In a pamphlet of that title the Catholic Bishops' Conference of England and Wales applied its teaching to the issues facing the electorate. The condition of the poor is used as the basic criterion of the economic well-being of the nation, liberal economic theories are criticised, *inter alia*, as tending to idolatry, and the subordination of economics to ethics and of capital to labour insisted upon: ownership is governed by a 'social mortgage.' (Para. 109.) The moral contradiction at the heart of the liberal view is spelt out: 'Those who advocate unlimited free-market capitalism and at the same time lament the decline in public and private morality, to which the encouragement of selfishness is a prime contributing factor, must ask themselves whether the messages they are sending are in fact mutually contradictory.' (Para. 80.) *The Common Good and the Catholic Church's Social Teaching*, a Statement by the Catholic Bishops' Conference of England and Wales (Manchester: Gabriel Communications, 1996).

[55] See p.65 above.

❖ *POWER*
The papal concern for the proper provision of social goods, an aspect of the common good, requires a strong public sector, and the role of the state in economic affairs goes well beyond that advocated by economic liberals. The state must act to remedy social injustice because the poor do not have the resources of the rich to shield them. Consequently, a leading role for the state is envisaged, particularly in ensuring that the needs of the poor are met, Paul VI going so far as to advocate social programmes for the alleviation of poverty. There is also a marked concern about the concentration of economic power, and the concept of subsidiarity, which aims to facilitate the proper functioning of the community by placing responsibility for different activities at the lowest appropriate level, has been developed as a counterbalance to this. Another response to the problem of power is the concept of structural sin, which presents a demanding critique of the values on which a power structure is actually based.

The social encyclicals represent an important attempt to re-assert the primacy of ethics over economics in the context of modern needs and modern conditions. The Popes have refused to identify Christianity with any one political programme, and have been highly critical of the dominant ideologies of both left and right. Their social teaching emphasises two basic concepts, solidarity and subsidiarity, and they underlie the requirements of the common good.

2. Developments in Social Teaching

Others have developed this teaching further, and not always with the Vatican's approval as is the case with the liberation theologians. Like the social justice movement at the beginning of the century, liberation theology is determined to connect Christianity with the real world; individualistic interpretations of the faith are rejected, and the moral importance of social structures, as embodying or obstructing social justice, is emphasised. Both criticise oppressive power structures, identifying them with economic interests, and this has meant in practice a willingness to use Marxist concepts as a means of expressing their theological insights, but it would not be accurate to describe either simply as an expression of Marxist doctrine. Gustavo Gutierrez, one of the first liberation theologians, expresses the tenor of liberation theology in his insistence on 'the radical incompatibility of evangelical demands with an unjust and alienating society.'[56] Gutierrez widens the understanding of the preferential option for the poor to mean giving special attention to the point of view of the poor. From that perspective poverty is seen to result from alliances between the wealthy and not from the laziness or inadequacies of poor people. The international capitalist system is a conspiracy against the poorer nations, and the only way

[56] Gustavo Gutierrez, *A Theology of Liberation* (London: SCM Press, 1974, revised 1988) p.145. (References are to the revised version.)

out is a revolution through which the poor become empowered.

Although most liberation theologians have been at pains to distance themselves from institutional Marxism, including its legitimation of violent revolution, and have pointed to its deficiencies as a social system, the church as a whole has not felt able to include their point of view within its teaching. That said, however, it is not without influence, and Wogaman suggests four contributions that are likely to endure.[57] First, it has underscored the importance of structural, institutional moral issues. Henceforth, Christian ethics 'must give greater emphasis to the criticism of social power and its consequences.' Second, it has brought into Christian ethics the connection between social location and the perception of moral truth. 'It will never again be as easy for Christian ethics to ignore the extent to which theological views serve selfish personal and group interests.[58] Third, it has underscored the full humanity of oppressed peoples. The poor and disadvantaged are not, simply on account of their social position, appearance or education, to have their needs or view-point ignored. Fourth, it has reminded the church that the moral health of the whole community, including that of its worst oppressors, is tied up in the liberation of all its members. Any fracturing of the life of the community diminishes that life for all its members, not just those who are most visibly oppressed. 'Thus, the "preferential option for the poor," taken in its most general sense, is a constant reminder that the highest priority of any Christian teaching about community must be the plight of those whose condition of oppression or deprivation constitutes its point of greatest vulnerability.' These four points reiterate, albeit from a different perspective, the general conclusions derived from the social encyclicals.

From a liberal theological perspective Ronald Preston criticises both the Vatican and the World Council of Churches for putting doctrine before evidence, and he is particularly critical of the liberation theologians in this respect.[59] Preston's argument is considered further below. From a 'neoconservative' standpoint (the term is his) the Roman Catholic theologian Michael Novak offers a reading of the social encyclicals favourable to the capitalist cause.[60] While he is right to say that Pope John Paul II has moderated the criticisms of the market made by his predecessors, pointing out that *Centesimus Annus* acknowledged, contrary to *Quadragesimo Anno*, that there is no third way between capitalism and socialism, his argument depends on a re-interpretation of some of the key concepts of Catholic Social Teaching. Novak's ideas may have merit, indeed

[57] Wogaman, *Ethics*, p.256. All the quotations in the paragraph above are from this page.
[58] Wogaman points out that the irony that this insight entails searching criticism also of revolutionary movements whose leaders, having gained power, turn to new forms of oppression. However, this point re-inforces rather than vitiates the moral critique of social location.
[59] This theme comes across in all Preston's writing. His 'parting shot', *Confusions in Christian Social Ethics* (London: SCM Press, 1994) is a good review of his argument.
[60] Michael Novak, *The Catholic Ethic and the Spirit of Capitalism* (New York: The Free Press, 1993).

they probably fit American culture very well, but they have all the attraction of special pleading, and differ substantially from the magisterium. His approach to social justice is a good example. He dislikes the concept because, among other things, 'free modern societies are so complex that no one authority can control their manifold outcomes', and like Hayek, he does not believe that there is a sufficient measure of agreement (even among Catholics) concerning means and ends to give the requirements of social justice a precise content.'[61] However, the term has papal authority, and so it cannot be rejected; accordingly it is redefined: 'Social justice is a specific modern form of the ancient virtue of justice. Men and women exercise this specific social habit when they (a) join with others (b) to change the institutions of society.... It does not necessarily mean enlarging the state; on the contrary, it means enlarging civil society.'[62] Redefined in this way social justice becomes just another term for social activism or even altruism. While it includes reforming the welfare system, it also covers putting up a statue in a public park, tutoring a disadvantaged person in the inner city, building a factory in a poor area, and organising a pro-life or a pro-choice group.[63] This seems far removed from the spirit of the encyclicals where social justice is inextricably linked with the outcomes produced by the economic system, and their insistence on the position of the poor as the standard by which that system is judged. In remoulding social justice to conform to liberal ideas, Novak glosses over the many statements in which the Popes have expressly linked it to state action, even to the point of saying that the common good may require some industries to be taken into pubic ownership. They were not talking about the exercise of a social habit! In effect Novak is posing alternative criteria for judging economic activity, and although his criteria are not those of the Popes, he does share their concern to improve the lot of the poor, and in this he is right to point out the dangers of relying too heavily on state action, as the history of communism shows. He also argues persuasively that a more complex concept of the common good is required than in earlier times 'because of the greater scope advanced societies today give to free persons and free associations.'[64]

3. Statements of the World Council of Churches

Non-Roman Catholic social teaching has been developed denominationally,[65] but its equivalent of the Papal encyclical has been the reports of the great

[61] *Ibid* p.77.
[62] *Loc. cit.* Much of Novak's criticism is directed to rebutting the idea that social justice is a virtue, an idea he rejects because he sees virtues as personal not social attributes. Hence his definition is careful to emphasise the personal nature of the concept. Civil Society is the New Right term for the way the invisible hand leads people to combine together to improve their common lot. The emphasis is very much on individual initiative rather than collective action.
[63] Talking of the common good, Novak is more collective. He says it includes highways, low-cost health care, low inflation, universal education, abundant employment, and balanced government budgets - the last item clearly allying the common good with monetarist economics. *Ibid*, p.84.
[64] *Ibid*, p.83.
[65] *E.g.* Church of England, *Faith in the City* (1985); CCBI, *Unemployment and the Future of Work* (1997); Churches Together in Wales, *Wales: A Moral Society?* (1996); and the Lutheran Church in America, *Economic Justice: Stewardship of Creation in Human Community* (1980).

ecumenical conferences, and the statements of the World Council of Churches. These have generally addressed the same problems as the social encyclicals, and show striking similarities in their themes and criticisms. Justice is taken as the starting point in the Christian critique of the economic order.

❑ OXFORD 1937

The Oxford Conference in 1937 declared that justice entailed the positive creation of 'forms of production and methods of co-operation' which advance 'the cause of human brotherhood by serving and extending the principle of love beyond the sphere of purely personal relations.' Echoing the words of Pius XII,[66] the conference also declared that Christians must not allow individual acts of charity to become a screen for injustice and a substitute for justice.'[67] Oxford was also searching in its criticism of both communism and capitalism, indicting them, *inter alia*, for materialism 'which derives all moral and spiritual values from economic needs and economic conditions, and deprives the personal and cultural life of its creative freedom'; and for disregard of the dignity of the individual. Capitalism is particularly condemned for its 'enhancement of acquisitiveness', its tendency to exacerbate inequalities, its leading to concentrations of economic power 'wielded by a few individuals or groups who are not responsible to any organ of society', and the tension it produces between work that is responsive to the will of God (vocation) and work required by the economic order. The report also criticised capitalism for its tendency to create a 'constant threat of unemployment.'[68] In relating the faith to the economic order, the report stated that Christian teaching should deal with ends rather than means, and identified five ends or standards for economic policy, among them:

> (1) right fellowship between man and man: which means avoiding dividing people into classes based upon differences in wealth; affording to each a worthy means of livelihood; and limiting the possibilities of amassing private accumulations of wealth so that 'the scale of social values is not perverted by the fear and envy, the insolence and the servility, which tend to accompany extreme inequality;'
>
> (2) the intrinsic worth and dignity of labour: which means emphasising the right and duty to work; rejecting the notion that labour is a mere commodity; and providing for the working man a living wage, wholesome surroundings and a recognised voice in the decisions which affect his welfare as a worker; and
>
> (3) the right use of the resources of the earth: which 'should be recognised as gifts of God to the whole human race and used with

[66] See p.42 above.

[67] *The Churches Survey Their Task: The Report of the Conference at Oxford, July 1937, on Church, Community and State* (London: George Allen & Unwin, 1937) in *Christian Ethics*, W.Beach & H.R.Niebuhr (eds.) (New York: The Ronald Press Company, 1973), pp.483-4.

[68] These points are developed persuasively in the report: *ibid*, pp.486-491.

due and balanced consideration for the needs of the present and future generations.'

The Report recognised that 'The implications of even one of these standards, seriously taken, will involve drastic changes in economic life.'[69]

On the right to private property, Oxford noted that Christian thought offered an important conceptual framework but that it had not been brought into effective relationship with the institutions and conditions of the modern economy. The conference 'reaffirmed without qualification that all property rights are relative and contingent only, in virtue of the dependence of man upon God as the giver of all wealth.... This fundamental Christian conviction must express itself both in the idea of stewardship or trusteeship and in the willingness of the Christian to examine accumulations of property in the light of their social consequences.' It also affirmed 'that individual property rights must never be maintained or exercised without regard to their social consequences or without regard to the contribution which the community makes in the production of all wealth.'[70] Further, Oxford believed that property which represents social power 'stands in special need of moral scrutiny, since power to determine the lives of others is the crucial point in any scheme of justice.'[71] Industrial property was singled out particularly in this respect because of its tendency to encourage the concentration of power, leaving the worker relatively powerless. In a world soon to embark on rapid industrialisation spurred by Keynesian teaching, Oxford represented a powerful call to the Church to acknowledge the systemic element in economic injustice, and issued a clear challenge to individual Christians to recognise the extent to which conventional economic wisdom had departed from Christian norms.

❑ AMSTERDAM 1948

The Amsterdam Assembly reflected the teaching of Oxford, echoing in particular the analysis of the systemic nature of the social ills of the world, and calling on the churches to recognise their contribution to these ills, *inter alia*, through providing a purely spiritual or other-worldly or individualistic interpretation of their message and responsibility.[72] It reaffirmed that, although there are economic necessities which no economic system can afford to deny, justice

[69] *Ibid*, pp.492-3.
[70] *Ibid*, p.494.
[71] *Ibid*, p.495.
[72] *Findings and Decisions of the First Assembly of the World Council of Churches*, Section III: 'The Church and the Disorder of Society', in W.Beach & H.R.Niebuhr (eds.) *Christian Ethics*, p.500.

demands that economic activities be subordinated to social ends.[73] Amsterdam also echoed the teaching of Pius XI in *Quadragesimo Anno* concerning subsidiarity, arguing against excessive centralisation and in favour of a variety of smaller forms of community in local government, industry, trade unions and voluntary associations. Against this background the Assembly called for the creation of a 'responsible society' inspired by the ideals of freedom and justice and in which there was proper accountability of both political and economic forms of power:

> Man is created and called to be a free being, responsible to God and his neighbour. Any tendencies in state and society depriving man of the possibility of acting responsibly are a denial of God's intention for man and his work of salvation. A responsible society is one where freedom is the freedom of men who acknowledge responsibility to justice and public order, and where those who hold political authority or economic power are responsible for its exercise to God and the people whose welfare is affected by it.[74]

❑ EVANSTON 1954 & LATER ASSEMBLIES

The Second Assembly at Evanston, Illinois, emphasised that the responsible society was not an alternative to existing social and political systems, but a standard by which all existing systems were to be judged. On economic matters, Evanston affirmed the state as a major force in economic life: 'When necessary in the public interest, the state must intervene to prevent any centre of economic or social power from becoming stronger than itself, for the state alone has the power and authority under God to act as a trustee for society as a whole.'[75] By the Fifth and Sixth Assemblies (Nairobi, 1975, and Vancouver, 1983) the responsible society theme had developed to include environmental concerns and was reformulated in the slogan the 'Just, Participatory and Sustainable Society' (JPSS). In the later 1980s JPSS gave way to JPIC: 'Justice, Peace and the Integrity of Creation'. As has been observed, the difference in the two formulations is not merely semantic: 'A "sustainable society" can be understood as a human society in a sustainable natural

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[73] *Ibid*, p.501. The Assembly was clear that the church could not resolve the debate between those who wished to socialise the means of production and those who opposed it. However, in the light of the Christian understanding of man, to the advocates of socialization it said that the institution of property is not the root of the corruption of human nature, and to those who defended existing property relations it said that ownership is not an unconditional right; 'it must, therefore, be preserved, curtailed or distributed in accordance with the the requirements of justice.' (*Loc. cit.*) In support of these remarks the Assembly described the fundamental points of conflict between Christianity and both communism and capitalism, arguing that the church should seek to draw men away from the false assumption that these extremes are the only alternatives. *Ibid* pp.504-5.

[74] *Ibid*, p.502. In developing this theme the report registers what Wogaman describes as 'the now familiar theme of the Faith and Order Movement: 'Man is not made for the State, but the State for man. Man is not made for production, but production for man.' *Loc.cit.* (Wogaman, *Ethics*, p.262.)

[75] *The Evanston Report: The Second Assembly of the World Council of Churches 1954* (New York: Harper and Brothers, 1955), p.116.

environment that exists for the sake of the human. "Integrity of creation", on the other hand, suggests that the whole of creation - not just the human - has intrinsic value and unity derived from its creator.'[76] The Assembly argued for a biblical and trinitarian grounding for the appreciation of the intrinsic and not merely instrumental value of creation: 'The universe in all its beauty and grandeur manifests the glory of the Triune God who is the source of all life.... We are accountable before God in and to the community of life, so that we understand ourselves as servants, stewards and trustees of the creation.'[77]

❑ SUMMARY

Although brief, this discussion of ecumenical official statements does show a striking convergence between the Churches on social and economic matters. There is a similar stress on the community,[78] and a similar concern for its impairment through the growing inequality between rich and poor, an impairment for which, in the WCC view, capitalism bears a heavy responsibility. There is also a similar insistence that economic activity is not *sui generis*, and this is seen particularly in the condemnation of materialism which makes the economic the source of the spiritual. As an overall criterion, matching the common good, the WCC offered the concept of 'the responsible society'; it was less successful, being too Western for Third World countries,[79] but it led to the JPIC concept, maybe the most significant contribution of the WCC. This concept, which insists that economic activity must be assessed within a global ecological context, may be thought a timely return to the biblical view of the land as gift, and provides an important corrective to the exploitative attitudes towards the natural environment typical of the Industrial Revolution, and which have continued to the present day. However, it has been criticised by Preston, along with the general thrust of ecumenical social ethics.

In *Confusions in Christian Social Ethics* Preston criticises the WCC for putting ideology before rational reflection,[80] and in consequence advocating ideas which are simply inadequate to the complexity of modern economic life, and in the case of JPIC, to the diversity of the biblical accounts. In enunciating this slogan (JPIC) Preston criticises the WCC for heavily endorsing one secular 'western' approach to ecological and environmental issues, which it has sought to give a biblical sanction, and contrasts its work unfavourably with that of the Vatican which, he says, drawing on a wider biblical picture, has moved from nature to the dignity of the human person as the centre of moral attention. He concludes that 'the efforts of the WCC to elucidate the meaning of the phrase

[76] Wogaman, *Ethics.*, p.267.

[77] *Signs of the Spirit: Official Report, Seventh Assembly of the World Council of Churches, 1991* (Grand Rapids: Wm. B. Erdmans Publishing Co., 1991) pp.238-9.

[78] *E.g.* in the insistence that the principle of love must be extended beyond the sphere of personal relations, and in the concern about the concentration of economic power.

[79] Preston, *Confusions*, pp.115-117.

[80] *E.g.* the Canberra assembly passed a resolution calling on the churches to give up any theological or moral justification for the use of military power, only to rescind it the next day when its implications were realised. *Ibid*, p.84.

"the Integrity of Creation" has not been impressive, biblically or doctrinally.'[81] While Preston is right to point to the lack of intellectual rigour in some of the WCC's work, reading him leaves the impression that he is more concerned to advocate a method of doing ethics than specific conclusions. As he notes, the Canberra Assembly called for lifestyle in harmony with nature, being severely critical of the human pretension to define the centre of value in the universe, and called for an eco-centred theology which sees God's spirit in all creation, rooted in the relational life of the Trinity. As a basis for economic life it seems not only theologically appropriate but positively required by the ecological signs of the times. The WCC, like the Popes, is seeking to develop an approach which stands above and judges all.

[8] *Ibid*, pp.119-123. *Inter alia*, on p.121 Preston points to the 'variety of attitudes to nature on the Bible...both its friendly and its hostile aspects to humankind.' His main concern is with the term 'integrity'. He argues that there too many ambiguities in the natural order to be able to talk of its integrity (p.190, note 16). The WCC has now replaced JPIC with a new slogan in which the term is omitted: 'Theology of Life, Justice, Peace and Creation.'

IV

The Political Case

This chapter examines the political arguments for and against the privatization of the gas, water and electricity industries put forward in the Parliamentary debates on the privatization Bills. The aim is to illustrate the different ethical arguments advanced from a secular perspective in order to form a basis for comparison with the biblical criteria established in chapters II and III. Each industry is taken in turn, and the chapter concludes with a critique of the arguments.

1. Gas

The British Gas Corporation (BGC) was privatized as a single entity. In this it differed from the other two utilities which were privatized as regional units. Unlike the other two, the privatization of British Gas does not seem to have been preceded by a White Paper; instead the Secretary of State, Peter Walker, set out the reasons in a brief statement to the House of Commons,[1] in the course of which he said:

> This change, like the earlier ones, will remove state intervention and substitute realistic tests of performance for bureaucratic or political ones. It will create a real ownership by the public and employees in place of the nominal public ownership of the nationalisation statute. It will place new emphasis on efficiency for the benefit of consumers and give employees a new stake in the business.

He added that as a private company the BGC would be able to develop other areas of its business in a competitive environment; employees would be able to secure 'a new stake in the company's performance and success' by buying shares, and that this would be facilitated by a special scheme. The underlying thrust of the proposal was to free the industry from inappropriate (and non-commercial) restraints so that it might better serve the interests of the nation.

Responding to the questions which followed his statement, Mr Walker stressed the Government's belief that it was in the consumers' interests to have an organisation supplying gas motivated by commercial criteria of competitiveness and efficiency rather that subject to 'constant bureaucratic control, [the] horror of nationalisation'. Pressed on this, with the argument that as British Gas was to remain a monopoly it would be better for it to be a public rather that a

[1] House of Commons 7.5.85, Hansard (HC) 1985/86, cols 637 - 646.

private one, he said: 'There is a general argument that it is rather nice to keep all this in the public sector. By chance, at some time during my political life I happen to have had Cabinet responsibility for virtually every nationalised industry.... All I can say, in no doctrinaire way, is that under all Governments the Treasury and appropriate departments have crawled over every project and plan and interfered on a considerable scale, which is a great disadvantage to these industries.' Consistent with normal commercial criteria, the Government thought it right that 'if the management and employees of British Gas pursue matters efficiently and effectively...they should be given a personal stake in that success.' Profit and increasing personal financial rewards were clearly accepted as the best incentive.

The statement also announced that new regulatory arrangements would be established 'to oversee gas prices to the consumer and terms and conditions of supply'. The basic obligations of the nationalised industry would be transferred to the privatized industry: the requirement to supply customers; protection against discrimination; safety provisions; maintaining emergency services. In the light of present day developments it is surprising to note that there was no expectation of lots of competition in gas. Mr Walker explicitly made the point that nowhere in the western world was this the case. The only real possibilities for competition in the UK were seen to be supplying large industrial users and areas which did not have gas supplies.

In the second reading debate on the Gas Bill,[2] Mr Walker added nothing to his statement seven months earlier. His speech was rightly criticised by Stanley Orme, who led for the Opposition, as providing no evidence that the privatization would provide better service, cheaper gas, or greater competition. The debate which followed was uniformly uninspiring; the certainty of the Bill being passed, because of the Government's large majority, was no doubt a factor in this. In these circumstances the speeches with the most telling criticisms usually come from the Government benches. Their aim, of course, is not to dispute the basic policy of the measure, but to improve it, and their concern was mostly with technical matters like the provisions for common carriage, exploration, safety, retail sales, research and development. The ethical arguments were inextricable from the party politics. For the Government the dominant values were efficiency and commercial freedom, for the opposition public service, accountability, and fairness. These two approaches united, however, in the general criticism, from both sides of the House, that the Bill offered no return to the market place, or to market forces; it just created a private monopoly, unaccountable to Parliament, and insufficiently controlled by regulation. Several members, especially on the Government benches, criticised the failure to place a duty on the Regulator to promote competition. This was

[2] House of Commons 10.12.85, Hansard (HL) 1985/86, cols 767 - 858. Column references to individual speeches are omitted.

done when British Telecom was privatized, why could it not be done for British Gas also? This point went unanswered by the Government, though John Maples argued that although there would not be competition in domestic supplies, there would be real competition from rival energy supplies: oil, coal and electricity. That competition, already exists, and to say that it would continue to do so is not a strong argument in favour of privatization. Malcolm Bruce took up the point that the regulatory regime proposed was not strong enough to control adequately a huge centralised monopoly, and this point was developed by Lord Stoddart in the House of Lords.[3]

One of the major criticisms of this privatization was that it reversed a general consensus that it is better for a monopoly to be publicly rather than privately owned, especially if, as some argued, that BGC was bound to be sold for less than its full market value.[4] Baroness Burton linked this with the light regulatory regime: stronger regulation had been resisted because it would have reduced the attractiveness of the flotation to the City. On the other hand there was general agreement that publicly owned monopolies had suffered too much from ministerial control, though it was debatable that privatization was the only, or indeed the best way, to deal with this problem.

Another basic issue in the debate was the abdication of control over a basic fuel supply. The point was put forcefully and succinctly by Tony Benn. He considered the case for the common ownership of gas to be unanswerable. First, it is an essential part of life, especially for warmth, and people expect high standards of service at prices they can afford. 'To look at this industry as a way of making more profit, rather than of meeting a need' is wrong. Second, gas is a vital national asset, and the Government must be able to control the rate of depletion. Energy pricing between gas, electricity and coal affects the rate of depletion and is (or ought to be) a central part of national policy. In the House of Lords Lord Stoddart observed that the Bill imposed no duty on the privatized BGC to conserve gas, with the consequence that 'depletion policy and a large part of energy policy will be in private hands and left to the exigencies of market forces.' Lord Ezra, a former Chairman of the National Coal Board, also criticised this aspect of the Bill in strong terms: where did the omission of a duty to conserve gas and to promote energy efficiency leave the Government's energy efficiency policy? None of the supporters of the Bill responded to these arguments directly; the general assumption seemed to be that because the market is a more efficient mechanism than bureaucracy for the allocation of scarce resources, this 'vital national asset' would be used in the best possible

[3] House of Lords 10.4.86, Hansard (HL) 1985/86, cols 312 - 324, 329 - 378. The short form of a Peer's title is used throughout.
[4] Lord Stoddart thought that the undervaluation might amount to as much as 50%, and Tony Benn expressed outrage at the prospect of city institutions gaining millions in fees for professional services in managing privatization sales. Their receipts were likely to amount to £300m ' four or five times as much as the amount raised by Band Aid and Live Aid for the starving in Ethiopia.'

way. Stanley Orme highlighted another aspect of the problem of control: the possibility that ownership of a major British industry would pass out of the UK.

The supporters of the Bill stressed the greater efficiency that the market would bring to the operations of BGC, and were apparently unimpressed by the fact that Deloitte, Haskins & Sells, the accountants appointed to examine the corporation prior to privatization, reported that it had an excellent commercial record. However good it had been in the past, there was room for improvement. Much was made of the point that in the future BGC would be free of day-to-day Government control: supplying gas was a commercial activity, just like supplying petrol, and it should be governed by normal commercial criteria. One specific advantage, said John Maples, was that a more efficient company would be more profitable and that meant increased revenue for the Government in corporation tax. This confidence in the world of commerce was the overriding feature of the speeches in favour of the Bill, so much so, that they never really engaged with the arguments of the Opposition. Issues like accountability and conservation were not debated. In vain, therefore, did Robert C. Brown express the fear that the drive to make profits would put pressure on safety: after privatization 'we shall have only the protection of commercial suicide rather than the ethic of public service.'

2. Electricity

Although not next in date to be privatized, it is convenient to consider the electricity industry after Gas because both are suppliers of energy. The White Paper setting out the Government's proposals was published in February 1988, again by the Secretary of State for Energy, now Cecil Parkinson.

The Electricity industry is more complex in structure than the Gas industry, and more basic in importance to commercial and domestic life. In England and Wales the industry before privatization comprised: the Central Electricity Generating Board (CEGB), twelve independent Area Boards, and the Electricity Council. The CEGB was the monopoly supplier of electricity; it owned the national grid and the vast majority of power stations, and determined the design and specification of all new power stations and supervised their construction. The Area Boards received bulk supplies of electricity from the CEGB and distributed it to the final consumer. The Electricity Council exercised a co-ordinating role in matters of industry-wide concern. The privatization scheme ended the CEGB's monopoly by dividing it into two generating companies: National Power and PowerGen; the Area Boards were converted into twelve independent distribution companies, and a separate company, wholly owned by the twelve Area companies, was established to run the National Grid. The reasons behind these changes were similar to those behind the privatization of the Gas industry.

In the first place it was argued that the needs of customers are paramount and should be the driving force behind decisions affecting electricity supply, changing the industry 'from a producer-centered monopoly into a service industry oriented towards the consumer.'[5] The Government took the view that the nationalisation structure gave too much influence to the CEGB in power station investment decisions, which play a major part in determining prices, and too little to the Area Boards whose customers have to meet the costs.[6] Secondly, the Government wished to free the industry from ministerial interference in the running of the industry. The Government's powers included the appointment of the members of all the Boards, and the approval of all capital expenditure plans. Removing these powers would allow normal commercial freedom to prevail in the management of the industry. Thirdly, the Government believed that it was not in the interests of customers to be supplied by a monopoly producer because 'So long as electricity generation remains a monopoly, there will be no way of telling whether costs are as low as they could be and [there will be] no effective pressure to reduce them.'[7] Consistent with this it was desired to ensure that normal commercial considerations would be the only factors affecting decisions on purchasing fuel. The whole competitive arrangement has a neat, circular logic:

> Under the new structure, no single generating company will have a statutory duty to meet all requirements for new capacity; every generator will have to compete to meet the distributor's requirements. Because the distributor's prices will be regulated, and their costs not simply passed on to the customer, their profits will depend on how well they control their costs. And because generating electricity accounts for some three-quarters of these costs, the distribution companies will have a very strong incentive to contract with the most efficient generating companies. Real competition in generation will develop.
>
> In the new structure, the distribution companies will seek competitive tenders for the construction of new capacity and the grid company will call up the stations of competing companies based on their quoted prices. There will be real financial incentives for generators to build plant efficiently, to have their plant available, and to run them efficiently. So because there will be competition, the grid company will have more chance of meeting demand at minimum cost to the customer.[8]

[5] Lord Sanderson, Minister of State, Scottish Office.

[6] An example was given in the Commons debate by Michael Spicer, the Parliamentary Under Secretary of State for Energy. When the Government insisted that the rate of return on capital in the electricity industry be improved in order to provide funds for essential new investment, the CEGB simply raised prices rather cut costs.

[7] Cmd. 322, para 32.

[8] *Ibid*, paras 36 & 40.

However, despite these changes, the White Paper acknowledged that for most people the situation would remain unchanged: 'Even after privatization, the supply activities of the distribution companies and the national grid company will remain, in large part, natural monopolies.' An 'effective regulatory regime' would therefore be established 'to promote the interests of consumers.'[9] The White Paper ends with the statement that the privatized electricity industry will be 'widely owned by the public.'[10] The belief that through selling shares a true public ownership will replace a fictional one under nationalisation is, of course, a feature of the whole privatization debate.

The Parliamentary debate on the Electricity Bill was a much more substantial affair than the Gas debate, two days being allocated to it in the House of Commons.[11] Cecil Parkinson, the Secretary of State for Energy, leading for the Government, followed the basic arguments of the White Paper. As with Gas, the mainstay of the Government's argument was that competition would produce a more efficient industry providing a better service and better value for money for the customer. The concept of public service, said Mr Parkinson, was not helped by insufficient pressure on costs, efficiency, and prices. By introducing competition into generation, prices would be moved away from the present basis of 'cost-plus and take it or leave it, to one of customer choice and real service to the customer.'

Tony Blair, leading for the Opposition, advanced four basic arguments against the Bill. First, the duopoly in generation that the Bill created was an unsatisfactory market structure. The expert witnesses who had appeared before the Select Committee inquiry into the electricity industry had criticised this because the two tend to collude in the hope of avoiding price wars. Moreover, the experts expected prices to rise more than they would have done under nationalisation. Secondly, competition would operate only on the generators and not on the suppliers to the consumers. Competition operates through choice; the only choice under the Bill was given to the monopoly [regional] suppliers. 'There is no competitive pressure ... at the point of consumption, which is the only competitive pressure that matters.' Thirdly, the Bill provided for energy policy to be determined by the interests of the private sector. 'The very considerations most critical to securing the long-term future electrical supply are the very ones least suited to the inevitable short-term demands of the market.' Fourthly, privatization would contribute nothing to wider issues, *e.g.* energy conservation; environmental problems associated with coal and nuclear power; research and development projects which the private sector would find too expensive and incompatible with short term profits; fuel poverty and justice for the poorest who heat their homes inefficiently, spending four times the average on heating.

[9] Cmd. 322, para 50.
[10] *Ibid*, para 68.
[11] House of Commons 10.12.88, Hansard (HC) 1988/89, cols 677-867.

The debate revolved essentially around the issues developed in the leading speeches. Government supporters lauded the bright future created for the industry by the new competitive framework, the opportunities for 'real' public ownership, and an open system of regulation replacing the old 'breakfast table directives and instructions behind closed doors....a miserable mixture of politics and pressure whereby...the consumers and customers always came last while wheeling and dealing went on in Whitehall as to how these industries should operate and invest.'[12] The values most stressed were efficiency, managerial freedom, and better service for the consumer. Quentin Davies pointed to the diversification of decision-making about investment as one important consequence of privatization. This meant a diversification of risk, which in turn meant a reduction of risk. In the Lords' debate,[13] Baroness Oppenheim-Barnes, the Chairman *(sic)* of the National Consumers Council, added her support because it improved considerably the position of consumers. In her experience national utilities - monopoly suppliers to captive consumers - had the worst record over recent years in standards of service. They represented a system that was rigid and inflexible; the Bill would improve this situation. George Buckley, in the Commons, was not convinced: if anything the consumer would get a worse deal; any private enterprise worth its name is more concerned about its investors than its customers.

On the duopoly in generation, Government supporters in the Commons pointed out that the Area Boards would be able to build power stations, and argued that this made the creation of the National Power/PowerGen duopoly acceptable. The most effective criticism on this point came from David Owen. He argued rightly that electricity generation was not a natural monopoly, and that more than two major generating companies were required. However, the Grid was a natural monopoly, and the public interest in transmission meant that it should be publicly owned. Vesting it in the twelve distribution companies was to invite collusion over costs.

Criticism of the lack of competition at the point of consumption was generally combined with other arguments, the gravamen of the charge being that this very lack of competition vitiated the whole scheme; without it there was no justification for turning a public monopoly into a private one. Jimmy Hood was typical in his complaint that the Government preaches against monopolies, but here it proposed to create a 'most dangerous private cartel.'

Arguments over energy policy raised the basic question whether there such a thing as an energy policy, and if so, who determines what it is? Given the New Right emphasis of the Government's approach, little was said on their side about this issue. The whole philosophy of privatization assumes that decisions

[12] David Howell.

[13] A one day debate: House of Lords 25.4.89, Hansard (HL) cols 1151-1243.

about choices between different sources of energy supply, conservation, investment in renewable sources and other new technologies are best left to the market. Sir Ian Lloyd was typical in his declaration that an energy policy is a chimera: 'there is no convincing energy policy that can be applied to the United Kingdom.' The Opposition were not so sanguine about the market's omniscience in these matters, and were trenchant in their criticisms. They ranged from deep political scepticism - the market could not ensure security of supply; the national interest should not be sacrificed to the short-run equilibrium of supply and demand - to specific fears for the coal industry. Indeed, the effect of privatization on the coal industry was a major concern, and there was a widespread feeling that the Bill was an anti-coal measure. Left to the market, said Alex Eadie, coal production will decrease and gas fired generation will increase, an outcome that will look foolish in the years ahead. Anger at the perceived wasting of a precious natural resource surfaced in several speeches. Typical was Lord Taylor who speculated that it would be too tempting for private commercial organisations to take short-term views, import overseas coal, use gas and thus bring about the end of our coal industry: 'it would be a very unwise country that allowed one of its great natural resources to die on the altar of privatization of the electricity industry.' Jack Thompson predicted an acceleration in the run down of the coal industry, adding to the hidden burden of job losses, redundancy and social deprivation. Huge coal reserves would be abandoned, some of which would never be recoverable. Our dependence on imports would increase, and we would put ourselves at the mercy of foreign suppliers producing coal with 'low-paid workers in near-slave conditions.'

Lord Lovell Davis argued that an integrated energy policy was necessary because energy resources are finite. It was proper for the Government to ensure efficient, safe, reasonably priced energy, while at the same time conserving vital supplies of gas, coal and oil on which economy, society, and civilisation depended. Energy policy, he said, was not just an expression of political intent, but was aimed to provide the best service to society. But the Government had thrown the idea of an integrated energy policy out of the window. Market forces were to be the driving force, a prospect which he found astonishing: 'I believe that we shall one day look back with a sense of disbelief that anyone could seriously have proclaimed that as the answer to the problems posed by such a complex society as this.' If energy policy was largely to be consigned to the market, nevertheless a vestige was to retained by the Government; it reappeared in the speech of Baroness Hooper. Reminding the House of the commitment in the White Paper to oblige Area Boards to buy a minimum percentage of electricity generated by non-fossil fuels, she announced that a new obligation would be introduced into the Bill: special extra tranches of capacity would be set which could filled 'only by renewable forms of energy.'

Clearly the Government's faith in the market's tendency to pursue environmentally friendly forms of generation on grounds of efficiency alone was not total.

Issues concerned with conservation and environmental protection elicited strong cross-party criticism. The major concern was with nuclear safety. The original proposal was that the nuclear power stations would be privatized along with the rest of the industry. After the second reading debates the Government dropped this proposal, and Nuclear Electric continued to be publicly owned. Because of this the various arguments about nuclear generation, particularly its high unit cost, and the special protection for it[14] written into the Bill, have been omitted from this discussion. However, the environmental arguments surrounding nuclear power are part of the general environmental debate, and provide an illuminating insight into the Government's general approach to these issues. One Government argument was that nuclear energy was environmentally friendly, chiefly on the grounds of the minimal fume emissions from nuclear power stations. This claim was derided: had the government forgotten the massive environmental hazard of disposing of nuclear waste? (The problem of nuclear waste did not feature in a single Ministerial speech - a quite astonishing omission, and scarcely likely to raise the level of public confidence.) The most telling speech came from Lord Hatch. It was nonsense, he said, to advance nuclear power as a contribution to the environment. It is not environmentally clean; it produces 27,500 cubic metres of radioactive waste every year, plus the added waste caused by the decommissioning of plants. Lord Diamond addressed the considerable public anxiety about nuclear safety. The problems of nuclear generation, he said, were too great to be left in the hands of private companies. In the same way that the Government proposed to establish a public body, the National Rivers Authority, to deal with the environmental aspects of the water industry, so it should establish a public body to deal with nuclear generation. This would remove anxieties about issues which should not be left to market forces to decide.[15]

There was equally widespread concern about other environmental issues and energy efficiency. On the Government side, Michael Colvin (the only Government supporter to voice concern over nuclear waste disposal) criticised the Bill's failure to deal with emissions from power stations, audible and visual pollution, and research and development. David Owen saw the Bill as a missed opportunity; the major advantage of taking the Government out of

[14] Alan Beith, e.g., criticised the protected status of nuclear power as a blatant rigging of the market.

[15] In the light of these criticisms it is revealing to note that the reason generally given for removing the Nuclear power stations from the Bill was economic rather than environmental. The original proposal was that National Power, the larger component of the duopoly, would include the nuclear power stations. However, the management-designate, so to speak, expressed reluctance to take them on fearing that they would be a severe restraint on the company's profitability.

electricity generation was that they could start to do what successive governments had failed to do, namely apply stringent environmental standards to it. In the Lords on the Government side, the Earl of Swinton said it was ironic that with Electricity and Water privatization proceeding in tandem the opportunity had been taken with Water to clean up pollution in rivers, but that nothing was being done to clean up the electricity industry, one of the country's greatest polluters. He criticised the Government for ignoring the advice of their official advisory bodies, *e.g.* the Countryside Commission and the National Consumer Council. Lord Swinton believed that there should be a statutory duty to promote energy conservation including the protection and enhancement of the environment, the planning of new power stations and transmission lines, the undergrounding of low voltage cables, landscaping and screening, and avoidance of sites of ecological and archeological interest. Lord Swinton's argument was widely supported. Lord Hatch said it was about time deeds began to match the Government's environmental rhetoric: electricity generation accounted for 39% of British carbon dioxide emissions, 73% of sulphur dioxide emissions, and 35% of nitrogen dioxide emissions; the Bill should contain measures to ensure energy efficiency and specific targets for the reduction of pollution. Rather than make progress the Government were dismantling the energy conservation programme. Taking up this point, Lord Lovell Davis recalled some words of the Secretary of State defending the decision to cut the budget for energy conservation. The Government, he had said, were not in the business of bribing industry to save its own money - 'a remark breathtaking in its lack of perception of the essential need, which is to preserve the nation's energy resources.'

On the related issue of energy efficiency, Lord Ezra, a former Chairman of the National Coal Board, criticised the weakness of the energy efficiency measures in the Bill. He argued that proper measures for energy efficiency should be a condition of obtaining a licence, as in many States in the U.S.A. In the Commons, two Conservative back-benchers criticised the failure of the CEGB to pilot combined heat and power schemes (CHP), and by implication the Bill's failure to promote them. John Hannam argued that CHP could make a useful contribution to reducing greenhouse gases. At present coal-fired stations produce 235m tonnes of carbon dioxide *per annum*; a single CHP installation would reduce that by 150,000 tonnes. Peter Rost echoed this argument, adding that the CEGB had generally ignored cheaper generating technologies, among them using municipal refuse as a fuel as was done in Sweden. It was the cheapest fuel, it used a clean-burn technology, and could easily be combined with CHP schemes which gave a 45% fuel efficiency gain over coal-fired generation. However, he added a revealing comment: 'If the argument in favour of combined heat and power production was environmental alone, I might have second thoughts, but such production is also competitive.' In the scales of political economy it would appear that the environment might be sacrificed if the monetary price is too high.

The most powerful speech on the question of energy efficiency, however, was that of Lord Carver, the Chairman of the Lords' Select Committee on Science and Technology. He expressed grave doubts about the responsibility for research and development in the privatized industry, despite the fact that the 'Whitehall' controls being put in place seemed greater than those governing the CEGB. R&D was essential to the security of long-term energy supplies. The Government assumed that the private electricity companies would undertake R&D, but not, it seemed, that which had long-term national interest implications. Dealing with the green-house effect, *e.g.*, would require global efforts and governments would have to be the agents. It will, he said, require a strong R&D programme. He continued: 'It will almost certainly mean forcing the electricity supply industry to adopt systems which will increase the cost of supply... systems, which in the pursuit of free market competition, they would reject. Energy conservation is clearly not attractive to an industry trying to sell energy, however eloquently government appeals for it may be phrased, and however pious the expressions of hope may be that such a need will be met.'

The Government's response to these criticisms was disappointing. In the Commons, Michael Spicer winding up the debate, claimed that privatization would have environmental advantages because the Director-General of Electricity Supply (the Regulator) would have a duty to improve energy efficiency, and in the Lords, Lord Sanderson said that on energy conservation the Government did not favour least cost planning (*i.e.* a supplier or regulator deciding that a particular conservation measure should be adopted) because this would take decisions away from consumers, and thus run counter to Government objectives. He added the rather sanguine view that consumers can and should decide which energy efficiency measures are appropriate; they should pay for the measures and receive the benefits of any savings. This would ensure both that such decisions were more relevant to customer's needs, and that the best efficiency measures were chosen.

3. Water

The water industry differs from Gas and Electricity in that as well as providing a basic resource, water management involves important public regulatory functions. Prior to the Water Act 1973 nearly 1600 local undertakings had been responsible for water services, and many of them had bye-law making powers. The Act reorganised the industry into nine English regional Water Authorities and a Welsh Water Authority on the principle of integrated river-basin management. This principle was a major innovation establishing, as it did, public authorities which combined utility and regulatory functions. Thus in addition to supplying water, the new authorities assumed responsibility for sewage and sewage disposal, water resource planning, pollution control, fisheries, flood protection, navigation, water recreation and environmental conservation. The catchment-based structure was widely considered to have worked well, and accordingly the Government proposed to maintain it in the privatized industry. Given the wide-ranging nature of the water authorities' powers, it is perhaps surprising that commercial freedom and the interests of the industry's customers and employees came first in the Government's proposals for privatization. This order of priorities is, of course, the same as those seen in all privatizations, and reflects essentially similar underlying reasoning.

The White Paper[16] listed eleven benefits to be gained from privatization. Some are incidental to privatization as such because they could have been enacted under the previous arrangements, the best example being measures to provide 'a clearer strategic framework for the protection of the water environment.'[17] Putting these benefits on one side, the main reasons for privatization are as follows. First, freedom from Government intervention in day to day management. Second, greater financial incentives for management leading to greater efficiency, lower cost, and better responsiveness to the needs of customers. Third, a degree of real public ownership through shareholdings by employees and local customers. Fourth, improved motivation for employees through their ownership of shares. Fifth, greater attractiveness to 'high quality managers from other parts of the private sector'. In sum this amounts to the belief that the greater the opportunity everyone has to make money the better will be the deal that everyone receives, including the consumer. It is the underlying rationale of all privatizations, and it goes hand-in-hand with the belief that private enterprise is simply better:

> Private enterprise is both more flexible and readier to pursue energetic and innovative approaches than the public sector. The demands of the market will give management and staff the impetus they need to secure greater efficiency. Freeing the authorities from the constraints imposed by state ownership will help them to carry out their tasks with vigour and imagination.

On the other hand, the Government recognised that an element of strategic concern - something which private enterprise usually lacks - had to be retained in the privatized industry. It had been argued that the regional water authorities were too large to be privatized as single units. The Government

[16] Cmd. 9734, 1986.

[17] The other incidental benefits are: (1) supervision of the industry by a Regulator rather than by a Government Department; (2) release from constraints on financing imposed by public ownership; (3) access to private capital markets [in fact just a variant on the last point]; (4) an improved competitive position 'in the provision of various commercial activities, notably in consultancy abroad'.

rejected this argument: 'the size of the authorities as presently constituted allows both the planning and development of water resources on a regional basis and the fullest use to be made of scarce professional skills.'[18]

This strategic element in the provision of water and of water services is a clear public dimension not found in the gas and electricity industries. As already noted, the Water Authorities were responsible for sewerage, land drainage, flood protection, pollution control and the regulation of navigation and fisheries. The Government's original intention was to transfer these substantial public functions to the privatized industry, i.e. to private companies accountable primarily to their shareholders. This policy preserved the principle of integrated river basin management, and the only amendment to the pre-existing arrangement foreseen as necessary was to provide a much more explicit and formalised policy framework for pollution control, land drainage and flood protection. This was also, in part, a corollary of the desire to end government by informal methods which had characterised the nationalised industries; as the White Paper put it: 'a private company will expect any policy instructions or guidelines from the Government to be conveyed explicitly.'[19] And it was in part also a recognition that certain Government functions could not be delegated. Land drainage and flood protection also required special provision and here the approach was revealing. These works involve capital and maintenance expenditure of around £100 million a year (1986 prices), and it was considered that 'their non-commercial nature would make it difficult to vest them in private sector bodies having no commercial incentive to carry out works desirable in the public interest.' However, these activities are a basic part of integrated river-basin management and ought not to be separated from the other functions of the water authorities. The solution proposed was to establish 'special public bodies' responsible for financing and co-ordinating flood defence, drawing on the expertise of the private water companies, 'perhaps by employing them under contractual arrangements based on levels-of-service data.'

It was on this public interest/public policy aspect of their original privatization scheme that the Government ran into trouble. Their proposals were politically unacceptable to almost all interests except the Water Authorities themselves, and were susceptible to challenge in the European Court of Justice as contrary to E.E.C. water pollution legislation. This set back the original timetable for privatization, and after reconsidering the Government published revised proposals to establish a National Rivers Authority designed to inherit the main regulatory and water management functions of the Water Authorities, leaving the utility roles of water supply and sewerage for privatization. The National Rivers Authority (N.R.A., now the Environment Agency) was set up as a non-departmental public body responsible for water resource management

[18] Cmd. 9734, para. 41.
[19] *Ibid*, section 5.

including abstraction licensing, land drainage and flood protection, fisheries and navigation, and the control of river and coastal pollution. It also has a general duty to promote conservation and recreational interests.

When the Water Bill came to be debated in the House of Commons,[20] Nicholas Ridley, the Secretary of State for the Environment, introducing the Bill expressly acknowledged the need to separate the regulation of public interest matters from the supply of water and water services. The NRA will, he said, administer a 'regime of improved standards' relating to water quality, protection of the environment and water sources 'which will be transparent to the public.' He gave four reasons for privatizing the industry shorn of its public interest functions. First, private ownership had long been a feature of the water industry and it had worked well. Second, economic regulation should be based on price control rather than on dividend limits; this would improve competition and efficiency. Third, the water companies would be given scope for innovation and diversification along the lines of the French water companies.[21] Fourth, there will be improved access to capital markets. Public ownership cannot generate the capital required for improvement, innovation and diversification; free access to the capital market will ensure that in future there will be no political control over water finance. The Minister's speech gave the impression that the government were using privatization to bring about a wholesale improvement in water quality and the water infrastructure - something long overdue but impossible to finance out of public funds.[22]

Needless to say, the Opposition were not impressed by Mr Ridley's speech. They adduced wholly different arguments; John Cunningham, their leading spokesman, made four points against privatization. He argued first that water was our most fundamental resource upon which health and well-being depends, and therefore, it should be publicly owned and controlled. Moreover, managing water openly and efficiently in the public interest required that the management should be democratically accountable at regional and national levels: 'an essential resource such as water should [not] be managed and sold for private gain.' Secondly, establishing private monopolies was wrong. There would be no market in the supply of water and water services, and no competition to provide protection for the consumer. Such extensive monopolies should be

[20] House of Commons 7 & 8.12.1988, Hansard 1988/89 Cols 336 - 398, 457 - 542.
[21] The French companies are the world leaders in this respect, having diversified into municipal services, housing, communications, construction, manufactures and cable TV. It is tempting to read a subtext into the Minister's remarks: Britain will outdo the French!
[22] A tax-cutting Government could hardly raise the necessary finance through taxes or borrowing. One argument notable for its omission by Mr Ridley was that privatization would bring about a true public ownership in place of the nominal public ownership under nationalisation. It was used by some Government supporters, most forthrightly, and in an interesting variation, by Sir Anthony Grant: 'It is important that the water industry is owned by those who are actually interested in and wish to be associated with it rather than by a faceless bureaucracy'.

controlled and managed in the public interest.[23] Thirdly, the national heritage would be put at risk. The Bill involved selling 500,000 acres of land, much of it in National Parks and Areas of Outstanding Natural Beauty; access to the countryside would be jeopardised, and public bodies like the National Trust would be priced out of the market. Fourthly, environmental protection was at risk. Under the system envisaged, whereby the NRA contracted back to the companies many of its monitoring functions, the companies would be policing themselves, 'the very situation the NRA is said to be intended to avoid.'[24] Given that the priority of private companies is to make profits, it was extremely unlikely that they would pursue vigorous policies of environmental protection.

In the depressing way that seems to characterise Parliament, the debate never really met. The Government viewed the water industry from the point of view of efficiency, value for money, managerial innovation, and new sources of finance; the Opposition from the point of view of service, ownership, accountability and consumer protection. So in the House of Lords,[25] the Earl of Caithness stressed that businesses were more efficient and successful in the private sector, whereas Lord McIntosh, quoting Joseph Chamberlain,[26] asserted: 'All private regulated monopolies, sustained by the state, in the interests of the inhabitants generally, should be controlled by the representatives of the people, and not left in the hands of private speculators.... The water works should never be a source of profit, as all the profit should go to the reduction of the price of water.' This view reflects Jack Cunningham's first point, and underlying it is the belief that water is in a category of its own. It was an argument pressed by many opposition speakers, perhaps to best effect by Earl Russell:

> The sense that has underlain a great deal of the debate on this Bill is that there is something special about water. It goes a long way back. Even Adam Smith, whom I hope that this Government will not fault on ideological grounds, reckoned sanitation as among the acts of public

[23] Related to this lack of public control was a fear about excessive price rises. There was a measure of agreement that water prices had to rise, under public or private ownership, to fund the necessary improvements; the Opposition argued that under privatization these increases would all the greater because of the need to pay dividends to shareholders. Gareth Wardell estimated that the privatized companies would need £350m for corporation tax, £400m for dividends, £100m for higher salaries, etc., amounting to a 20% increase in charges just because of privatization. Even discounting these figures as politically motivated (and maybe they were not - Lord Nugent, a government supporter, argued that privatization meant price increases of at least 27%, maybe 40%), the point remained: why should people pay more just to fund dividends and high salaries? In the Lords, Lord Caithness, leading for the Government, countered this argument by insisting that, although prices had to rise to provide better quality water, they would rise no more than was necessary to allow companies to provide water and water services efficiently to the standards laid down. Ultimately, there is no way of assessing the validity of these arguments because there is no way of determining what would have happened had privatization not taken place.

[24] Mr Cunningham also contended that the establishment of the NRA destroyed 'the important environmental concept of integrated river-basin management.'

[25] House of Lords 17.4.1989, Hansard 1988/89 Cols 547 - 679.

[26] A nineteenth century Conservative local politician and philanthropist in Birmingham.

> good that should not be left to the provision of the market. In part that is because water is essential for life. I take the point that the Prime Minister[27] has made that food is equally essential to life. But one imagines that the Prime Minister knew enough about the market to know that food is not a single commodity. Every day we observe foods competing with each other in the market. What is so special about water is not only that it is essential to life but also that, for once in a blue moon, it is generally true that there is no alternative.

To the same effect Roy Hughes asked 'Who owns the rain?', and Joan Ruddock argued that access to clean water is a basic human right. That right, she said, should be maintained especially for those who cannot afford to pay high water charges: human rights and justice come before profits.[28] Peter Pike, quoting the *Lancashire Evening Telegraph,* said: 'water is the stuff of life - a vital commodity that people have no choice other than to use.... It is a natural monopoly...a fundamental service that should not be cast into the arena of free enterprise, where the making of a profit for investors is the bottom line and where the notion of improved efficiency and service to the customer is inevitably blunted because there is no risk of them taking their business elsewhere.' In the same vein were arguments, echoing Jack Cunningham's point, that something so basic as water should be subject to democratic control, especially local control; that water belongs to the people and should not be given away by the state for the benefit of private enterprise; and that an essential life-support system should not be exposed to the perils of a private monopoly whose ultimate sole aim is to make profits.

If anyone on the Government benches agreed they certainly did not voice their opinion, apart from one or two members of the House of Lords.[29] Indeed, hard-headed commercial common sense left no room for getting sentimental over water. Dudley Fishburn was the most outspoken. He argued robustly that it was nonsense to say that because something is a public and universal commodity it should be publicly controlled and supplied - rather the opposite: it should be privately controlled and supplied. There was a case for a Government seeking to control something that is new and rare, but no case for a Government to seek to control the supply of so natural a commodity as water. Martin Brandon-Bravo was to the same effect:

[27] Mrs Margaret Thatcher.

[28] Mr Hinchliffe had earlier said that the Bill was about the big 'P' - Profit; but it would also have major effects on the small 'p' - poverty. In Yorkshire in the previous three years there had been a 20-fold increase in disconnections. Disconnections were a major cause of concern to many speakers, especially because they bore most heavily on the poor. Richard Livsey argued that because water is basic to life people should not be cut off, and John Cartwright pointed again to the uniqueness of water: in the case of disconnection from gas or electricity there are other fuels; there is no alternative to water.

[29] *I.e.* Lord Nugent who said that water was God-given, essential to life: it was wrong to make a profit out of it; and Lord Pym who said that water was a resource of such a particular character that concepts such as profit motive and competition were simply unsuited to its supply.

There seems to be some mystique about water. It is looked on as life itself, which makes it seem to many as a sacred trust in the hands of the public sector. I cannot see it that way.

Against such opinions the point was made in vain that water was essentially a non-commercial undertaking. Again the most impressive was Earl Russell, who, having first said that he had no general ideological preference either for private or for public ownership, continued:

> Having said that about my inability to form a general preference, I force myself to the difficult task of considering criteria.... [One] possible criterion is the objectives we wish to set for an industry. On these Benches we are perfectly content with the privatization of an industry where the profit motive may legitimately apply and where it is a suitable management objective. Jaguar, Rolls-Royce and British Steel are cases in point. However, the objectives of the water industry seem primarily non-commercial. The chief priority must be at all times and in all circumstances to provide a service. That includes the uneconomic task of providing resources in a drought of the kind that happens once in a century. I cannot see that as being in the interests of a commercial company, and I cannot see it as fair to impose on a commercial company non-commercial objectives without paying to meet those objectives....
>
> One possible criterion, and a good one...is whether we could let [the industry] go bankrupt. The relevance of that factor to the story of Rolls-Royce is clear.... [T]his Bill provides clearly that the water authorities cannot be left to go bankrupt. Indeed, the Government are aware that they cannot run water on strictly commercial criteria.

The absence of effective competition persuaded many speakers that it was wrong to privatize water, echoing Jack Cunningham's second argument. John Cartwright put the point well. He derided the Government's argument that there would be competition by comparison.[30] Privatization, he said, rests on the assumption that competition will lead to increased efficiency, lower prices and greater sensitivity to customers. In Water there would be no competition at all. He continued:

> Instead it is said there will be competition by comparison - a concept dreamed up by the Government. What use is that? People cannot change their water supplies like they can change their pub or supermarket. The consumer will have no power to influence the water plcs. Customers will be completely captive, bound hand and foot to a

[30] Effectively competition in the share price.

private profit-making monopoly. This Bill bestows on private companies an effective power to levy taxes.

Surprisingly the Government supporters did not really argue this point. Some, like Sir Charles Morrison, agreed that the Bill did not create competition but maintained that this was acceptable because the new private monopolies would have access to private capital which would enable them to raise funds to bring the industry up to standard. In line with this reasoning the general approach seems to have been that creating a private monopoly was the price of bringing about a more efficient, cost-effective industry; in other words the end justified the means. Martin Brandon-Bravo added that major privatizations, especially water, provided the blue-chip investment base which are essential for pension fund portfolios. Commenting on this in the Lords, Earl Russell asked whether the Government realised what a self-condemnation was involved in privatizing an industry just to free it from Government financial constraints. Who fixes the limits? he asked: 'The Government know perfectly well that more money needs to be spent, and yet they say that, even though Parliament is sovereign and they have a large majority, they cannot spend that money.' Clearly the Government could have raised the necessary funds through taxation, and equally clearly chose not to do so. This decision is an eloquent statement of their policy of transferring the burden of financing public works from the public to the private purse, and this in turn flows from a more basic policy of creating a low-tax economy, an essential aspect of an enterprise culture.[31] Both policies represent important ethical choices.

Issues concerning public health were also used to make the point that the management of water was essentially a government function. Lord Addington, equating water with 'the air we breathe', argued that clean water makes the biggest contribution to the health of the nation. Other speakers said that this was particularly, and crucially, the case with water disposal and sewerage. Nigel Spearing pointed out that these services determine the purity of the rivers and coasts, and for that reason this part of the water industry at least should be publicly owned. Lord Monson argued similarly that sewerage is essentially the province of government: 'it has nothing to do with the convenience of individuals, but everything to do with public health, which is by definition a government responsibility.'

Another issue going to the root of the matter, and not addressed by Government speakers, was whether the Government had the right to sell off the water industry at all. The point being that before the re-organisation of the industry in 1974 the local Water Board and Local Authority undertakings had been financed through the rates. They were handed over to the new regional

[31] As many commentators have pointed out what this amounts to in practice is a low *income* tax economy. Indirect taxes have risen in recent years, and aggregate tax revenues have not declined.

Water Authorities by the government without compensation, and now the government was selling off those, very considerable, assets and pocketing the proceeds even though it had given nothing for them. Baroness Stedman declared that privatization without compensation was as wicked as nationalisation without compensation, a sentiment with which several speakers agreed.[32] Lord Ezra proposed that the proceeds of the sale be used to create a Water Development Fund under the control of the NRA to pay for bringing the industry up to standard, a point echoed by Baroness White and Lord Pym, the latter saying quite simply that it was not right for the Government to 'gobble up the money' and then require the consumers to foot the bill for many yeas of neglect under successive governments. Silence in the face of such arguments tends to reinforce the impression that one of the unstated objectives of the sale was indeed to raise money to finance tax cuts and buy popularity at the polls.

The third of Jack Cunningham's points concerned the national heritage. Great anxiety about access to the countryside, and about the preservation of the countryside, surfaced in many speeches. The long-accepted principle of free access to the countryside was felt to be threatened by the profit motive which would not easily resist the temptation to charge for access and for other amenities. Concern was expressed about the disposal of land in scenic areas: in Wales, said Barry Jones, the Welsh Water Authority had been a sensitive developer and exploiter of land, but the Bill opened up the possibility of speculation by people and forces with fewer scruples. Baroness Stedman expressed alarm that the powers of the Secretary of State to enforce action to protect the countryside were subject to the need to give precedence to financial considerations, and that no duty was imposed on the privatized companies to manage land sensitively, nor to maintain access agreements on land no longer needed by them. Perhaps the best expression of these anxieties was that voiced by Joan Ruddock. She asked what would be the social cost of disposing of land for commercial reasons: 'These holdings have a significance far beyond their potential commercial value. They have an environmental worth for wildlife and recreation. They are the green lungs of those of us who live in the congested inner city.' The Government, she said, failed to understand the need for open space: 'Some things cannot be bought and sold to the highest bidder without a disproportionate cost to society.' The Government's response to this gave little cause for encouragement. Wyn Roberts, the Minister of State at the Welsh Office, said that it was not intended that the new water companies should be lax in caring for the environment, nor that profits would be their dominant concern, but he was unable to give any assurance about the disposal of land in National Parks because the Water Authorities already had the

[32] John Cartwright, Eric Martlew, and Lord McIntosh as well as those mentioned in the text. Daffyd Wigley maintained that the assets of Welsh Water were worth £2000m, but were to be sold for £250m - £300m, i.e. 1/6th to 1/7th of their book value: 'That is giving away public assets which have been paid for by the water ratepayers of Wales. On what grounds can that be justified?'

necessary powers, and were being encouraged to dispose of surplus land. And on the principle of not charging for access he was very discouraging, arguing that it was right that those who use the facilities should pay for them and not the general mass of consumers. In the end the best guarantee of public-spiritedness would be the concern of the new companies for their corporate image: '[the Water Companies] will have a public image to project and...will seek to show the community that they are worthy and effective custodians of the water environment.'

Jack Cunningham's fourth point was the related issue of environmental protection, and on this there was a wide measure of all-party agreement. Sir Hugh Rossi was among those on the Government benches who argued for strong action to improve pollution controls and to strengthen the Inspectorate, while believing that privatization was the right policy. And there is substance in the argument that the Government could control more effectively an industry which they did not own. However, it is equally true that all police work depends in the end on the prevailing standards of morality; external controls only reinforce internal norms, and there was doubt whether the internal norms of a profit-making enterprise were likely to be adequate. As Barry Jones asked, can a company whose main motivation is to make profits be trusted to pursue a vigorous policy of environmental improvement? There are no profits to be made there, nor in pollution control. The powers given to the Director-General of Water Services did nothing to allay concerns on this point. His first concern in fixing prices, as Lord McIntosh pointed out, was to ensure a reasonable rate of return on assets, and that came before duties to the consumer or to the environment.

4. The Debates Considered

The three debates concerned progressively more important services, and in consequence touched on progressively deeper issues. While all three 'products' are an essential part of a modern economy, they differ in their basic importance. Gas is the least essential of the three; although it is widely used, both in the home and in industry, it is quite possible to live without it. Electricity is much more basic, it affects almost every aspect of modern living; it is a virtual necessity, but, even so, life is possible without it. Water by contrast is wholly indispensable; without water we die. Thus, while all three debates recognised the special nature of the utilities, it was only in the water debate that arguments about the God-given nature of the 'product' were used. The gas debate, by contrast, had a much more 'commercial' feel, typified by the assertion that there was no difference between the supply of gas and the supply of petrol. How then do these arguments measure up to the biblical criteria discussed in chapters II and III?

1. COMMUNITY The New Right philosophy behind the privatization programme comes out clearly in the debates. The Government, reflecting scepticism about the notion of social justice and the common good, appears more concerned with the individual than the community. This is seen in the desire to move away from producer-centered monopolies to a consumer-oriented industries, even though this represents an improvement (and may seem more community-minded), and in the emphasis on obtaining a better deal for the consumer. Both make the individual the centre of concern rather than the needs of the community. An good example, as will appear from chapter VI, is the abandonment of uniform pricing; prices for gas and electricity now vary according to region,[33] and this means that those in the more remote and, usually, poorer areas have to pay more for their energy needs. This is less conducive to the well-being of the community than uniform pricing, with its built-in element of subsidy, which, it is arguable, the common good requires. Against this, it has to be said that there is a community interest in receiving better value for money, and economic liberals would argue that the invisible hand aggregates all the individual benefits producing a happier nation. Concern about the poor and the disadvantaged (described by Paul VI as the 'new poor'[34]), clearly has the well-being of the community at heart, as does the alarm expressed over the perceived threats to public health, environmental protection, pollution control and access to the countryside posed by water privatization.

2. JUSTICE A concern for justice marked the debates less than might have been expected. The Opposition drew attention to issues such a fuel poverty and disconnection policy, but they took second place to the political arguments about energy policy, ownership and control. Both sides accept that the market should operate within a framework of values, but differ markedly as to what they should be, the Government stressing efficiency, managerial freedom and consumer satisfaction; the Opposition public service, conservation and accountability. Neither list really addresses the Christian concern for subordinating economic activity to 'higher values', although the Opposition's list is more consistent with the biblical and papal views that economic activity is not *sui generis*.

3. GIFT Again we find the Opposition more in tune with the Christian position that some things are outside the category of tradeable commodities, although the point is not actually made in these terms. The concern for conservation just mentioned, and the argument for a national energy policy, are akin to seeing natural resources as gifts and place a limit on their exploitation for gain, but neither would necessarily take them out of the market. However, some Opposition members did go so far as to say that water was not a marketable

[33] Water prices always did, though this is not an argument in favour of differential pricing on social grounds.
[34] *Octagesima Adveniens*, section 15. He included the handicapped and disabled, the old and those on the fringes of society.

commodity because it was too essential to be managed and sold for private gain. This was refuted directly by Government supporters who rejected that water was a 'sacred trust'. Reasons of survival rather than theology prompted a general concern for better environmental protection measures, though some questioned whether private enterprise would have enough incentive to take the measures required.

4. *EGALITY* Privatization places a high value on monetary incentives, and assumes that that the enrichment of the few will produce improved well-being for the many. Beyond this, it is no part of the philosophy to ensure that the rich help the poor, and the acceptance of differential pricing actually works in the opposite direction. If, as was insisted, water belongs to the people, and access to clean water is a basic human right, privatization is not seen as a way of satisfying rights nor of recognising universal ownership, but simply of providing a service more efficiently. The two may go hand-in-hand, but equally they may not.

❑ SUMMARY

Inevitably the debates reflect the familiar right/left clash which dominates our Parliamentary scene. The different values advocated represent the different interests of the supporters of Government and Opposition. Thus efficiency is opposed to bureaucracy, competition to accountability, and profitability to public service.[35] All this appeared readily enough on the surface; but underneath there was a deeper debate going on about the source of value in our society: is it the individual or the community or the planet? This fundamental debate can be seen in almost all aspects of life today,[36] and within that debate privatization raises acute issues for Christians about the spirit of the times: Is the exploiting commercial spirit alien to the Gospel? Or, as Atherton argues, do we have somehow to take it on board as part of the new knowledge about the world demonstrated for us by economics?[37] Privatization may also be seen as a rebellion against the controls necessary in a large complex society. An element in the Christian response must be that the debate is based on a false polarisation. The individual and the community are not opposed but complementary; the Christian unit of concern is the individual-in-community, and the economy should be structured so that both are given an appropriate value.[38]

[35] These values are not as polarised as the Parliamentary debates suggested. There is no necessary incompatibility between efficiency and public service; it all depends on the criteria used to judge public service efficiency.
[36] It surfaced in a remark of Lord Sanderson, winding up for the Government in the electricity debate. He said: 'Privatization is not only transforming the economy, it is transforming society by enabling the people to become a nation of shareholders.'
[37] This has a distinctly 'Old Testament feel'! Maybe the privatizers text is 'subdue and multiply'! Technical advances lend strength to Atherton's argument. In the electricity debate David Howell said that modern economics and technology undermine views based on the predominance of state ownership. 'Economies of scale are being substantially reversed by electronic technology.'
[38] An important element in this structuring is how Government and industry work together to pursue national goals.

V

The Economic Case

This chapter examines the economics of privatizing the utility industries. It has two parts: the first part considers the macro-economic context, concentrating on the role of the state in economic management; the second part examines the mirco-economic context, the economics of privatization *per se*.

A. THE ROLE OF THE STATE IN ECONOMIC MANAGEMENT

Privatization is not something which 'just happened', a phenomenon which emerged spontaneously from the political process; it is the result of the combination of very specific economic and political ideas and circumstances. As the analysis of the Parliamentary debates in the last chapter made plain, a central aspect of economic policy is the extent to which the state should be involved in economic management, and one of the circumstances was that thirty years or so after the second world war life had moved on to the extent that the policies that had been used in the process of post-war reconstruction seemed tired and no longer in tune with the needs of the times. Post-war economic policy ascribed to the state a major role in economic management and saw the state sector in the economy expand. Part of the process by which those policies became obsolete resulted from their very success, and from the hopes and expectations which they engendered. Privatization can be seen as an attempt to ensure, in the provision of basic services, that those hopes and expectations continue to be met, and is founded on the conviction that this requires the provision to be made by private enterprise. Privatization, therefore, reflects ideas of a limited state, and a much reduced, if not non-existent, state economic sector. However, even economic liberals stop short of creating uncontrolled private monopolies, and thus one of the main questions raised by utility privatization is the proper role of the state. In considering this issue it is helpful to examine the recent history of macro-economic ideas, particularly since the end of the second world war.

1. Epochs in Economics

A marked tendency in economic thought has been the belief that there is a continuity in the development of economic theory, in the manner of the sciences, from the particular to the general. There is now a growing realisation that this way of viewing the development of economic doctrine is misleading because the data upon which economic theories is based lacks the universal and objective quality of the data of the physical sciences. The physical world is not supposed to change, it is the scientist's appreciation of it which changes. It is otherwise with the economic world. It is constantly changing, as well as the economist's appreciation of it, because much of it is made up of human ideas, hopes and desires. An economic theory evolves in response to questions that are provoked by a given set of circumstances in an economy. As circumstances change, or people's attitude to them changes, questions are revised, and a new system springs up. A more helpful way of looking at the development of economic ideas is the one offered by A. K. Dasgupta, namely that of epochs in economic thought.[1] He writes:

> Economists deal with a universe where data are freakish and are not valid universally, and where phenomena emerge which were not only not known before but had not existed before. It is of the nature of economic science that it involves events and phenomena which not only change complexion from time to time but do not also occur at all places. Problems that emerge as crucial at one time may turn out to be totally irrelevant at another time in the same economy, and those that are relevant in the context of one economy may well be irrelevant elsewhere. In economics old theories do not die. And they do not die not because one is built on the other but because one is independent of the other.[2]

Dasgupta identifies three epochs in the British economy - classical, marginalist and Keynesian.[3] Some argue that the Keynesian epoch has now come to an end;[4] whether or not this is the case, privatization is one of the responses to the perceived limitations of Keynesian theory in the new political and economic dispensation ushered in by the Conservative victory in the general election of 1979. It is, therefore, important to begin with an examination of Keynes' ideas.

2. Keynesian Economics

John Maynard Keynes (1883-1946) was motivated by the state of obstinate depression which gripped the economies of the West in the later years of the inter-war period. Although he accepted capitalism as the best available economic system, he considered it in many ways to be 'extremely objectionable'. 'Our problem', he wrote, ' is to work out a social organisation which shall be as

[1] A.K. Dasgupta, *Epochs of Economic Theory* (Oxford: Blackwell: 1985)
[2] *Op cit.* p.2
[3] To talk of a 'Keynesian' epoch is perhaps to claim too much for Keynes. Many economists would deny that 'Keynesianism' represented a coherent body of theory, but perhaps most would agree that Keynes was the moving spirit behind the development in economic thinking which advocated the mixed economy, with government and private enterprise working in partnership.
[4] See, for example: R. Skidelsky (ed.), *The End of the Keynesian Era* (London: Macmillan: 1977)

efficient as possible without offending our notions of a satisfactory way of life.'[5] Keynes' particular concern was unemployment, which was running at an alarmingly high level, and causing widespread distress and social tension - a concern which is essentially ethical. To address this problem he set out to discover what determines the volume of employment, believing that the existing economic theory, with its strong *laissez-faire* bias, was incapable of offering the answer.

Classical *laissez-faire* theory pictured the economy in the same way that Newtonian physics pictured the world, i.e. as a giant machine held in equilibrium by a natural process governed by natural laws.[6] The assumed equilibrium between supply and demand was part of this natural order. The application of this view to employment was expressed in Say's Law which stated that, given time, unemployment would be cured by the normal operation of supply and demand. J.B. Say (1767-1832) had argued that general over-production and unemployment cannot exist because supply creates its own demand. Say's Law became part of conventional economic theory, although there was one notable dissenter, T.R. Malthus. Malthus argued that unemployment could be caused by deficient demand, but had been unable to explain clearly how and why effective demand could be deficient or excessive, and so his view had not made headway among economists. Keynes believed that Malthus was right, that it was demand rather than supply which was the key to the level of employment, and on this basis set out to solve the 'puzzle of effective demand'. His solution appeared in the book for which he is best known, *The General Theory of Employment, Interest and Money*, published in 1936.[7]

Keynes rejected the idea that full employment was the normal state of affairs, achieved by some self-adjusting mechanism. He believed that the economy might come to rest at a position of unemployment equilibrium, that is, a position where, contrary to Say's argument, there were no natural forces operating to achieve full employment. Keynes maintained that effective demand was determined by the sum of two factors, consumption and investment, consumption being the total of individual spending. If either of these factors was too low employment would decline. To correct this situation he believed that deliberate action by the government was necessary. This might mean raising consumption directly, *e.g.* through tax cuts, social security payments, or pensions, or by introducing public investment programmes. The resulting

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[5] J.M. Keynes, 'The End of Laissez-Faire' (1926) in *Essays in Persuasion*, p. 294, Vol IX *Collected Writings of John Maynard Keynes*, (London: Royal Economic Society: 1972). This account of Keynes' work is based on Alexander Gray, *The Development of Economic Doctrine*, (London: Longman, 2nd edn. 1980, Alan Thompson (ed)).

[6] See Jane Collier, 'Contemporary Culture and the Role of Economics' in H. Montefiore (ed.). *The Gospel and Contemporary Culture*.

[7] J.M. Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936).

increase in effective demand would be multiplied throughout the economy as the beneficiaries of these policies spent their additional income on consumer goods, resulting in higher incomes for the workers in consumer-goods industries, who in turn spend their money on more consumer goods, and so on. The net effect is to increase both incomes and employment, and to bring the equilibrium between savings and investment nearer to one which maintains full employment.

Keynes offered an economic analysis with a direct relevance to public policy, and in the post-war years there is evidence that it produced the desired effect. Armstrong, Glyn and Harrison show the effect of Keynesian policies in stimulating the installation of new machinery with consequent rises in productivity, which in turn boosted output, wages, consumer spending, and employment. 'Rising wages,' they argue, 'were important for markets primarily because workers' additional spending accounted for the bulk in the growth of consumption expenditure. Rising spending on consumer goods in turn allowed the industries producing them to grow more or less in line with those producing the means of production. Indeed, an important element of the boom was the mass production of durable goods and the improvement of the technologies required to produce them.'[8]

Two further aspects of Keynes' thought should be noted, both of which show significant differences to post-1979 policies. The first concerns the possible methods which a government might use to stimulate demand: Keynes' preference was for public investment rather than for changing interest rates. The second is his concern for equality. Keynes was one of a number of economists who were uneasy about the way that the dynamic of capitalism, which had brought triumphs of technological innovation and rising economic output, had not also brought economic equality. For the classical economists who preceded Keynes, this 'Darwinian' aspect of the working of capitalism constituted another 'natural' justification for the system like the Newtonian view already referred to. This allowed them either to overlook the inequalities, or to justify them as part of the natural order. However, some economists before Keynes shared his disquiet, among them his own teacher Alfred Marshall. For them the goal of increasing equality was either a moral or a political objective which had to be grafted on to an economic system not entirely compatible with its assumptions. Keynes took a different view, pointing out that increasing equality was not merely a Christian-moral-political goal belonging to the distant future, it was a practical goal attainable in the present.

[8] P. Armstrong, A. Glyn. & J. Harrison, *Capitalism Since World War II* (London: Fontana, 1984), p.175. However, they also caution against ascribing too great an importance to Keynesian policies. Keynesian pump-priming was generally to be financed through government borrowing, so-called deficit financing. In their view the overwhelming bulk of state spending in the boom years was financed through taxation: see p.181.

Keynes' influence was immense. His work brought a new theoretical analysis to economics, and, unlike many of his predecessors, he was willing to pursue his conclusions into the sphere of public policy. He offered to governments a body of economic theory which offered explicit and immediate guidance, and, not surprisingly, his ideas were soon taken up and put to use; the effect seemed like the advent of a new world:

> The astonishing achievements of the golden years led many to conclude that capitalism had undergone a qualitative transformation - that the bad old days of slumps and class antagonisms had been transcended for ever. The most important expression of this view was the development in many countries of a broad political consensus, embracing the major parties of both left and right, and subscribed to by trade unions and employers' associations. Its central feature was acceptance of the so-called mixed economy - that is, a capitalist framework within which state enterprise was tolerated and the government held responsible for managing the economy.[9]

The consensus is evident in the enormous expansion of the welfare state in the post-war period, an expansion brought about across Europe by governments of the left and right alike.[10] However, Keynes was not a collectivist; he favoured the creation of conditions in which private enterprise could flourish, and although this might involve significant government intervention, he stopped short of recommending outright state ownership of large sections of the economy. But this did not prevent successive governments from believing that they now had the tools to control the economy to achieve their goals, particularly full employment. The result, according to J.T. Winkler, was a much greater intervention in the economy than Keynes believed to be right. Even during the years of the Heath administration (which at one stage advocated policies akin to those pursued under Margaret Thatcher), there was an unwillingness to accept the fluctuations of the market. An extensive battery of controls was developed, described by Tony Benn as 'the most comprehensive armoury of government control that has ever been assembled over private industry.'[11]

In time weaknesses in Keynes' analysis became apparent, perhaps the most important, for the purposes of this study, being the role he ascribed to

[9] *Capitalism Since World War II*, p.193.
[10] In the United Kingdom, for example, the share of gross domestic product absorbed by government civil spending rose from 15% to 24% in the twenty-one years from 1952 to 1973, a period predominantly of Conservative rule, the only time of majority Labour Government being the six years from 1964-1970. *Ibid* p.195.
[11] J.T.Winkler, 'The Coming Corporatism', in Robert Skidelsky (ed), *The End of the Keynesian Era* (London: Macmillan, 1977), p.81.

intelligence in the management of public affairs.[12] It is nicely illustrated in the evidence he gave to the Cunliffe Committee on the Gold Standard. The great merit of the gold standard in the eyes of its defenders was that it was politician-proof; it imposed an automatic check on any inflationary increase in the money supply. In its place Keynes advocated a managed currency, and he was asked how he would prevent inflation. His answer was, in effect, by the exercise of responsible intelligence. He believed England to be a sufficiently mature country for it to be possible to assume that the authorities would not indulge in a series of feckless note issues.[13] Quite clearly this faith in economic rationality was misplaced. Samuel Brittan suggests that it did not occur to Keynes that the political process was also a market, governed by the self-interest of politicians, officials and voters. 'He took it for granted that decisions would ultimately be made by a small group of the educated bourgeoisie, who were inspired by a disinterested concern for the public good. He assumed that wrong decisions were taken out of intellectual error or, at worst, narrowness of vision; and that if the correct ideas were promulgated with sufficient clarity and vigour they would eventually win the day.'[14] On the other hand, Keynes was clear that the task of the government was a limited one - he was much concerned to distinguish what he termed the Agenda of government from the non-Agenda. 'Its task should be to secure an "aggregate volume of output corresponding to full employment", leaving the market to allocate resources and rewards as hitherto.'[15] One way in which government might achieve this objective was to augment private investment with public investment, often perceived as the quintessential Keynesian technique. Robert Skidelsky offers the following assessment of the political significance of Keynes' concentration on aggregate demand.

> First, his view that, if demand was right, supply would look after itself undermined not just Say's Law (which said the opposite), but also the socialist case for public ownership, which rested on the inefficiency and injustice of the the allocative system under capitalism. It suggested, in fact, an alternative economic strategy to the one outlined by the Labour Party at that time. Secondly, it

[12] Keynes was also criticised for being too concerned with the short-term; encouraging inflation (a problem which he foresaw); failing to foresee the trend towards the concentration of industrial power into the hands of huge corporations, or 'oligopoly'; and the effect of technical change on economic growth. On this last point it has been argued that the spiralling productivity between 1952 and 1970 was mainly caused by a phenomenal increase in quality and quantity of the means of production. Not only was the stock of machines greater, increasing by some two-and-a-half times over this period, but the new machines were technically much more advanced. (*Capitalism since World War II*, pp.168 & 175.) Hutton has defended Keynes against the charge of short-termism, pointing out that Keynes advocated the reform of the stock market and other financial institutions to remove their short-term perspective which had turned the capital development of the country into the 'by-product of the activities of a casino'. (*The General Theory*, ch.12, quoted by Hutton in *the State We're In*, (London: Vintage, 1996), p.243.)
[13] Quoted by R. Skidelsky, 'The Political Meaning of the Keynesian Revolution' in *The End of the Keynesian Era*, p.38.
[14] Samuel Brittan, 'Can Democracy Manage an Economy?', *ibid*, pp.41-2.
[15] Skidelsky, *ibid*, pp.34-5.

> avoided having to choose between capital and labour. Keeping demand buoyant would simultaneously underwrite high profits, full employment and rising wages, thus eliminating or at least easing the conflict over the distribution of wealth. Thirdly, the decision for macro-economic, as opposed to micro-economic, intervention was a decision for indirect and general, as opposed to direct and detailed, economic control by government; for a 'managed' rather than a 'commanded' economy. Fiscal and monetary leverage by government could be reconciled with economic free will by individuals and groups. In this, Keynes was quite consciously seeking an alternative to dictatorship.[16]

Skidelsky goes further to suggest that Keynes gave capitalist democracy a philosophy to put up against its critics, but that he overestimated the possibility of rational economic management by democratic governments. Contrary to the views of libertarians like Hayek, who thought Keynesian government would be too strong for democracy, it has turned out to be too weak: 'too much penetrated by, dependent on, or at the mercy of, outside forces to be able to make its will prevail.... Industrial concentration, and with it the power of big corporations to plan their markets, have blunted the edge of traditional Keynesian fiscal and monetary instruments, facing governments with the choice of either abdicating or superseding private by public planning.'[17] Keynesian policy, with its commitment to full employment, had contributed to 'cost-push' inflation, because it had blunted the effect of traditional market disciplines to control the power of unions and employers.

If Dasgupta is right, and economics should be viewed as a series of epochs, then it is not surprising that Keynesian ideas eventually were found wanting, though it may be premature to assume that Keynesianism is a spent force.[18] As Skidelsky has pointed out, Keynesian economics encouraged inflation, and by the mid-1970s the level of inflation was causing considerable concern. A new approach was required to deal with this problem.

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[16] *Ibid*, p.35.

[17] *Ibid*, p.39. The criticism that Keynes did not foresee the growth of oligopoly (note 12 above) makes the same point.

[18] Among others Will Hutton believes that the Keynesian approach is still basically right: see *The State We're In*, ch.9. Geoffrey Barraclough suggests that the problem was the 'selective one-sided application of Keynes' teaching.' ('The Keynesian Era in Perspective' in *The End of the Keynesian Era*, p.110.) Keynes saw the two basic faults of the economy to be the failure to provide full employment and the arbitrary and inequitable distribution of wealth and incomes. (*General Theory*, p. 372). The first point had been addressed but not the second. Thus at the end of the era, in 1975, the distribution of income in both the United Kingdom and the United States was virtually the same as it had been in 1944, despite the fact that in the United Kingdom the post-war welfare state brought about a large flow of resources to the disadvantaged. However, it never came close to eliminating poverty, it being estimated that in the early 1970s 7.5% of the British population still lived in poverty. The only radical innovation was the introduction of the National Health Service, free, as of right, without means test or contribution; otherwise the expansion of welfare was along the lines established in the pre-war period. *Capitalism Since World War II*, p.196-8.

3. The Monetarist Response

The decline of Keynesianism led to the rise of monetarism as the preferred system of economic management. Monetarism is usually associated with the American economist, Milton Friedman, who came into prominence in the immediate post-war period, but its history goes back much further. As its name implies, monetarism focusses on the total amount of money circulating in the economy, 'money' being defined as currency, bank and other deposits and credit. Monetarists share with Keynesians the assumption that the capitalist economy aims to secure high employment, stable prices and continuous growth; however, they do raise questions about the mutual compatibility of these goals, and they disagree markedly about the means through which they are to be achieved. Friedman and the monetarist school believe that inflation is best tackled by ensuring orderly economic growth, and that the key to this is the proper control of the money supply. Demand management as advocated by Keynes is rejected, instead the best contribution governments can make to stable economic growth is to keep the money supply growing steadily at a rate equal to the growth of aggregate supply plus any target rate of inflation, which may well be zero.

Friedman's view is based in part upon economic analysis, and in part upon his political/philosophical beliefs. In his essay 'The Effects of Full-Employment Policy on Economic Stability',[19] described by Edmund Phelps as 'the veritable *magna carta* of monetarism,[20] he argued that the Keynesians had not properly understood the way the economy worked and that in consequence their economic model was too limited. His analysis led him to doubt whether it was possible to achieve full employment by manipulating total spending - whether through the budget, monetary policy, the exchange rate or import controls - and instead returned to the earlier idea of a 'natural' rate of unemployment. He maintained that the minimum sustainable level of unemployment is determined by underlying economic forces, the chief of which are the speed of industrial change, training and mobility, and Trades Union and other monopolistic restrictions. Any attempt to run the economy persistently below the sustainable level requires an ever-increasing money supply, which leads not simply to inflation, but to accelerating inflation, and eventually to severe and prolonged unemployment. Attempts by the government to influence the 'real variables' in the economy, like the level of employment are ineffective beyond the short-term. The only way of reducing an unacceptable level of unemployment is to reduce the natural rate itself, and this requires not macro-economic policies but micro-economic policies, often called supply-side measures. Such measures are aimed at increasing the flexibility of the labour market; some are unexceptional, *e.g.* education and training, but others are controversial, *e.g.*

[19] Milton Friedman, *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953).
[20] Edmund S. Phelps, *Seven Schools of Macro-Economic Thought*, p.30. (Oxford: Clarendon, 1990)

reducing unemployment and redundancy benefits, and curbing the power of Trade Unions.

Friedman clearly offers a different understanding of the way the economy works to Keynes, one which has little or no room for government management of demand. Instead he favours leaving to 'the market' the task of adjusting to shocks, and he argued vehemently against so-called 'counter-cyclical measures', which he believed to be an exercise in economic futility, because, *inter alia*, the science (or art?) of economic prediction was not sufficiently advanced to enable governments to know the outcome of their corrective actions. Friedman's preference for market solutions also derived from the experience of Keynesian policies at work. He considered that not only were Keynesian methods inflationary, but also that they produced 'artificial' economic activity, i.e. activity which the free market would not have generated unaided, and which necessitated increasing public support in order to keep it going. The efforts of the Heath and Wilson Governments to maintain British Leyland and the shipbuilding and coal industries exemplify this. In addition to these economic points, Friedman's views are also based on a particular view of government, namely limited government. In his view the individual consumer does not receive the same value for money from government spending as he does from competitive enterprise, and so he argues that government spending should, in any case, decrease. As Gray and Thompson observe, 'Friedman is here echoing an older classical view on the need to limit the role of the state, with philosophical and political implications for the liberty of the individual, and his challenge to the Keynesians is more fundamental than a [disagreement] on the mechanics of money supply.'[21] Allied to this belief is Friedman's view that public money should not be used to offset private sector deficiencies. Harking back to what may be called the 'Darwinian' economic perspective,[22] this view maintains the superiority of market forces, the 'natural' forces in the economy, over man's attempts to manipulate them or correct the outcomes they produce. The essence of the monetarist response is that underlying stability and predictability are more important in the economy than attempts to ameliorate the adverse effects of the economic cycle. Thus government should provide a stable background for the economy by avoiding sharp swings in policy and by setting at least a medium-term target for a steady rate of growth in the money supply. 'His Keynesian opponents have described his [monetary] target as the "fixed throttle" formula, which locks the steering gear into place, regardless of the twists and turns in the road ahead. What, to Friedman, is setting a steady, orderly course for the economy is seen by some Keynesians as an invitation to catastrophe.'[23]

[21] *Ibid*, p.404
[22] See the reference to Jane Collier, p.101 above.
[23] Gray & Thompson, *op. cit.*, p.408.

When he first advocated his views Friedman confessed that at one and the same time he felt he was preaching in the wilderness and belabouring the obvious.[24] But his views gradually found favour. In 1979 the incoming Conservative Government embraced the monetarist creed,[25] and the practical effects of monetarist policies soon became apparent. In addition to measures designed to move the budget deficit down towards zero and to reduce the rate of growth of the money supply, there was a progressive reduction in economic regulation and an increasing reliance on market forces as a means of economic management, together with a marked preference for privately rather than publicly financed initiatives. Supply side measures to increase the flexibility of the labour market concentrated on reductions in income tax and corresponding reductions in the value of unemployment and supplementary benefits in relation to wages. Earnings-related unemployment benefits were abolished, unemployment benefit became taxable, and supplementary benefits were increased only in line with prices not with earnings. These measures brought about an immediate rise in unemployment (though the position has since improved), a fall in real wages (except for the top earners), and a growing gap between the rich and the poor. Public expenditure was progressively reduced resulting, in the opinion of many observers, in a serious under-investment in the economic infrastructure. But this was not all, for accompanying these measures there was a continuing reduction in the powers of institutions that might oppose the new direction in policy, especially Trade Unions and Local Authorities, and a corresponding increase in the use of appointed bodies, the so-called 'quangos'.

Aspects of monetarism were adopted by the 1974-79 Labour Government towards the end of its life before it was taken up with enthusiasm in 1979 by the incoming Conservative Government. However, as early as February 1981 the Select Committee on the Treasury reported that there had been no true monetarist experiment,[26] and, in Christopher Johnson's view, monetarism was abandoned by John Major in 1989.[27] However, it is questionable whether this is entirely true. In practical terms the government found it impossible to keep to strict monetarist principles in regulating the money supply, but other aspects of the monetarist agenda have been maintained, even after the change of government. Even so, one may dispute the assumptions about human behaviour underlying monetarism, and this fuels doubt about its long-term validity. Thus even the views of an extreme critic like Michael Stewart may have merit. Stewart rejects the monetarist position as 'fatally flawed' because 'it starts from unreal assumptions about how the economy works', the most serious being the belief that the economy is self-stabilizing at full employment.

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[24] Friedman, *op. cit.*, p.131.

[25] See e.g. Nigel Lawson's Mais Lecture in June 1984, quoted by Johnson in *The Economy Under Mrs Thatcher*, pp.7&8.

[26] Quoted by Johnson, *ibid*, p.40.

[27] *Ibid*, p.66. Johnson was Chief Economic Adviser to Lloyd's Bank and a specialist adviser to the Select Committee on the Treasury during the period of Mrs Thatcher's premiership.

> It is one thing to construct an econometric model in which prices, wages and interest rates are all fully flexible, so that markets continually clear and full employment equilibrium is maintained.... It is quite another thing to argue that such a model bears any resemblance to the real world. By and large, agents do not optimize and the crucial markets do not clear. A strong case could be made for saying that given the conflicting drives and emotions that characterize any individual, given the imperfect knowledge that attends most decision-making, given uncertainty about the future, and given the time it takes to adapt to new developments, it is inconceivable that any human society could behave in the way postulated by monetarist theories.[28]

Common experience suggests that Stewart has a point, and there is now much academic research in support.[29] Humans find it impossible to maintain consistent beliefs and preferences, and information is necessarily incomplete. Moreover, the track record of monetarism was not at all in accordance with its theoretical statements. According to the monetarists, measures to bring down inflation would have no more than a temporary effect on unemployment because the economy was self-stablising, but this is the precise opposite of what occurred. Inflation was indeed brought down to single figures by 1982, but unemployment rose dramatically, from about 5% of the labour force in 1979 to 13% by mid-1985. Equally counter to the theory, total output fell initially, and by 1984 was only 3.5% higher than it had been in 1979; manufacturing output was 10% lower than in 1979, and manufacturing investment was 30% lower.[30] Monetarist policies also had an adverse effect on infrastructure investment. In 1979 the new government took over from its predecessor a system of 'cash limits' on public expenditure, which made it difficult for government departments and public bodies to claim extra money from the Treasury. This system was turned into a means of controlling public expenditure solely in cash terms. 'This was all very well if the inflation rate was correctly predicted, but if it was underestimated - as was usually the case - the effect was inevitably that the volume of public expenditure, or expenditure in real terms, was less than had been intended or desired. Because public authorities' current expenditure is difficult to cut in real terms, at any rate in the short run, most of the brunt was borne by capital expenditure. Capital expenditure was in consequence cut back in a wholly unplanned and irrational way. By the mid-1980s, the damaging effects on the country's basic infra-structure - the housing stock, schools and hospitals, roads and sewers - were increasingly in evidence.'[31]

[28] Michael Stewart, *Keynes and After* (London: Penguin, 1986), p.178.
[29] See Will Hutton, *The State We're In*, ch.9 and the sources cited therein.
[30] The statistics are quoted from Stewart, *op. cit.*
[31] Michael Stewart *op. cit.*, p.194.

4. The Economic Role of the State

Although the basic difference between Keynes and Friedman is in their understanding of the way the economy works,[32] underlying their theories there are some very specific preferences for the way people should live their lives, and this led them to different conceptions of the economic role of the state. Keynes was not a socialist, but nevertheless he emphasised the importance of collective action to bring about prosperity for all. Keynes was much influenced by the philosopher G.E. Moore in the conscious rejection of the earnest, puritan lifestyle of the Victorians, describing himself as an 'immoralist'.[33] Whereas the Puritans and the evangelicals had an austere and eschatalogical attitude to life, Moore emphasised pleasure as a permissible good and the absolute value of living in the present. It is not surprising, therefore, that Keynes' economic system was designed to enable people to enjoy life now, not in the future when, as he said, we shall all be dead! But this did not make Keynes an egalitarian. He believed that there was a social and psychological justification for significant inequalities of wealth, but not for the large disparities which existed in the early years of this century. He argued for individualism as the best defence of personal liberty, and defended the enlargement of the functions of government as the only practical way of maintaining 'existing economic forms in their entirety' and the successful functioning of individual initiative'[34] - an argument which raises the question of whether it is possible to accommodate *laissez-faire* doctrines in a modern, complex state. Consistent with these views, Keynes believed that the economy must be managed, and placed a high value on the use of intelligent discretion. (Here he departs from Moore's thinking. It is difficult to hold together both a commitment to 'immorality', with its desire to overthrow the established order and its values, and a commitment to rational, disinterested public administration. The latter depends upon certain established attitudes like valuing the common good and a willingness to postpone rewards, even to accept self-denial as a goal, which fit ill with Moore's private, individualistic, here-and-now philosophy.) Keynesianism is the economic expression of what might now be termed social democratic ideas, showing a willingness to expand the realm of ethical concern from the narrowly personal and individualistic. Keynes described economics as one of 'the moral sciences',[35] and although he did not answer it, he at least raised the question of the social purpose of economic activity. In giving to government the task of keeping demand high enough to make it possible for all those seeking work to find it - a vital task in his view if the abundance which modern technology made possible was to be realised - Keynes suggests that the overriding value of an

[32] This point is made by Friedman in the introductory essay in his *Essays in Positive Economics*.
[33] Later in his life, just after he had published *The General Theory*, Keynes referred to the publication of Moore's *Principia Ethica* thirty-five years earlier as 'the beginning of a new renaissance, the opening of new heaven on earth.... [I]ts effect on us dominated, and perhaps still dominates everything else.' (Quoted by R. Skidelsky, 'The Revolt Against the Victorians', in *The End of the Keynesian Era*, p.4.)
[34] *The General Theory* p.380.
[35] *Ibid*, Preface p.vii. Scarcely an 'immoralist' position.

economic system is justice.

Milton Friedman set out his basic values in his essay 'A Monetary and Financial Framework for Economic Stability'[36] written in 1948. His basic long-term objectives were 'political freedom, economic efficiency, and substantial equality of economic power'.[37] These objectives may well, as he believed, be shared by most economists, but, as he admitted, there is not the same agreement over the way they are to be realised. He explained his own position thus:

> I believe that all three objectives can best be realised by relying, as far as possible, on a market mechanism within a 'competitive order' to organise the utilisation of economic resources. Among the specific propositions that follow from this general position, three are particularly relevant: (1) government must provide a monetary framework for a competitive order, since the competitive order cannot provide one for itself; (2) this monetary framework should operate under the 'rule of law' rather than the discretionary authority of administrators; and (3) while a truly free market in a 'competitive order' would yield far less inequality than currently exists, I should hope that the community would desire to reduce inequality even further.[38]

Friedman comes from the libertarian tradition and his ideas echo those of the *laissez-faire* economics of the classical school. His philosophy is actually truer to the spirit of Moore than was Keynes', and his individualism is much more thoroughgoing; collective action is essentially suspect and must be kept to a minimum. This means a very reduced role for the government, basically, providing a framework within which the market can operate; even Keynes' limited Agenda is much too much. The common good - if indeed it is meaningful to talk in such terms - results naturally from the operation of the market, and those who find themselves disadvantaged as a result cannot expect government action to ameliorate its effects. Discretion, however intelligent, is suspect, and a high value is placed on the use of law to provide the framework within which the market operates. Within this framework the economy is seen as a self-regulating mechanism and therefore there is no need for it to be managed. In giving government the duty of maintaining a steady rate of growth in the money supply, Friedman indicates that the overriding value of an economic system is stability.

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[36] *Essays in Positive Economics*, p.133.
[37] *Ibid*, p.134.
[38] *Loc. cit.* Developing these points, Friedman argued that the volume of government expenditure on goods and services should be determined solely 'on the basis of the community's desire, need and willingness to pay for public services'; and that transfer expenditures (*e.g.* social security payments) should be based upon what 'the community feels it should and can afford'.

Justice and stability are essential ingredients of any social system, but there is a tension between them. The demands of justice can be profoundly destabilising to an established order, and the need for stability can mean justice denied or at least delayed. This tension is reflected in economics as in any other 'moral' science, and must underlie the epochal nature of its development. As Dasgupta has said, economics deals with events and phenomena which change complexion from time to time and vary in their importance within the one economy. The pressures which led to the privatization programme were of this nature; new phenomena like persistent high inflation and the failure of the public service ethic of nationalisation brought with them a demand for new ways of managing the economy. This may or may not mark the beginning of a new epoch in economics, but either way three basic questions arise: What does the analysis of Keynesian and monetarist theory suggest as the appropriate role of the state in economic management? How are the needs for justice and stability to be met? and How do the arrangements for the privatized utilities measure up?

Both Keynes and Friedman believed that the government must have some role in economic management, but neither believed it should have a large role. Keynes, who advocated a larger role for government than Friedman, argued for a much more reduced role than had actually come to pass by 1979. He advocated a managed economy but not a commanded economy; intervention but not state ownership. It seems fair to conclude that there is an economic presumption against state ownership. That, of course, was the intention of the nationalisation programme, with the ownership vested in public corporations to ensure that they operated at arms-length from the government, but that is not how it worked out. Too much was left to the discretion and good sense of those in power, assuming that they would abide by the rules of the game like gentlemen, but in practice the temptation for ministers to interfere with management decisions proved too much. This suggests that Friedman was right to warn against leaving the framework defining the government's role to discretion, and to insist that it should operate under the rule of law. This would provide for reasonable stability, but leaving things to the competitive order - another of Friedman's preferences - would not provide justice. His belief that 'a truly free market competitive order would yield far less inequality than currently exists' has not been borne out by the operation of monetarist policies, the practical results of which have been to reduce equality - understood substantively in terms of outcomes and not merely formally, as, for example, equality before the law. This is seen in the growing gap in Britain and other countries between the rich and the poor, creating an economic underclass.[39] If, as Friedman hoped, the community desires to reduce

[39] Friedman might respond that this is because 'a truly free market' has not been established. It is arguable that a truly free market exists only in theory; in the real world, as Michael Stewart has pointed out, theoretical models break down, and corrective action is needed. (See p.109 above.)

inequality further than the competitive order would allow, it can only be done by government action as Keynesian theory requires. Securing justice cannot be left to private enterprise; it can only be done by the state setting clear social goals for the market, especially in the provision of basic services. In a way, this is to provide in our own day one of the foundations of classical theory, namely the moral framework within which the market and which, among other things, implicitly set goals for economic activity, or at least regulated how goals determined by other means were achieved. Today in a more complex world, where there is less agreement on the ends of society, what was implicit in Adam Smith's day needs to be spelled out explicitly. We may conclude that another of the proper functions of government is to provide a moral framework around the free market.

❑ SUMMARY

Macro-economic theory does not offer any hard and fast solutions; rather it shows that the economic role of the state depends on the nature of the society in which we wish to live. However, it does suggest a preference against state ownership and the need for government action to regulate the market to achieve specified social goals. Broadly speaking the structure set for the utilities fulfils these criteria: state ownership has been removed - though it remains to be considered whether it is right to do this where natural monopoly functions are involved, and the utilities are subject to regulation, which, as will appear from chapter VI, has constructed a moral framework around the way they are managed.

Questions of ownership and regulation are considered further in the next part of this chapter; the way the new arrangements have worked out in practice is considered in chapter VI. In concluding this part it is appropriate to ask how the macro-economic position measures up against the criteria of Christian social teaching?

1. COMMUNITY Accepting that an economic system will vary according to the social objectives set for it, through appropriate policies and ethical constraints it should be possible for the basic unit of the person-in-community to be reflected in its arrangements. This may mean government intervention of the kind recommended by Keynes, and would represent a departure from a strict competitive order, and, more than likely, understanding the virtue of efficiency in a broader way than simply *cost-effective* efficiency. The preference for law rather than discretion as the basis for an economic system would seem to be essential for the proper working of the doctrine of subsidiarity.

2. JUSTICE Of the two overriding values mentioned above, the Christian priority is for justice over stability. While this would dispose Christians to a more

Keynesian position, it should be noted that Friedman did not argue for a completely *laissez-faire* system, and accepted that economics must be concerned with increasing equality. Neither of them maintained that there is something given about economic structures which prevents them being based on wider values than the merely utilitarian. They would agree that economics is not exempted from the demands of justice and fairness, though almost certainly they would not agree that those demands have been divinely mediated, nor about what they actually entailed.

3. GIFT Although this has not been specifically discussed, it must be the case that modern economics refuses to put land or any other commodity in a special economic category. This follows from the very nature of economics, namely the study of how scarce resources are allocated. Land is a scarce resource and has its price like any other. Cost-benefit analysis has been developed precisely to help make difficult decisions, for example about environmental protection, but it depends on treating everything on the same, monetary, level.

4. EGALITY Economic theory is at one with the Bible in eschewing any strict doctrine of equality, but it goes further in two respects: (1) it argues that inequality is essential for the operation of the market, and (2) it declines to advocate any sort of social solidarity - this falls outside the scope of economics with its concentration on exchange. Keynesians would argue that social solidarity might be expressed through transfer payments within the economy. Monetarists reject this approach, and rely on private philanthropy for the relief of need, but their individualist spirit has not in practice provided much incentive towards this. Therefore, if the preferential option for the poor is to mean anything it must be imposed on the economy by the government.

B. THE ECONOMICS OF PRIVATIZATION

The second part of this chapter assesses the economic case for privatization. First the basic economic concepts are examined, then the sale of state assets on the stock market; finally each industry is examined in turn, concluding with a critique of the arguments.

The economic case for the privatization of the utilities rests on the belief that the private sector will provide a setting in which they will operate more efficiently given the objectives which they are intended to achieve, economic efficiency being defined in terms of cost effectiveness and profit maximisation. The private sector differs from the public sector in several respects, among them the competitive forces of the market, the incentives for management and employees, and the sources of capital finance. The strength of the economic case for privatization depends upon the extent to which the private sector provides a better environment for the utilities to achieve the objectives set for them. The leading analysis of the economics of privatization is that of Vickers and Yarrow,[40] and it will be used to examine the economic arguments; there are three sections: the basic concepts, the policy for selling the shares, and the arrangements for each industry.

1. The Basic Concepts

Essentially the economic case for privatizing the utilities must establish (1) that a change of ownership to the private sector would provide a more efficient industry; (2) that competition can be introduced; and (3) where competition cannot be introduced, that an effective regulatory regime can be put in place.

❑ OWNERSHIP & INCENTIVES

A basic assumption in much of the political argument is that a change of ownership would have a major impact on the performance of the newly privatized utility, making it more efficient. Efficiency depends essentially on the performance of management, and so it is necessary to examine the effect a change in ownership from public to private is likely to have on managerial incentives. While it is true that changing the entitlement to the profits of operating an enterprise will lead to a different structure of incentives for management and hence to changes in both managerial behaviour and company performance, it does not necessarily follow that the enterprise will become more efficient. The argument depends upon the usual private sector disciplines which work to improve managerial performance, *e.g.* shareholder monitoring, the threat of take-over and performance related pay, working as effectively in the newly privatized enterprises. This simply cannot be assumed. The effectiveness of shareholder monitoring depends on the ability of shareholders to match the power of the management. Dispersed shareholdings, such as those aimed at for the privatized utilities, do not necessarily lead to effective control of management: no one shareholder has enough at stake to give them an incentive to attempt to exercise control, nor, in general, are they able to combine effectively to enable concerted action.[41] The threat of take-over also has its limitations as a form of capital market constraint on the performance of managers, in part because take-overs may be prompted by reasons other than poor managerial performance.[42] Moreover, empirical work on U.K. acquisitions done by Singh showed that size was the best deterrent to take-over;[43] thus huge companies like British Gas are unlikely to be subject to take-over discipline. There is also some evidence that take-overs have been used to promote

[40] Vickers & Yarrow, *Privatization: An Economic Analysis*, 1988. ['*Op. cit.*' references refer to this work.]
[41] As the campaign against excessive executive remuneration in British Gas showed.
[42] *E.g.* it was reported that the Hanson Group was interested in acquiring a utility because of the reliable income flow.
[43] Vickers & Yarrow *op. cit.*, p.22 and the references there cited.

managerial interests at the expense of shareholders,[44] again weakening its effectiveness as a form of control. Performance related pay has not generally been used in the public sector, but there is no reason why it could not be. The government *can* set performance targets, including profit-related bonuses, and dismiss incompetent managers. Public ownership, therefore, even though it lacks the discipline of take-over and bankruptcy threats, is not necessarily less effective in improving efficiency, and in some circumstances it may be more effective. Indeed, for a welfare-maximsing government public ownership has advantages over private because it provides government with additional policy instruments to tackle market failure or distortions. From a theoretical perspective, therefore, if a profit-maximising monopoly is not operating in the public interest, it is much easier to control it through the mechanisms of public ownership than through those of competition and regulatory policy.[45]

An important aspect of any form of control is the possession of information, and here private ownership may bring advantages. Private monitoring is likely to be more effective because more people are trying to obtain information, and thus more information is likely to be discovered, leading to more effective control. In public enterprise there can be a marked asymmetry of information which generally works to the advantage of the management and workers in the industry. Because they have more information than the voters their position is likely to be disproportionately influential; and because their 'voice' is more focussed and clearly expressed, the negative effect on them of efficiency measures is likely to outweigh in the political scales the positive effects for the voters.

Public control also has other problems; Vickers and Yarrow identify four: the displacement of social objectives by political objectives;[46] a preference for direct political intervention in managerial decisions over an arm's-length relationship that would restrict government departments to the task of setting appropriate managerial incentive structures; internal inefficiencies in bureaucracies;[47] and inefficient levels of bureaucratic activity. They conclude 'safely' that the

[44] *Ibid*, p.24. The threat of bankruptcy as a check upon management is also examined by Vickers & Yarrow: it depends upon shareholders being able to control the level of debt in the firm - something which typically is delegated to managers!

[45] However, as was all-too-evident, in practice this is not what happened, and privatization seems to have been the necessary catalyst for such changes actually to come about. Within the industries, privatization has been experienced as releasing new attitudes towards the need for and the pursuit of greater industrial effectiveness which changed the culture of the business. (This point reflects conversations with a former senior executive of British Steel. It is borne out by the regulators who remark on the change of culture necessary as first the the utilities became more customer oriented and then as they adjusted to the competitive market. See ch. 6, section 1, below.)

[46] Vickers & Yarrow describe as 'heroic' the assumption that the government represents the public interest (*op. cit.* p.29). Those involved in government are politicians and civil servants, concerned to maximise their individual interests, which are unlikely precisely to coincide with the general interest. Politicians in particular may not have a long period of office overseeing the industry and thus their perspective is apt to be short-term and concerned with both career advancement and re-election.

[47] Typically bureaucratic concern is with the size of the budget, which leads to activity to increase budgets and to inefficient monitoring.

incentive structures for public enterprise will tend to show significant imperfections at each level of the monitoring hierarchy.[48] Within the industries these problems were experienced quite severely,[49] but it does not follow that private ownership would lead to better control: 'privatization is likely to improve social welfare only if it provides significantly keener managerial incentives than does the control system for public enterprise',[50] the implication being that transfer to private ownership *per se* is unlikely to improve the performance of the industry. Ownership is only one of a variety of factors which influence managerial incentive structures and economic performance, and, in particular, the competitive structure of the industry in which the firm is operating and the regulatory constraints that it faces will each have significant effects on incentives and hence on both allocative and internal efficiency. A survey of the literature leads them to the conclusion that privately owned firms tend to be more efficient internally when competition in product markets is effective. Thus so long as there are no substantial allocative inefficiencies resulting from market failure 'we would argue that the available evidence supports a presumption in favour of private enterprise. However, when market power is significant, and particularly when company behaviour is subject to detailed regulation, there is little empirical justification for a general presumption in favour of either type of ownership, and case-by-case evaluation of the various trade-offs is therefore in order.'[51] Commenting specifically on the water industry they say: 'we are led to the conclusion that, where firms face little product market competition and are extensively regulated, there is no generally decisive evidence in favour of one or other type of ownership.'[52] However, in areas of the economy where both public and private firms operate in competition, e.g. airlines, ferries, and the sale of gas and electricity appliances, they conclude that 'where competition is effective the available evidence suggests that private enterprise is generally to be preferred on both internal efficiency grounds and, subject to the qualification that other substantive market failures are absent, social welfare grounds.'

What is striking about their conclusions is their very guarded nature, an impression reinforced by their concluding observation: '...this does not mean that, in competitive markets, we believe that public ownership is always and everywhere the less efficient type of ownership. Relatively efficient public enterprises can and do survive,[53] but, on average, we would expect the

[48] *Op. cit.*, p.34.
[49] As one former senior executive said: 'The effects of ministerial concerns, of officials' interventions and of constant exposure to political/public comment on the effectiveness of the Corporations were overwhelmingly deleterious; and whatever their other weaknesses, privately owned businesses do not have to bear that back-breaking burden.' (Source: private conversation.)
[50] *Ibid*, p.39.
[51] *Ibid*, p.40.
[52] *Ibid*, p.41. This supports the conclusion of Saunders & Harris that by the time water came to be privatized political rather than economic considerations were paramount. (See p.15 above.)
[53] British Steel immediately before privatization is, perhaps, the best example.

frequency of this occurrence to be lower than for private enterprises.'[54] If this caution is so evident in assessing the relative performance of public and private industries in areas where they do compete, how much more problematic is it to make a judgement between public and private ownership on economic grounds in areas of natural monopoly, where, *ipso facto*, there is no competition.

❑ COMPETITIVE FORCES

A second basic assumption of the political arguments for privatization is that efficiency would be improved by exposing the utilities to the competitive forces of the market. Indeed, so intertwined are privatization and liberalisation (the opening up of competitive forces) in policy debate and public perception, it is frequently assumed that they are two sides of the same coin; this is not the case. Privatization and liberalisation are distinct concepts, and the economic case for liberalisation has to be properly established. The basic question is whether it is possible to introduce competition into industries where it has been absent. The question needs to be pressed because public ownership is one of the main solutions for the problems of market failure which exist in industries in which competition is impossible or undesirable, or where major externalities exist, and this is precisely the situation of the three utilities under consideration; indeed, this was the basic economic justification for their nationalisation. However, times change, and although the concern to find appropriate solutions to the problems of market failure were - and are - well founded, the danger exists that competitive forces become too neglected, and are assumed to be irrelevant, when perhaps they have a useful role to play. 'Conditions of demand and technology may change so that yesterday's natural monopoly no longer persists, and the difficulties of controlling public enterprise may turn out to be such that competitive forces have significant advantages despite being imperfect.'[55] Thus we need to ask whether industry conditions have changed sufficiently to permit the introduction of competition. The telecommunications industry is an example of where this has happened; new technologies have weakened the natural monopoly element, and may remove it altogether, making it possible to introduce competition. Introducing competition has the further advantage that it weakens the 'grip' of public sector managers and civil servants.

Competition improves both allocative and internal efficiency. Clearly alternative sources of supply will tend to drive down price (so long as the number of competing firms is large enough to avoid collusion) and to act as an incentive to expand markets; both these improve allocative efficiency. Internal efficiency is improved because a competitive market keeps management on their mettle: 'It has been said that the greatest of all monopoly profits is the quiet life, and if that is so there is a case against public monopoly. This case is all the stronger

[54] *Op. cit.*, p.43.
[55] *Ibid*, p.45-46.

if mechanisms for regulating public enterprise...have serious weaknesses, as both empirical and theoretical evidence suggests. In particular competitive forces break the "monopoly of information" about industry conditions that may otherwise exist, and which tends to hamper the effectiveness of the regulatory regime.'[56] Opening up competition also creates opportunities for innovation. In networks and vertically related markets competition is more feasible in some areas of a business than another, e.g. in electricity generation but not in transmission and distribution where a network is required. The policy question is whether the area in which competition is possible can be separated from that where it is not. The recent history of both gas and electricity supply shows such a separation taking place. Supply is not a natural monopoly, and competition has been introduced with a considerable increase in both allocative and internal efficiency.

Introducing competition means allowing other firms to enter the market. In industries with economies of scale, like the utilities, the disadvantage of doing so is that it leads to the undesirable duplication of fixed costs; the disadvantage of not doing so is that the fewer the firms the greater market power becomes, and allocative efficiency is impaired. The trade-off between economies of scale and allocative efficiency is an important issue in the economics of privatization which did not feature in the political debate. In fact, the privatization programme did not take a consistent line on liberalisation. Although Mercury Communications were licensed to compete with British Telecom (even if only in non-domestic business), and National Power and PowerGen were set up to compete in electricity generation, British Gas was left intact as a monopoly, as was each Water Company. However, even if competition is introduced, the size of the incumbent firms means that it is unlikely to have much effect, especially given the inevitable sunk nature of many costs. If competitive forces cannot be effectively introduced, including effective competition policies which strike at anti-competitive behaviour against potential entrants by incumbent firms, then the economic case for privatization is considerably weakened.

❑ REGULATION

Regulation is used to promote competitive behaviour in industries where it is weak or non-existent. It may be viewed as a game between the government and the firm, a central feature of which is the asymmetry of information between the two. The basic problem for the regulator is to to design an incentive mechanism to induce the firm to act in accordance with the public interest without being able to observe the firm's behaviour. Although the direct object of regulation is pricing, which is easily measured and changed, the effect of regulatory policy upon social welfare depends critically upon the investment behaviour it induces, *e.g.* in new water pipes and sewerage systems. Investment is not so easily quantified and cannot be changed in the short-term.

[56] *Ibid*, p.51.

Regulation generally takes one of two basic forms: rate-of-return regulation, *i.e.* controlling the return on capital invested, or price regulation, *i.e.* controlling the maximum product price. Neither is entirely satisfactory. The Averch-Johnson model[57] shows that rate-of-return regulation generally has two opposite effects: output increases but allocative efficiency declines. However, rate-of-return regulation is better in stimulating good investment policies. Price regulation of the 'RPI-X' style used in the U.K. gives good incentives for efficiency immediately after a review, but as time passes the firm's calculations will increasingly be affected by the benefit to be gained from influencing the outcome of the next review. 'As that time approaches the firm will have little or no incentive to reduce costs if its future prices are positively related to its current cost level.'[58] Price regulation also tends to result in under-investment: a firm would not wish to undertake a large investment programme if it could not be sure that the next price review would take account of this. Whatever its form, a prime requirement of the regulatory regime is that it provides a credible commitment to future fairness.

Regulation faces particular problems in multi-product firms because of the complexities of their pricing policy, and Vickers and Yarrow argue that the U.K. utilities should be viewed as multi-product firms. For example, in the electricity industry, not only do the companies sell a variety of appliances, but the supply of electricity is a complex business with fluctuations in demand between times of day and year, and according to the weather. Given the limitations on capacity and the difficulty of storing output, the electricity pricing structure must be sensitive to demand if rationing is to be avoided.[59] The multi-product nature of the utilities implies a fairly sophisticated pricing formula if regulation is to be effective. After examining the literature they conclude that that 'private ownership of a multi-product monopolist is no bar to allocative efficiency provided that the price control formula is aptly chosen.' They add that the proviso must be 'emphasised strongly' because of the difficulty of obtaining the information needed to determine the values of the appropriate formula.[60] Their analysis strongly suggests that the 'right' formula will not be produced because the government almost certainly does not have the necessary information. In other words, there are good economic reasons for questioning the effectiveness

[57] *Ibid*, p.84.
[58] *Ibid*, p.87
[59] *Ibid*, p.101.
[60] *Ibid*, p.104.

of the RPI-X type of price regulation used in the U.K.[61]

A way of overcoming this imbalance of information is to make use of the device known as yardstick competition. Yardstick competition aims to overcome the problem by promoting competition between the regulated units through the regulatory mechanism itself. For example, in a duopoly divided by geographical area, where each unit has a natural monopoly in its area, the two units could be brought into competition by making the price each could charge dependent on the costs achieved by its competitor. So long as they do not collude[62] internal efficiency is achieved because each unit retains the benefits of its cost-reducing activities because its price is linked to the costs of its competitor, and allocative efficiency is achieved (so long as there is symmetry between the units) because industry prices are kept in line with industry costs. In this way the disadvantage of lack of information on the part of the regulator is overcome.[63]

❑ SUMMARY

The economic case is much more limited in its concerns than the political case, resting essentially upon improved efficiency: privatization is justified in economic terms if it enables the business of running the utilities to be conducted at less cost per unit of production without loss of social utility. Again in contrast to the political arguments, the conditional nature of the economic case is striking, and it is clear that privatization of the natural monopoly elements of the industries is not an obvious economic imperative. Indeed, liberalisation (opening up to competition) is more important than privatization (transferring ownership) in improving economic efficiency, but it is possible only where a market exists or can be created. Natural monopolies are such precisely because this possibility does not exist, and thus the economic case for privatizing them is very weak. This does not mean, however, that utility privatization is entirely inappropriate, because it is only the network part of the business which is a natural monopoly, and privatization may be possible in other parts. If, nevertheless, privatization of the whole business is undertaken for political reasons, then economic concern fastens on the regulatory regime: (1) it needs to be strong enough to simulate the competitive

[61] This system essentially lays down a limit on the average price that the multi-product firm can charge, and there is a long regulatory lag. In principle the system could encourage an efficient price structure if the parameters of the allowed pricing formula were set correctly, but the authorities' relative paucity of information prevents this from happening, except perhaps by chance. Secondly, the system is vulnerable to inefficient strategic manipulation of costs by the regulated firm, especially as the time of regulatory review draws near. 'Finally, regulating a multi-product firm by the RPI-X method faces further problems when the firm faces competition in some of its regulated product markets.... If the average price constraint covers markets in which there is some actual or potential competition, incentives for an efficient pricing structure can become distorted. The average price constraint encourages the firm to undercut its rivals in the competitive business segments by allowing it to recoup the costs of doing so elsewhere. This problem, which arises from averaging, calls for more product-specific regulation and for safeguards against anti-competitive conduct.' *Ibid*, p.104.

[62] Collusion is the major problem in yardstick regulation, especially where there are few units.

[63] Vickers and Yarrow also discuss franchising as a method of utility regulation, but conclude that it does not offer advantages over the price control method.

forces which would exist if there were a market, and this means that the regulator must be supplied with sufficient information to do this; and (2) it must promote investment otherwise the social objectives of the industry will not be realised. The economics of privatization shows clearly that it is neither a panacea nor always inappropriate. The economic case involves making a judgement on a number of trade-offs, and can only be made out on an industry by industry basis. This is considered in section 3 below.

2. Selling State Assets and the Stock Market

The policy pursued by the Conservative Government of selling state assets on the stock market is open to serious criticism on economic grounds, the essence of the matter being that the share issues were excessively and needlessly underpriced. Underpricing is normal in new issues of shares in order to ensure that the sale goes well, and significant price rises on initial trading are normal, and, although the government and its advisers had a difficult balancing act to perform in setting the flotation price, there were serious and very expensive flaws in their policy which could easily have been avoided. The result was a much greater level of underpricing than is usual in private share issues. Vickers and Yarrow comment: 'It could not be expected that the government would fine tune the pricing of each issue so that the average premium would be zero, but the windfall profits to lucky applicants for shares have been far greater in both relative and absolute terms than the average profits to those who 'stag' private issues.'[64] The underpricing in private offers of sale is usually between 5% to 7%; the average for privatization was over 18%, and on top of this were the various voucher and bonus schemes for those who retained their shares for a minimum period - incentives which are absent in a private issue. The reasons for this policy seem clearly political: 'underpricing is a way of encouraging wider share ownership, it avoids political embarrassment, and it minimises the chance that individual investors (who have votes) will sustain capital losses. Underpricing is also greatly to the benefit of city institutions.'[65] Underpricing was most glaring when the company was entirely new to the market, and that, of course, includes the three utilities considered in this study. There were other and better ways of proceeding, for example, by offering for sale initially only a proportion of the shares, so that when the balance is offered there is an existing market for the shares which sets the price.[66] This is common private sector practice.

The underpricing was severely criticised by the House of Commons Public Accounts Committee in 1998, which called for strict guidelines, incorporating the ideas just mentioned, to ensure that the mistakes were not repeated in

[64] *Ibid*, p.178.
[65] *Loc. cit.*
[66] See further: Jenkinson & Mayer, 'The costs of Privatization in the UK and France', in Bishop, Kay & Mayer (eds), *Privatization and Economic Performance*, p.290ff, esp.297. They also conclude that privatization is not an appropriate way of extending share ownership.

future privatization schemes. The Committee estimated that a further £30 billions could have been raised form the water sale alone if the sale had been staged, and £2.6 billions from the sale of National Power and PowerGen shares.[67]

The underpricing has brought about a major redistribution of wealth; the gainers have been the successful applicants for shares, and the losers those who would have enjoyed lower taxes and/or better public services had the underpricing not occurred. However, the gains are much more apparent than the losses; the successful applicant who has made a quick capital gain through selling the shares is aware of his advantage, whereas the public are not equally aware of what they have lost. This way of redistributing wealth is open to economic objection: (1) it is arbitrary in the sense that the gainers have performed no socially useful function other than the bearing of (negligible) risk; (2) the prospective transfer of wealth to successful applicants encourages a great deal of unproductive wealth-seeking activity, for example the transaction costs involved; (3) many of the windfall profits have gone overseas, and from the point of view of the national welfare those profits are a direct loss; and (4) the cost to the economy of raising an amount of tax revenue equal to the extent of underpricing is far greater than the amount of the underpricing. While the costs of the sales were not excessive compared to private sector sales, they were still unnecessarily high because the government did not suffer the same risks as a commercial firm. In particular underwriting the issues was wholly unnecessary.[68] Underpricing and the costs of sales has also meant that privatization has not reduced the PSBR as much as was anticipated; moreover the exchequer loses the profits of the firms when they pass out of public ownership, and if the firm is subject to light regulation, it may not perform as efficiently as it should, resulting in lower tax revenue. It seems fair to conclude that the method of selling state assets cannot be judged otherwise than as a failure both economically and in terms of the general public interest, but as Vickers and Yarrow observe, '[Its]short-run success in political terms is another matter.'[69]

3. The Industries

❑ GAS

The original provisions of the Gas Act 1986 (which set up the privatized industry) did not foster competition in the industry because entry into the

[67] *The Independent*, 3.9.1998.

[68] Vickers & Yarrow suggest an intriguing way of reducing the expenses of the sales: *viz:* for every adult to be *given* an equal number of the shares in the massive companies like BT and BG. This would have four advantages: (1) it is a manifestly fair way of asset disposal - everyone would own exactly as much of the company after privatization as he or she did (in effect) under public ownership; (2) there is no arbitrary redistribution of wealth and no loss of profit to overseas institutions; (3) there are no concerns about pricing and underwriting; (4) it is the most direct method of promoting wider share ownership. The disadvantage is that giving shares away would increase the need to raise finance from other sources. *Op. cit.* p.185.

[69] *Ibid*, p.193.

domestic gas market was blocked, and the Director-General of Gas Supply (DGGS) only had a duty to 'enable' competition with regard to supplies to large customers in the commercial and industrial markets, nor was it anticipated that there would be lots of competition in gas supply in the future.[70] The accounting provisions in the Authorisation given by the Secretary of State to the newly privatized British Gas gave 'extremely poor' information to the DGGS. In particular, because British Gas was not required to keep separate accounts for its sales and its transmission system it was impossible for the regulator to determine whether access to the pipeline system was being unfairly denied, and it was impossible to check the extent of any cross-subsidisation or price discrimination. The price control formula applied only to domestic supply, and contract prices for industrial users were completely unregulated, even though competition from other fuels was relatively weak. 'Taken as a whole, the pricing constraints imposed on British Gas can hardly be described as stringent'[71] In fact it seems that the privatization of British Gas was influenced more by the need to strike a political balance between the various short term interests involved (politicians, management, potential shareholders) than the need to secure the longer-term benefits of promoting greater competition and effective regulation. What stands out is just how little weight was given to competitive and regulatory objectives: an extreme example of 'regulation with a light hand'. Major opportunities to improve incentives in the industry were missed. Vickers & Yarrow identify four major policy failures:

> (1) not restructuring the industry before privatization;
> (2) preserving the existing average cost pricing formula rather than changing to one based on marginal cost;
> (3) failing even to attempt to introduce actual or potential competition to the dominant supplier;
> (4) imposing a very limited regulatory regime. In each case the beneficiary of these failures was the management of British Gas.

It could be argued that the customer benefited from the average cost pricing structure, but in their view this is unlikely to be a long-term gain.[72] Overall, it seems that an excessive cost was paid to the management to secure their co-operation in the process of privatization. They argue that regionalisation would have been a feasible re-structuring policy which would have brought many benefits, including the possibility of the DGGS promoting yardstick competition, greater capital market competition, and lower barriers to entry for new producers. While this specific proposal has not been implemented, as will appear from chapter VI, most of these policy failures have now been reversed. The initial failure represents a victory for political expediency over economic

[70] See p.78 above.
[71] Vickers & Yarrow, *op. cit.*, p.265.
[72] *Ibid*, p.268.

efficiency. It is hard to avoid the conclusion that the government's priority was electoral advantage and the desire to score a political success with gas privatization.

❑ ELECTRICITY

While there are real economic benefits in an integrated regional or national power network,[73] there is a fundamental conflict between integration and competition:

> ...the existence of an integrated power system poses certain problems for the development of competition in electricity generation. To prevent system failures, electrical equilibrium must be maintained at all points in the network: the power 'demanded' at each point must be equal to the power 'supplied'. It follows from this that, unlike most markets, a company generating electricity at a particular point in the network *cannot* direct its output to a designated point of demand. Hence, the performances of the various generating sets attached to the system are, in a very direct and obvious way, interdependent. In practice it has proved difficult to handle these network interdependencies in an efficient manner through the use of a fully decentralized set of contractual relationships. Large networks, whether they be comprised of publicly owned or privately owned firms, therefore typically make use of come centralized 'planning' authority that makes allocative decisions (*e.g.* which power stations are to generate electricity at a particular moment) on a command or fiat basis. However, the establishment of central co-ordination...is in conflict with the goal of promoting greater competition.... In other words, the technology of electricity supply creates a policy dilemma - the benefits of co-ordination among firms have to be balanced against the benefits of competition - and the question of how this trade-off should be resolved is one of the most important issues in electricity economics.[74]

Maintaining the vertical separation between generation and supply and privatizing the industry in regional units were improvements over the arrangements for the gas industry because of possibilities for competition thereby created. This arrangement has also led to reduced barriers to entry into electricity generation, but privatizing the Area Boards is neither a necessary nor a sufficient condition for *significantly* enhanced competition in electricity generation. It is also arguable that a better economic structure would have been a mixture of publicly and privately owned area boards so as to increase

[73] These include reliability of supply through the consolidation of uncertain loads; efficient production through matching generating plants with different marginal costs to the level of demand; economies in responding to emergencies such as plant and transmission failures.
[74] Vickers & Yarrow *op. cit.*, p.291.

the range of incentives available in the industry as a whole, and to reduce the incentives to collusion in yardstick competition. From an economic perspective a uniform price structure across the industry is inefficient; it would be more efficient for prices to vary according to locality depending on the real cost of supplying electricity in that location.[75]

Operating the national grid is a natural monopoly function carried out before privatization by the Central Electricity Generating Board (CEGB), but the generation of electricity is not. In many countries generation is undertaken by a relatively large number of different companies, and international evidence does not indicate the existence of any clear cost-efficiency benefits associated with single firm production.[76] There were three basic policy options for the privatized generation industry: (1) keeping a single monopoly generator as with the CEGB; (2) creating regional generating companies; and (3) creating two or more generating companies out of the CEGB's assets. It is not possible to express a firm preference for one of these on economic grounds, there being substantial, though different, problems with each option. The third, which was in fact chosen involved the most difficult administrative arrangements, and in the form in which it emerged, namely a duopoly, was scarcely an improvement on the single monopoly generator. (The main disadvantages of a duopoly are collusion and relative ease of preventing new entry into the market.) With the CEGB divided into two generating companies, the best arrangement for the national grid would have been to set up a separate company to own it, the question being whether it should be in private or in public ownership. Establishing a grid company independent from the generating and distribution companies would assist in the development of a more competitive market in bulk electricity, and pubic ownership might be the best way of dealing with the considerable market power that the firm would possess. Public ownership also has the advantage of making collusion between privately owned utilities more difficult, including collaboration to obstruct entry. The original arrangement which placed the grid company in the joint ownership of the Area Boards scarcely secured these advantages. Given the basic trade-off at the heart of the economics of electricity supply, the introduction of privately owned companies into the industry has to be seen as but one way in which industrial performance can be improved through promoting greater competition and stronger regulation. A better approach would have been a partial, step-by-step privatization, producing a mixed public/private industry, coupled with strong regulation. In particular, a mixed industry, which is the norm in many countries, would make it easier both for the regulator to obtain information and to adjust the industrial structure as knowledge and circumstances change. As with Gas, political considerations obstructed good economics.

[75] The same is true, of course, for gas and water.
[76] Vickers & Yarrow *op. cit.*, p.299.

❑ WATER

The Water industry exhibits some important differences from the other privatized utilities: (1) opportunities for increasing competition in the water industry are generally fewer than in the other utilities, and thus economic efficiency depends much more upon regulation; (2) the water industry is itself a regulatory authority, and therefore privatization has important consequences for the conduct of environmental policy; (3) charges for many of the services supplied by water authorities are *not* quantity related because generally water is not metered; (4) water quality is unlikely to be raised to the prescribed standards by price controls alone, therefore regulation must extend to quality controls as well as to price controls; (5) the industry was regionalised before privatization, and therefore the regulator is likely to be able to have access to information which would permit effective yardstick regulation. Before privatization the principle of integrated river basin management was the centrepiece of government policy, and it had many advantages; privatization necessitated the abandonment of this policy, and so from the beginning it meant the industry suffered a substantive detriment.

As already noted, there is very little, if any, scope for competition in the supply and distribution of water and in the provision of sewage services;[77] moreover, if it were introduced it is unlikely to have much effect because at least in the domestic market the demand for water is independent of the charges levied, and thus water authorities face a completely inelastic demand for much of their output. However, the opportunities for competition in sewage treatment are greater, and there is also scope for introducing competition through franchising and contracting out services such as pipeline maintenance and construction.

The Water industry has generally low levels of profitability. Improvement requires continuing and substantial new investment, but the finance for this will only be forthcoming if the investors receive a market rate of return on their capital. In the USA this has been recognised through a regulatory formula which allows the industry a reasonable rate of return on capital employed. From this perspective, the RPI-X regulatory formula is deficient because it does not provide a long-term guarantee about the outcome of regulatory price reviews, undermining investor confidence and leading to a real danger of under-investment. Quality of service also presents a problem because a profit-seeking regulated monopolist will not face incentives which lead to quality choices expected by consumers. Economic analysis shows that at any given price the regulated monopolist has incentives to chose suboptimally low levels of service quality.[78] The temptation is to 'chisel' quality because by doing so it can reduce

[77] As this is now under consideration by Ofwat, it is interesting to note that Vickers & Yarrow dismissed the idea as uneconomic. The benefits of introducing competition in water supply through a common pipeline network are likely, they say, to be less than in the other utilities because the costs of producing water are relatively low in relation to the value added at the transportation stage. *op. cit.*, p.402-3.

[78] *Ibid*, p.412.

costs. In a more competitive market this would lead to customers switching to other products, but this option is not available in the case of water. Moreover, profit-seeking firms will have incentives to press for derogations and delays in meeting the prescribed quality standards. And because service standards are dependent upon investment, any tendency to under-investment will exacerbate the quality problem.

The economic case for privatizing the water industry is weak. Vickers and Yarrow list the following 'substantive detrimental effects on economic efficiency':

(1) loss of economies of scope from abandoning the principle of integrated river-basin management;
(2) the likely adverse effects of using commercial rather than social criteria in deciding whether or not to introduce metering:
(3) establishing a structure for the industry which is less favourable to competition than alternatives involving greater use of franchising;
(4) the incentives of privately owned firms to lower service standards and the difficulties faced by the regulators in preventing this effect;
(5) the possible creation of incentives for cross-subsidisation;
(6) the danger that in the absence of a clear long-term policy framework which protects the sunk investments of private shareholders and which commands general assent, capital expenditure in the industry will be suboptimally low.[79]

In the light of this 'formidable list of problems' they conclude that privatizing the water industry is likely to have a detrimental effect on economic welfare. Despite its deficiencies the system of controls for the nationalised industry achieved significant reductions in operating costs and significant improvements in productivity, and these have reduced the scope for further improvements under private ownership. 'More importantly,' they maintain, 'stronger incentives for reductions in both operating and investment costs can be introduced through compulsory franchising. Since this can be achieved whilst retaining the public sector status of the water authorities, it is also consistent with the maintenance of the integrated river-basin management system, the retention of cost-benefit criteria for metering decisions, and the promotion of effective competition in input markets. In addition, it avoids the creation of incentives for lower service standards and lower investment which are likely to arise from an increased emphasis on profit criteria in decision making.'[80] In effect they argue for a mixed public/private structure where the public bodies are responsible for regulatory functions, major investment decisions and service standards,[81] and the private firms more involved in pipeline construction and

[79] *Ibid*, p.422.
[80] *Ibid*, p.423.
[81] Such a scheme might also overcome a particular weakness identified by Cowan, namely the separation of price regulation (Ofwat) and quality regulation (mostly EU).

maintenance, and sewerage treatment.

❑ SUMMARY

The economic arguments for the wholesale privatization of the utilities could scarcely be described as strong, and even where there is a good economic case, it has not been acted upon in the most appropriate way. The essence of the economic case is that privatization is appropriate where competition can be introduced. Originally competition was not envisaged for gas, though it was for electricity and for water; however, the utilities were all privatized without competition being introduced into any of their core businesses, nor, with one exception, were they restructured so that competition could be partially introduced; and in the case of the exception, electricity generation, the re-structuring was of the most minimal type. The failure to restructure British Gas was quite indefensible economically, and this privatization may be fairly described as the nadir of the whole programme.

A second string of the economic case is that regulation may be an alternative to competition, but it must be strong regulation, all the more so where a natural monopoly remains, as it does at least with the network element in each utility. Nevertheless, the original regulatory regimes were uniformly weak, particularly so in the case of gas. The government was clearly aware of the economic arguments, but equally clearly chose not to give them much weight. The point made above about the later stages of the privatization programme being motivated primarily by political considerations is amply borne out, and instead of providing a support for the programme, the economic arguments actually provide ammunition for its critics. The micro-economic arguments also measure up less well against the Christian criteria.

1. *COMMUNITY* The driving force of the private sector, competition, can be inimical to community, as it tends to divide rather than unite, and concentrates more on the individual person than the person-in-community. The need is to harness the competitive spirit to ends other than profit and efficiency, and the existence of the regulatory regime provides this possibility.

2. *JUSTICE* The economic case is not concerned with this, concentrating as it does on *cost-effective* efficiency, and interestingly (especially in view of subsequent developments) the scope for regulation to prescribe social objectives forms no part of the economic argument. The sale of the assets of the former nationalised industries on the stock market resulted in a major injustice to the community.

3. *GIFT* The Bible sees land as a gift, and it may be appropriate to view water in the same way. If so, then the privatization of the core water industry would

seem to be wholly inappropriate, and this conclusion is given added force by the extremely weak economic case for doing so. In particular forfeiting the principle of integrated river-basin management seems to be an environmentally unfriendly step.

4. EGALITY The economic case for privatization does not rest in any sense on a duty of the rich to help the poor, or upon any notion of improved social efficiency. Some New Right theorists argued that in a climate of improving prosperity all would gain, wealth trickling down from the rich to the poor, but this was irrelevant to the economic case, and in any event the widening gap between the rich and poor shows that the theory was, quite simply, wrong.

The early privatizations were preceded by considerable economic research, but as the programme developed the economic arguments became less important and political objectives became dominant. This is reflected in the marginal contribution that economic values actually made to the case for privatizing the utilities. As Vickers and Yarrow say, 'to treat privatization as an all-or-nothing issue is to create an arbitrary and unnecessary constraint on policy decisions. Indeed, one of the weaknesses of the UK privatization programme...has been that, in its enthusiasm for private ownership, the government has opted for policies that allow for rapid transfer of complete industries to the private sector, frequently with scant regard for the more fundamental issues of competition and regulatory policy.'[82] Nor have they paid sufficient regard to issues of justice and community.

[82] *Op. cit.*, p.311.

VI

The Utilities Since Privatization

This chapter reviews the performance of the three utilities since privatization. The first part reviews the commercial and social performance of each industry; the second part considers the balance of benefits, and the third part considers whether the aims set for the privatization programme have been achieved. The review is based on information contained in the annual reports of Ofgas, OFFER and Ofwat, and reports contained in *The Independent*. It covers the period from privatization to the end of 1998.

A. COMPANY PERFORMANCE

In assessing company performance six criteria are used: customer service, social justice, price control, competition, energy efficiency, and environmental protection.

1. Customer Service

James McKinnon, the first Director-General of Gas Supply (DGGS), stated in his first annual report that consumer protection was 'of primary importance', adding that an understanding of the factors which make for consumer satisfaction was the primary qualification for the job.[1] He took the view that 'any diminution in the level of service is tantamount to a price increase,'[2] and in a relationship with British Gas which his successor, Claire Spottiswoode, described as 'robust'[3] he harried the company continually to improve its customer relations and standards of service. Where Ofgas led the other Regulators followed, achieving a rising level of customer service in all three industries. The Regulators have all taken a similar approach, requiring either the industry to set standards of service, or prescribing the standards themselves. Information about compliance has also been required to be published - in the water industry this takes the form of a substantial Annual Return. Where necessary these standards have been incorporated into the companies' licences, thus placing them a legal basis which has given the Regulator the power of enforcement - which has not so far been used.

In all three industries there has been a clear overall improvement in standards

[1] Ofgas 1986, p.3. *NOTE*: The Annual Reports of the Regulators are published as Parliamentary Papers. References in the text and footnotes are given in abbreviated form. The full reference with the paper number and sessional year will be found in Appendix 3.
[2] Ofgas 1988, p.9.
[3] Ofgas 1993, p.5.

of service, allaying fears that they would fall, particularly with a system of price regulation with its incentive to cut costs, and hence levels of service. The guaranteed standards schemes imposed by the Regulators have been a deterrent to such temptations.[4] The level of complaints broadly supports this conclusion. Table 1 gives the number of complaints received by each Regulator since privatization.[5]

TABLE 1. **NUMBER OF COMPLAINTS SINCE PRIVATISATION**

Year	*Gas*	*Electricity*	*Water*
1987	252		
1988	275		
1989	431		
1990	366	10567	4613
1991	918	15264	10638
1992	1264	17432	14792
1993	1842	12471	14302
1994	2318	10007	13310
1995	3389	8300*	13192
1996	9287	7081	10074
1997	27274	6622	11123
1998		5996	**

SOURCE: Ofgas, Offer & Ofwat Annual Reports.

NOTES

1. Figures for Ofwat began to be published only in 1990.
2. The explosion of gas complaints in 1997 most likely results from the problems encountered in the introduction of competition.
3. In early years one third of water complaints were about the level of charges. As the new price controls took effect so the levels of complaints fell.

* Estimated figure. ** Figure not given

For electricity and water an initial increase in complaints has been followed by a fall, whereas for gas there has been a steady increase, but even the high figures represent less than 1% of customers. The most dramatic fall is for electricity, lending support to consumer surveys which have suggested that of the utilities the electricity companies were considered to be offering the best standards of service. Regulation has been vital in bringing about improved levels of service; it is most unlikely that without it there would have been a similar, indeed any, improvement. This was recognised in the Competition and Service (Utilities) Act 1992 which gave new powers to the Regulators to set performance standards on service and energy efficiency, collect and publish information on compliance, and to resolve disputes.

[4] See Ofwat 1991, p.29.

[5] Initially complaints procedures were worked out by each Regulator with 'its' industry, but in 1992 the Competition & Service (Utilities) Act required the companies to have complaints procedures approved by the Director-General.

❑ GAS

In 1990 James McKinnon stated that British Gas lacked 'a purposeful, dynamic approach to customer service' and that Ofgas had found progress in improving it a slow and difficult process.[6] When British Gas claimed that improvements in customer service were just the extension of best practice within the company, McKinnon commented: 'we saw very little evidence of it,'[7] and in 1991 Ofgas stated publicly that British Gas: (1) needed to change its culture from 'the company is always right' to 'the customer is always right', (2) should publicly declare the levels of service its customers should expect, the systems for dealing with complaints, and the compensation payments payable for poor service, and (3) set and publish adequate and measurable service delivery targets, and publish its assessment of performance against them'.[8] Under this onslaught British Gas gradually yielded and developed national standards of service and performance targets for staff. Data on compliance was collected and the results published. In 1991 a new condition was inserted, by agreement, into British Gas' licence requiring it to carry out its undertakings on levels of service. By 1993 British Gas' complaints handling had improved and it gained a charter mark.[9] When competition was introduced in the domestic market all suppliers had to guarantee certain minimum standards: a continuing gas supply, the ability to change supplier on reasonable notice, supply prices that are published, and a range of payment methods.[10]

❑ ELECTRICITY

The experience with British Gas led to the Director-General of Electricity Supply (DGES) being given better powers in the area of consumer protection. In 1990 the companies were required to draw up five codes of practice to protect customers covering: payment of bills, dealing with domestic tariff customers in default, services to the elderly and disabled, the efficient use of electricity, and the handling of complaints. The initial submissions were disappointing and the DGES declined to approve the codes. Revised proposals were approved in 1991. In the same year the DGES set standard levels of performance comprising *Guaranteed Standards* (*e.g.* restoring supplies after power cuts, providing supply and meters, maintaining voltage levels, and keeping appointments), and *Overall Standards* (*e.g.* reconnection following faults, meter reading, and relocating meters). Breach of guaranteed standards

[6] Ofgas 1990, p.26.
[7] Ofgas 1991, p.44.
[8] Ofgas 1991, p.44. Initially Ofgas lacked the powers to prescribe levels of service which were given to the other Regulators.
[9] The improvement was independently supported. At the direction the DGGS British Gas appointed an independent consultant to review its complaint handling procedures; the report was satisfactory.
[10] Other requirements are: giving advice on the efficient use of gas; keeping a register of customers who are of pensionable age, disabled or chronically sick; free annual safety checks; and special metering and billing facilities for certain customer groups, *e.g.* pensioners and those with special needs; further special arrangements for blind and deaf customers; arrangements for dealing with customers in debt; measures to protect pensioners from disconnection in winter months.

requires the payment of a monetary penalty, but no penalty is payable for breach of overall standards. Over the years OFFER has exerted constant pressure to improve standards of service, and to secure greater openness and accountability. Standards of service are reported to be good and rising,[11] and improved levels of guaranteed standards, especially in relation to keeping appointments, have been introduced. The reports also show that the level of compliance with overall standards has generally improved, in 1993, for example, nine out of the twelve RECs showed a compliance rate of 99% or 100%, and the average for all twelve was 90%. These reports were independently supported by consumer surveys. In 1993 a survey by Mori showed very high levels of satisfaction with overall service. However, although the electricity companies led the utilities on customer satisfaction, only 8% of those surveyed were totally satisfied and only 9% considered the service to have improved since privatization

❑ WATER

Unlike the other two regulators, Ofwat shares its regulatory functions with other bodies, principally the Environment Agency and the Drinking Water Inspectorate, which has meant that important aspects of the water environment are outside its control, namely water quality and environmental quality. Ofwat is concerned with the more 'industrial' matters, *e.g.* maintaining supplies and complaints about service.[12] In an early report Ofwat observed that before privatization 'the water industry was perceived as driven by engineers who decided what they thought what was good for customers and resented challenges to their judgements.'[13] Like Ofgas it called for a change of culture, and set about improving customer service. Water companies were required to prepare three Codes of Practice for domestic consumers: on leakages from metered premises, disconnections, and customer services, and to submit them for approval to the Director General of Water Supply (DGWS).[14] In 1991 Ofwat reported that over the year there had been a gradual change of attitude by water companies towards their customers: 'Although there is still a long way to go, companies are increasingly recognising the importance of their customers. The voluntary move by companies to raise prices by less than their charging limits in 1992/3 reflects this.'[15] Over the years a general improvement in levels of service is reported, and companies which performed unsatisfactorily were

[11] The improvement is revealed in the falling level of payments for failure to comply. In 1996 payments for non-compliance with guaranteed standards fell for the fifth successive year. In 1997 there was a further drop of 40% in payments.

[12] Ofwat took over the DoE Levels of Service Indicators covering: raw water availability, pressure of mains water, interruptions to water supplies, hose pipe restrictions, flooding incidents from sewers, response to billing queries, response to written complaints, and response to development control consultations.

[13] Ofwat 1990, p.51.

[14] In his first annual report he stated that he was disappointed 'by their general standards of accuracy, relevance and plain English,' and at the end of 1989 only the leakage codes had been approved. (Ofwat 1989, p.10.)

[15] Ofwat 1991, p.8.

investigated and the results published[16] together with the statement that poor performance would be taken into account in the next price review, thus building in an incentive to improve. A key element in Ofwat's policy has been to move from measuring levels of service according to levels of activity or expenditure to the quality of service actually delivered to customers. For example, in 1990 Ofwat introduced a new service indicator for water delivered, *i.e.* the amount of water which actually gets through to customers' taps - intended among other things to provide a reliable measure of leakage.

As with electricity a *Guaranteed Standards* scheme with financial penalties for non-compliance was introduced in 1990, and the penalties were doubled from £5 to £10 in 1992. However, Ofwat estimated that possibly as few as 1% - 2% of customers entitled to compensation payments actually claimed them, and in time automatic payments were introduced. In 1996 Ofwat announced that the compensation scheme was to be extended to cover, for example, service failures like loss of pressure and loss of supply through the imposition of drought orders. Initially fourteen companies voluntarily agreed to make payments in the latter case; a year later all the companies had agreed. This represents a major advance in consumer protection because these problems result from the poor infrastructure which the companies inherited rather than from poor service, but, nevertheless, they constitute sub-standard service for which redress is appropriate.

2. Social Justice

The principal social justice issue is the need to counteract the tendency of the market to work in favour of the rich through appropriate measures to protect the poor and vulnerable. Four particular matters are considered: methods of payment, social obligations, water metering and disconnection policies.

❑ METHODS OF PAYMENT

Methods of payment illustrate well the basic social justice problem, namely the tendancy of the free market to work to the advantage of the rich. In all three industries there are two principal systems: payment by cheque or direct debit following the presentation of an account (customers who pay this way are

[16] *E.g.* in 1995 an investigation was announced into Yorkshire Water, South West Water and North West Water which were considered to be performing unsatisfactorily in a number of areas, from compliance with quality obligations to poor performance against key levels of service. (Ofwat 1995, pp.24-27.)

referred to as 'credit customers'), and payment using a pre-payment meter.[17] The cost of servicing credit customers is much less than providing and servicing a meter, and the commercial response is to supply credit customers at a lower price, but this overlooks the fact that those who use meters are generally the poorest households and thus the overall effect is to discriminate against the poor - an example of the way the narrow economic model of society works to defeat the wider social model.[18] In fact, British Gas made a loss of several millions each year servicing pre-payment meters, which meant that households using them were subsidised by other customers. But socially and theologically this is precisely what should happen if the Biblical duty of solidarity with the poor is to mean anything. The alternative is a net transfer of resources from the poor to the rich.

With the change of Government in 1997 fears that a similar discriminatory pricing structure would be introduced with the advent of competition in the electricity industry were allayed. The new energy minister, John Battle, insisted that suppliers would not be allowed to 'cherry pick' by offering special discounts to direct debit customers. Fuel poverty, he said, was still a very real issue: 'Social obligations must not be allowed to fall between the cracks.... If competition doesn't deliver a better deal for those who need it most I do not believe it will have delivered at all.'[19]

In all three industries the Regulators have shown an equivalent concern to protect poor and vulnerable customers, and as with customer service, the method has been to require companies to publish codes of conduct which are then monitored by the Regulator. The results have been good, and in reducing disconnections, they have been impressive. Again the fears of the poor and vulnerable being 'squeezed' under privatization have largely proved groundless, but, it must be stressed, only because of strong and persistent pressure from the Regulators, although in one instance Ofgas was prepared to follow the

[17] Pre-payment meters are a recent arrival in the water industry, and have proved controversial. Following privatization pre-payment meters (known as budget payment units) were tried out in the Severn Trent area, producing a high level of satisfaction, as in the electricity and gas industries. As a result they were installed more widely, and as at 31 March 1997 27,055 units had been installed, four companies (Severn Trent, Welsh, North West and Wessex) accounting for 92% of the installations. The units are free of charge to the customer to install and to operate, and the newer units do not run out of credit when the local charging outlets are closed. All but two companies make no additional charge for the use of these units. However, Ofwat's policy of encouraging their use was challenged in the courts by six local authorities who argued that they were illegal because they failed to comply with the safeguards intended to protect poor families and vulnerable people from disconnection set out in the statutory code of practice under the Water Industry Act 1991: *R.* v. *Director General of Water Services*, ex p. *Oldham Metropolitan Borough Council* (1998) 96 LGR 396. The applicants maintained that the devices led to 'extremely high' levels of disconnections. The water companies had argued that the devices were lawful because customers using them were never disconnected, they disconnected themselves by failing to charge their card with the necessary units to ensure supply. Harrison J. upheld the challenge, and the DGWS decided not to appeal, considering it more appropriate for Parliament to decide whether the law should be changed.

[18] See the reference to the work of Nankivell, p.23 above.

[19] *The Independent* 5.6.97.

market approach.[20]

❑ DEBT COLLECTION & SOCIAL OBLIGATIONS

From the outset Ofgas pressed for new policies on gas debt collection, insisting on greater sensitivity to customers personal circumstances, especially by distinguishing those who cannot pay from those who will not pay. An important element in the new policy was to encourage customers with payment difficulties to contact British Gas because most disconnections (93%) involved customers who did not discuss their payment difficulties. 1991 saw the launch of a gas care scheme for elderly and disabled customers aimed at ensuring that they receive all the benefits to which they are entitled and a free annual safety check: 'Ofgas will not accept any dilution of British Gas' commitment on the ground that cost and resource issues take priority over vulnerable customers' rights and entitlements.' With the introduction of competition in the domestic market suppliers were required to meet a range of social obligations, *e.g.* ensuring pensioners were not disconnected in winter,[21] and all suppliers are required to produce an annual report detailing their compliance with their social obligations.

The arrangements in the electricity industry are broadly similar, and in addition most companies keep registers of customers who need electricity for special needs, *e.g.* to operate medical appliances.

The Water Act placed Ofwat under a statutory duty to protect the interests of customers, particularly in rural areas, and to take account of interests of elderly and disabled customers.[22] However, the water companies, unlike the other utilities, were not required by their licences to produce a code of practice on services for the elderly or disabled, even though the need for such codes was just as great. In consequence Ofwat made a survey of the services offered by the water companies to the disadvantaged; the results were 'very disappointing'. Some decided as a result to review their practices, but 'a significant number' appeared to see 'little need for for positive action.' Ofwat commented: 'It is not sufficient for a company to say, as many have, that it will help any customer who contacts them, if the customer is unaware that special

[20] The reduction in pipeline charges which resulted from the separation of British Gas into TransCo and Centrica reduced the price of gas, but Centrica proposed to pass on the reduction unequally, pre-payment customers receiving no reduction at all, while credit customers were to receive an average reduction of 9% with further benefits for prompt payment. The Gas Consumers Council (GCC) disputed the legality of the cuts, arguing that Centrica had a statutory duty in its operating licence to pass on the benefits of lower transmission costs to all its nineteen million customers. Ofgas had been informed about the scheme in advance and had offered no opposition, and declined to act on the GCC's complaint. The GCC responded by making a formal referral to Ofgas under the Gas Act, forcing an investigation. The Government also expressed concern over the scheme because it could lead to an increase in fuel poverty. The result of the referral was a reduction of 3.1% for customers using pre-payment meters. While this was an improvement over the original scheme, it scarcely met the argument about justice for the poor.

[21] The full list is given on p.133, note 10.

[22] Water Act 1989, section 7; Water Act 1991, section 2(4).

services are available.'[23] Ofwat then began discussion with disability organisations with a view to issuing codes of practice. Guidelines were issued in 1991 aiming to ensure that disabled and elderly people should not, because of their disability or age, receive a lesser quality of service by comparison with other customers.[24] In 1992 most companies had published satisfactory codes of conduct.

❑ WATER METERING

Water metering involves a clash of duties: the duty to the poor is set against the duty to the environment. Metering seems to reduce consumption: a trial on the Isle of Wight in 1992 showed average savings of 20% in consumption when meters are installed. On the other hand payment by rateable value has a built in element of social subsidy, and in most cases metering would result in increased bills for poor families.[25] Against the social subsidy argument there is the general feeling that people should pay for what they use,[26] and as Ofwat observed 'In the long term [metering] is the only satisfactory way of achieving payments which are well related to use.' Although it is arguable that relating payment to use is not always the fairest system, it is the system used in the other utilities, and maybe it is the most appropriate way for a privatized industry to operate, with subsidies for the poorer customers provided through the social security system.[27] Ofwat has consistently favoured water metering, one of its aims being to introduce metering without additional cost to customers.[28] By 1997 this policy had had some success with thirteen out of twenty-eight companies offering free meter installation, but the DGWS was disappointed that it had not been more widely taken up, and indeed that some companies were being obstructive.[29] However, in 1998 the new Government announced that compulsory metering would not be introduced, rateable values being retained as an alternative basis for payment, but where it would be to the advantage of people on low incomes to use a meter companies were to be

[23] Ofwat 1990, p.52.

[24] The key principles are: (1) vulnerable customers should feel secure when visited by company staff; (2) all customers should have access to essential information in a form they can use, *e.g.* braille; (3) all disabled customers should be able to check their meters at reasonable intervals; (4) blind customers should know the amount of their bills and when payment is due; (5) all customers should be aware of the services available to meet the needs of disability or age; and (6) so that companies can provide assistance when it is needed, *e.g.* during supply interruptions, they should keep a record of customers who have indicated a need for help.

[25] In 1993 Ofwat commissioned a study by the Institute of Fiscal Studies on the effect on customers of different methods of charging. They reported that even some lower income households would benefit from installing a meter.

[26] In 1991 Ofwat reported the results of a national survey, one of which was that metering was generally regarded as the fairest way of charging for water. (Ofwat, 1991, p.9.)

[27] Doing it that way achieves transparency, but it might not achieve justice, because publicising the figures is likely to increase resistance by the rich to supporting the poor. If it is known, without being quantified, that water bills contain a social justice element, then resistance is likely to be lower.

[28] Ofwat 1991, p.9.

[29] The 1997 report observed: 'In view of the onus being placed on the companies to do more to promote water efficiency, the decision by a few companies to increase optional meter costs or to propose additional restrictions on location is short sighted. (Ofwat 1997, pp.27,28.) In 1998 Ofwat announced that metered customers had increased from 11% to 15% of households in England and Wales. (Ofwat 1998, p.30.)

required to fit one free of charge.[30]

❑ DISCONNECTIONS

One of the surprises of privatization has been the massive fall in the level of disconnections. The figures are given in Table 2.

TABLE 2: **NUMBER OF DISCONNECTIONS SINCE PRIVATISATION**

Year	*Gas*		*Electricity*	*Water*
1987	38,622*			
1988	61,796	*0.40%*		15255
1989	21,513	*0.13%*	70000	8426
1990	19,118	*0.12%*	56000	7673
1991	18,009	*0.11%*	47913	21282
1992	16,991	*0.10%*	18018	18636
1993	16367	*0.10%*	3769	12452
1994	16,393	*0.09%*	1228	12832
1995	14,511	*0.08%*	838	5826
1996	8,820	*0.044%*	477	3148
1997	29,771		349	1907
1998			377	1129

SOURCE: Ofgas, Offer & Ofwat Annual Reports. * Estimated figure.

NOTES

1. The percentages in the gas column show the proportion of the total number of customers represented by the number disconnected. Percentages were not given for electricity or water.
2. The big fall in gas disconnections between 1988 and 1989 followed a major staff retraining exercise.
3. The gas figures for 1996 and 1997 are abnormal. In 1996 disconnections were suspended for part of the year giving an artificially low figure; the backlog was included in 1997.
4. Figures for water disconnections are not given in the first two Annual Reports, but the 1990 report records that between September 1989 and September 1990 'the number of disconnections shows a pleasing fall'. (Ofwat 1990, p.32.)

While disconnections in all industries have fallen appreciably, and in any event represent a very small percentage of total customers, the electricity industry has the best record. OFFER was concerned not to repeat the experience in the gas industry where disconnections rose after privatization, and each company was required to submit a disconnection code of practice. By 1991 Norweb had virtually eliminated disconnections, and the DGES believed this was feasible for all companies and stated that he was promoting this objective. The figures show that this objective has virtually been accomplished, but there are

[30] Special protection was also to be extended to those with special needs, such as large families on low incomes or those whose medical condition requires an abnormally large use of water, by requiring, *e.g.*, very flexible payment arrangements or for charges to be brought in line with average bills for the area.

variations between the companies.[31] However, in 1998 the Government expressed concern that the fall in disconnections resulted in part from the wider use of pre-payment meters. These disguised the problem because those who cannot afford to pay now effectively disconnect themselves when they fail to 'feed' their meter.

Water disconnection has caused the most debate. When, if ever, is it right to disconnect supply for non-payment? The companies, taking a commercial view, and treating water like any other commodity, insisted that they must have the power to disconnect for non-payment, even if only in the most persistent cases. Consumer groups and the 'poverty lobby' argued to the contrary that, because water is essential to life, disconnection is never permissible; other means must be found both to pay the bills of the poorest and to punish persistent non-payers. Ofwat has tended to support the companies[32] while at the same time, and very successfully, pressing for the actual levels of disconnections to be drastically reduced. In 1990 Ofwat stated that although bills must be paid, it was reasonable to expect the companies, 'who are in the privileged position of being monopoly suppliers of an essential commodity, to adopt practices and procedures which take proper account of the genuine difficulties faced by some of their customers.'[33] By 1992 the language had hardened: 'The companies are monopoly suppliers of an essential commodity and this places on them an obligation to to take reasonable steps to assist customers who have genuine difficulties, before resorting to legal action and disconnection.'[34] The following year, against a background of over 900,000 court summonses issued for non-payment of water charges,[35] the DGWS issued guidelines, including the offer of at least one frequent payment option, *e.g.* fortnightly payments.[36] Compliance

[31] *E.g.* in 1995 London Electricity made no disconnections, but Eastern made 260, an increase over 1994. In 1996 Seeboard joined London in having no disconnections, but wide variations continued with Eastern having 160, twice as many as any other region.

[32] Commenting on a Private Members Bill seeking to ban disconnection for debt, Ian Byatt said: 'I understand the concern expressed by the Bill's supporters but water bills must be paid; it is not right to ask other customers to pay higher bills to cover bad debts.' (Ofwat 1993, p.13) However, he has told companies that he is not prepared to raise price limits to allow for a rise in debt for unpaid bills. (Ofwat 1993, p.41.)

[33] Ofwat 1990, p.33.

[34] Ofwat 1992, p.42.

[35] Support for Ofwat's concern at the level of disconnections was provided by a report published by the Policy Studies Institute into water debt and disconnection. This showed the number of households experiencing arrears with their water and sewerage bills had increased significantly since 1989. The report also commented that the fall in disconnections, in spite of the continued increase in debt, was likely to be a consequence of changes in water companies disconnection policies as a result of the Ofwat guidelines. This study indicated support for the view, which Ofwat expressed in 1992, that high levels of water disconnection were related to the recession, the real increases in water charges and the separation of water bills from the rent paid by council tenants.' (Ofwat 1994, p.42.)

[36] Unlike the other utilities who issue quarterly bills, most water companies issue bills annually or half-yearly. The other guidelines are: avoid delay in the debt recovery timetable, whilst allowing sufficient time for customers to respond; issue a pre-summons warning before taking court action; provide clear information at each stage about how the company can help and the consequences if the customer takes no action; do more to alert customers on income support of the possibility of direct payments from their benefit; set payments arrangements to clear debt which are realistic and take account of a customer's ability to pay; contact customers at an early stage to set up payment arrangements to clear arrears; make a serious attempt at personal contact with the customer before proceeding to disconnection.

with the guidelines was mixed: some companies went further than required, but some remained reluctant to adopt certain aspects of the guidelines, particularly well-publicised frequent payment options, because of fears that high take-up rates would bring substantial extra administration costs. Ofwat pointed out that there was no evidence that this facility was widely desired; it was only wanted by households that have difficulty in managing their budgets. Although progress was patchy, attitudes began to change. In 1995 South West Water announced that it would not disconnect for debt unless there was clear evidence that the customer had no intention of paying the bill; in 1996 five companies made no disconnections, including three of the big ten (the combined water and sewerage companies); in 1997 seven companies made no disconnections.

The Government subsequently published a consultation paper on water charging which suggested, *inter alia*, a general ban on disconnecting customers who fail to pay. The DGWS resisted the idea on the grounds that water bills would rise as a result, and that the threat of disconnection was important.[37] At the time the level of bad debts was about 1.5% of turnover, and surveys by the industry suggested that bad debts could triple if disconnections were banned. However, at the end of the year the Government announced a ban on disconnections for non-payment. Michael Meacher, the Environment Minister, said the Government believed that 'no one should be deprived of water because they cannot afford to pay on both social and public health grounds.'[38] The measures were incorporated in the Water Industry Bill introduced in December 1998 which also provided a right to a meter free of charge.

3. Price Control

In all three industries price control has followed the same path, namely a progressive tightening of the price control formula. In theory this means that the interest of the customer has taken precedence over that of the shareholder, but the level of both ordinary dividends and, more particularly, of special dividends paid in defending take-over bids, has indicated that the new prices have not been tough enough.[39] This behaviour also had an adverse effect on the companies' ability to invest in new capital spending, resulting in a significant imbalance between the long-term national interest in proper infrastructure

[37] Ian Byatt, DGWS, reported in *The Independent*, 16.5.98. In 1992 Ofwat had referred to this question, then raised by the National Consumers Council among others, of whether it should be illegal to disconnect water supplies for non-payment, given the public health implications and the drastic effect of being without water. Ofwat declined to comment saying the matter was one of social policy and referred it to the DSS.

[38] *The Independent*, 19.11.98.

[39] *E.g.* Northern Electric fought the hostile take-over bid from Trafalgar House in 1995 by making substantial and unplanned dividends to its shareholders which revealed just how profitable the RECs actually were, and that the price review of the previous year had been unduly lenient. An independent analyst commented: 'There is really a significant imbalance between benefits for customers and shareholders.' (Nigel Hawkins, analyst at the merchant bank Hoare Govett, quoted in *The Independent* 21.5.95.) There was also considerable criticism of the companies themselves which followed the Northern example when defending take-over bids, in many cases taking on substantial borrowings to fund the special dividends.

investment and the short-term benefits for shareholders. It is, though, fair to say that the imbalance of the initial privatization scheme has been partially corrected. Commenting on the price review which followed the division of British Gas into TransCo and Centrica, *The Independent* said that British Gas had actually followed the path that all utility privatizations were meant to.

> [T]he company was sold on terms which were far too generous to investors and did not adequately address the interests of customers....[I]n the early years shareholders enjoyed quite spectacular returns....For a while, British Gas and its shareholders made hay at the expense of their customers. If utility regulation works as it should, then this apparent imbalance is addressed at the time of the periodic price review when customers get to claim the efficiency gains achieved over the previous five years. That is precisely what is now happening and what was always meant to happen.[40]

❑ GAS

It took time for British Gas, which was privatized without structural change, to adapt to the reality of regulation.[41] In each of the years before the first price review gas prices were increased (*e.g.* in 1990 by 11%), and each increase was accepted as justified by the price formula, although it has to be said the cumulative increases to 1990 were 10% below inflation. The first price review proposed a new price formula: (RPI-5) + (GPI-1) + E. In addition to tightening the inflation index from RPI-2 to RPI-5, the formula incorporated an incentive to economise on gas purchases by allowing only 99% of gas costs to be passed through (*i.e.* GPI-1), and an incentive to improve energy efficiency by allowing the costs of appropriate projects (E) to be passed on to customers.[42] Average customers were expected to benefit by £200 over the review period. On appeal the MMC broadly upheld the formula, changing it to RPI-4,[43] and recommending the divestment of British Gas' trading activities. The divestment came about around five years later with the division of British Gas into two operating companies, and Ofgas proposed to tighten further the price formula, the anticipated effect being a reduction TransCo's revenues of £650 - £850 millions

[40] *The Independent* 14 May 1996

[41] The first price review in 1991 provoked a major conflict, and British Gas appealed to the MMC. Commenting on this the DGGS (James McKinnon), in very strong terms for an official report, criticised British Gas for failing to adapt its culture to the new competitive environment which was emerging, which he described as a 'classic case of failure to bring about change in a monopoly management culture.' (Ofgas 1992, p.4.)

[42] Allowable expenditure under the E factor has to be approved by the DGGS, who must have regard to his duties, *e.g.* to protect consumers and to promote the efficient use of gas. E factor expenditure must be targeted and audited properly. The Government also established the Energy Saving Trust to promote energy efficiency in the electricity and gas industries, and the DGGS made much use of its advice. Schemes approved included installing condensing boilers, subsidies for residential CHP projects, Homes 2000, Social Housing projects, and an affordable warmth scheme providing subsidies for the most vulnerable pensioners.

[43] The reduction took account of the lowering of the threshold for monopoly supply to tariff customers from 25,000 therms to 2,500 therms which had been agreed previously. A further reduction to 1,500 therms was recommended by the MMC.

in 1997, a figure larger than its profits in the two preceding years and larger than its dividend payment in the 1995. Average gas bills were expected to fall initially by £30, with a saving of £40-£50 over the five-year period. British Gas described the proposals as 'the seizure of shareholders' income on an unprecedented scale', and 'the biggest smash-and-grab raid in history'; the price of British Gas shares fell from 228p to 201p (described by the financial press as a 'plunge'). The company appealed to the MMC, but as in 1992, the MMC accepted virtually all Ofgas' proposals.[44] The last word in this saga belongs, however, to British Gas. A year later it announced that it had beaten the financial target imposed on it by the regulator. It had achieved a rate of return of 8% as against the 7% implied in the Ofgas formula; shareholders had received good returns and the number of jobs lost was around 2,500 as against the 10,000 predicted. The feeling in the city was that overall British Gas had, in the end, got off lightly, although some argued that this was what incentive regulation was really about. Over the ten years from privatization to full competition gas prices fell by 24% in real terms, and they fell a further 20% in one day when competition began.

❑ ELECTRICITY

Price control in the electricity industry is more complex than either gas or water because not only are there more companies to regulate, there are four separate businesses: generation, transmission, distribution and supply, the later two being carried out by the same companies, *i.e.* the RECs, and each business is separately regulated.[45] Between privatization and the introduction of competition electricity prices fell, although, as with gas, there was a initial rise. The price reductions reflect the consistent tightening of the various price formulas,[46] and by 1997, just before the onset of competition, prices in real terms for domestic customers had fallen by 21% since privatization, and for industrial customers by 22% - 30%. In 1997 a new supply price formula was set bringing average reductions of 9% over the next two years, and ensuring that those with pre-payment meters received the same guaranteed price reductions as credit customers.[47] Possibly learning from the experience of

[44] It was anticipated that British Gas' annual revenue would fall by around £380 millions, dividends would be halved, and the average domestic gas bill would fall by £29 in the first year.
[45] Generation is making electricity; transmission is transporting electricity through the National Grid of high voltage wires; distribution is transporting electricity through the regional network of low voltage wires; supply is the business of selling electricity to customers.
[46] *E.g.* in 1992 Grid price formula adjusted from RPI-0 to RPI-3; in 1993 price cap for supply tightened from RPI - 0 to RPI - 2; in 1994 the new price formula for distribution provided for a reduction of between 11% and 17% in real terms and a further reduction of 2% in each of the following four years; in 1995 the review of price control following the Trafalgar House bid for Northern resulted in further real price reductions of between 10% and 13% from April 1996 and a tightening of the formula from RPI - 2 to RPI - 3 for the three years to 2000. In 1996 new price controls over transmission business of NGC were announced providing for a 20% reduction in prices in 1997/98, and 4% in each of the following three years.
[47] These price reductions were paralleled by reductions in turnover and profitability. In 1995/96 the aggregate turnover and operating profit of the RECs fell by 7% and 27% respectively compared with 1994/95, reflecting the first year of price controls. In 1997 REC's distribution turnover dropped by 6%, but costs were lower and profit increased by 6%. Supply turnover fell by 2%, and operating profit by nearly 50%.

British Gas, and despite threats, none of the price reviews was appealed to the MMC.

❑ WATER

Pricing policy in the water industry had to reflect the need to make good the under-investment which characterised the industry before privatization, and this meant that water bills would rise. In 1990 Ofwat reported that the level of investment required meant, on average, a doubling of each companies' level of expenditure from the past. This would be paid for through increased bills, and Ofwat foresaw an increase in water bills of 47% over the ten years to 1999/00.[48]

Because of the need to increase investment the water price control formula differed from that for the other utilities, the basic form being RPI+K, where K represents the increase allowed to fund new investment. K values were fixed initially for ten years individually for each company, but the companies and the DGWS were able to request a review after five years. Initial K values averaged 5.5% for the initial five years and 4% for the second five years.[49] In 1990 most companies raised their prices by the full amount permitted, the price increases ranging from 12% to 32.2%. It soon became clear that the financial assumptions on which the initial price formula had been based needed re-assessing, and in 1991 the DGWS announced a fundamental review of price limits to take effect from April 1995. The review would also allow other factors to be taken into account, namely the evidence so far on what amounted to a reasonable return on capital, absence of efficiency targets after 1994, and new environmental obligations. In approaching the review the DGWS announced that he would be guided by three principles: (1) the willingness of customers to pay higher bills,[50] (2) the need to place more emphasis on results rather than expenditure,[51] and (3) the need for companies to be able to plan their investment in a stable manner. This approach reflected a deliberate policy to redress the absence of public consultation when the initial price limits were set.[52]

The new price limits reflected Ofwat's belief that the companies should be able

[48] Ofwat 1990, p.17.

[49] For the twenty-nine water companies (*i.e.* excluding the ten water and sewage companies), there was some 'front loading' of the increase and the average permitted price increase in April 1990 was just over 13%

[50] Ofwat noted the response to its consultation paper *The Cost of Quality*, which showed that for customers affordability was the main criterion in planning environmental and quality improvements.

[51] 'Companies and the regulator should concentrate on the service provided to customers, and the recoverable costs of achieving specified levels of service, rather than on the achievement of particular levels of spending.' (Ofwat 1991, p.5.)

[52] Ofwat, 1992, pp.46-8. Ofwat also reported in 1992 that the companies themselves had undertaken considerable research to discover what customers viewed as spending priorities, and this was built into their market plans. In 1992 DGWS announced the key principles which he believed should underlie charges: (1) charges should relate to the cost of providing the service; (2) customer-related costs (*e.g.* billing and meter reading) should be separately identified and included in a standing charge; (3) measured and unmeasured customers should pay the same for the same service.

to provide existing standards of service at prices which were below the current levels in real terms; that improvements in standards of service should be financed through improved efficiency rather than higher prices; and that price increases should be limited to what is necessary to meet new quality and environmental obligations. A new basic price formula was proposed, RPI-X+Q, bringing water into line with the other utilities. (RPI-X represents the normal utility operation of maintaining service standards while reducing costs; +Q reflects improvements in environmental and quality standards.)[53] Despite pressure to do so, Ofwat declined, in fixing the new formula, to claw back the initial higher-than-expected returns because this would damage incentives.[54] The price review was announced in 1994 with the expectation that prices would fall in real terms over the next ten years. The average price cap was RPI-1.4% (most companies were in the range between 1% and 2%), and companies were required to inform their customers 'exactly what service improvements they could expect to see over the coming years'. In setting the limits the DGWS assumed 'that companies would be able to implement capital programmes within a return on capital well below that assumed by the Secretaries of State in 1989.' If cost savings greater than those assumed in the review materialised the companies were expected to share the benefits with their customers.[55]

The price review led to smaller increases in bills for most customers. In the following two years household water bills increased by 3.4% in real terms, and sewerage bills by 8.4% in real terms.[56] Some companies agreed to pass on to their customers the benefits of lower than expected expenditure, in some cases by giving rebates (suggesting that the price formula was not quite tight enough). In 1997, four years after the review, average household bills had increased by 4.5% in real terms (17.8% taking inflation into account); average household bills varied considerably from £158 for South East Water to £73 for Portsmouth Water.[57]

In 1997 the Government announced a review of water charges. The key points were: (1) increased choice for customers including a free meter option and the right to continue paying an unmeasured charge if they were not using water for discretionary purposes; (2) the right to revert to an unmetered supply within a year for customers who opt for a meter; (3) a ban on disconnection for household supplies; (4) the use of meters and measured tariffs to promote the sustainable use of water; (5) the protection of vulnerable customers; and (6) the continued use of rateable values for charging after 1st April 2000 [under the previous administration rateable values had been due to be phased out by this

[53] Ofwat 1993, p.46.
[54] Ofwat 1993, p.47.
[55] Ofwat 1994, pp.5-6.
[56] Ofwat 1996, p.10. Two years earlier, as a result of lower than expected levels of capital expenditure in 1992, the DGWS issued review notices to 19 companies reducing prices by 2%, a total saving for customers of £200 millions.
[57] Ofwat 1997, pp.21& 22.

date]. The DGWS welcomed the proposals but voiced concerns about possible costs which might arise from the ban on disconnections and the right to revert to an unmetered supply.

At the 1994 price review Ofwat stated that the object for next price review (due in 2004) would be to obtain a reduction in bills in real terms. It soon became apparent that the 1994 review had been unduly lenient, and the 2004 review was brought forward to 1999.

4. Introducing Competition

One of the aims of privatization was to open the utilities to competition, and each regulator had a duty to promote or facilitate competition. By the end of the review period (December 1998) full competition had been introduced for gas and electricity supply, and substantial competition in electricity generation; but competition in providing water and sewerage services was virtually non-existent. The reason for the difference is, of course, that there is a national transmission network for gas and electricity but not for water. The basic approach with gas and electricity was to grant rights of common carriage over the networks, making it possible for any supplier to contract with any customer throughout the network. The effect of this was to identify the network as the only true natural monopoly element. In both industries competition was introduced first for industrial companies and other large users, and then for domestic customers, usually in a phased operation gradually covering the country. For water some other methods of introducing, at best, partial competition, have been tried, but the volume delivered in this way is insignificant.

❑ GAS

Hardly surprisingly introducing competition in gas supply was controversial - attacked on the one hand by those who feared that the poor would lose out in a competitive market, and on the other by British Gas and the independent suppliers who feared that the terms would not produce a level playing field. Competition was introduced into the industrial gas market on 1st March 1990, but in practice competition emerged slowly because virtually all gas supplies were contracted to British Gas, and remained so until 1993. Various measures were proposed to bring about competition for industrial supplies,[58] which by 1992 had allowed 13 firms to enter the market, but Ofgas found British Gas obstructive and anti-competitive all the way.

Introducing competition has brought significant price reductions,[59] but it has

[58] These included the 90/10 scheme for new discoveries (BG agreed to allow 10% of new discoveries to go to rival suppliers), and the gas release scheme whereby BG undertook to reduce its share of the industrial market to 40%.

[59] In 1996, when competition was introduced in a pilot project in the South West, gas prices fell by between 10% and 20%, and by the end of the year 16% of domestic customers had switched.

also meant the abandonment of uniform pricing across the country with those furthest away from the east coast (where the gas is brought ashore), notably Wales and the west country, paying more. However, so-called 'cherry picking' was discouraged by requiring all suppliers to provide a service on request in their areas, including the elderly, the disabled and the poor. Should British Gas be left with a disproportionate number of these customers, the Gas Act 1995 provides for a levy on all suppliers to help cover the cost. In 1997 the DGGS boasted that the UK was the first country in the world to have a fully competitive gas supply system with the accompanying benefits of lower prices. 'In years to come' she said, 'consumers will no more think of gas as a utility than they do now of food.'[60] By December 1997 twenty-one licensed gas suppliers were operating and had secured up to 25% of the market depending on the area.

❑ ELECTRICITY

Introducing competition in the electricity industry was no less controversial than gas, and was a much more complex business covering both generation and supply.

❖ *GENERATION*

The privatization scheme envisaged competition in generation by allowing the RECs to build their own generating capacity, but the emergence of competition was inhibited by the flaw in the original proposals, namely the National Power/PowerGen duopoly. In 1991 and 1992 OFFER accused the duopoly of abusing their dominant position to maintain prices at a high level (in 1992 pool prices, the wholesale price of electricity, rose 16% with a further rise of 15% in 1993), and the DGES threatened to refer the operation of the Pool to the MMC if agreement could not be reached on the disposal of capacity to enable new entrants to join the generation market. The threat worked and in February 1994 National Power and PowerGen undertook to dispose of about 4000MW and 2000MW respectively of coal- or oil-fired capacity by the end of 1995, thereby doubling independent generating capacity. However, this 6000MW was acquired by Eastern Electricity, thus converting the duopoly into a triopoly, hardly a major advance. In 1997 OFFER reported that over 1000MW of new independent capacity had come on stream bringing the total since privatization to 6700MW.[61] However, in practice generation operated more like a cartel, in particular excluding consumers from the price fixing process, so that although by 1997 National Power and PowerGen accounted for only 40% of generation, the advent of independent gas-fired generators had done little to inject competition into pricing, and in October 1997 the new Labour Government announced a review of the workings of the Pool.

[60] Ofgas 1997, pp.4&5.
[61] OFFER 1997, p,3. Together with the 6000MW acquired by Eastern making a total of 12.7GW.

The sale of capacity by National Power and PowerGen was bound up with other moves to restructure the industry. In 1995 Scottish Power made a bid for Manweb and PowerGen expressed its intention of taking over Midlands Electricity. Both bids challenged directly the structure chosen for the industry before privatization, and in each case the Regulator argued for a referral to the MMC, the chief concern being that the generating company would sell electricity to its captive supply company on favourable terms; there was also concern about the consequences for the consumer of a concentration of power. The Secretary of State decided against referring the Scottish Power bid, which eventually went ahead on agreed terms, and in an attempt to forestall it own bid being referred, PowerGen promised that the different arms of the merged company would be kept separate in accounting terms. However, this promise raised a real question as to the purpose of the deal. The answer became clear when Midlands accepted the bid: PowerGen announced that it was aiming to become a national supplier of electricity under its own brand name, and wished to acquire Midlands because of its expertise in billing and marketing. The take-over offered no benefits to consumers other than those which would come anyway through increased competition in the industry. Spurred by PowerGen's move National Power announced in October 1995 an agreed merger with Southern Electricity. Both bids were referred to the MMC because of concerns over the competition issues, which the Secretary of State considered to be of a 'different order of magnitude' to other bids which had been cleared.[62] A major structural change was being proposed which could have an adverse effect on competition. In the end this argument won the day and the bids were disallowed. However, the logic of vertical integration persisted, and in 1998 further proposals, conditional on a further disposal of 8000MW of capacity, were approved. The new Secretary of State, differing from his Conservative predecessor, took the view that vertical integration was 'not in itself objectionable',[63] thus opening the way for similar deals.[64]

This change is a good example of market forces at work to produce a structure more suited to a competitive industry. The regional structure favoured the incumbent supply companies: they would not benefit from competing with one another, and the barriers to market entry were too great to allow the generators to cut out the middle man and market their product direct to customers. PowerGen argued that the industry required a structure like that for petrol, banking, or supermarkets, with companies involved in both generation and supply: 'Five or six strong players and a number of smaller competitors would

[62] The essential difference between the Scottish Power and PowerGen bids was in the amount of electricity each could sell to its 'captive' supply company: Scottish Power is restricted in the amount of power it can sell south of the border by the limited capacity of the power lines.
[63] *The Independent* 25.9.98.
[64] In the deals in question PowerGen acquired East Midlands Electricity and National Power acquired Midlands Electricity, PowerGen's original quarry. National Power agreed to sell 4000 megawatts of generating capacity, *i.e.* 40% of its total capacity, in the form of its most efficient coal-fired power station at Drax in north Yorkshire.

have a powerful incentive to compete to win business from each other.'[65] There is something to be said for this arrangement: the bigger the customer base the more the costs of serving customers can be reduced; the wider the portfolio, the more a company is able to hedge the risks when capital costs are high and demand is volatile; the more competitive the market, the greater the incentive to invest in a strong brand and good customer service. On the other hand it might simply produce a much bigger cartel; the petrol market, for example, has not always been noted for its competitiveness, and the major supermarket chains are under investigation by the MMC.

❖ *SUPPLY*

For customers whose annual consumption exceeded 1MW competition was allowed from privatization and by 1992 it was flourishing, with about half the demand met by suppliers other than the local REC, so-called second tier supply. On 1st January 1994 the competitive market was extended to include customers whose annual consumption exceeded 100kW, and by May 1994 25% had changed supplier. In the following years second tier supply continued to expand, and in 1997 64% of sites in the above 1MW market and 42% in the above 100kW market were contracted to second tier suppliers. In 1996 over half of all electricity sold was sold competitively.

Competition in the domestic supply market was envisaged from privatization, and in 1989 the target date of April 1998 was set. Originally, it was hoped that competition would start then for all customers, but this was soon changed to a phased programme with full competition being implemented over a six month period ending in September 1998. However, by the end of 1995 there were signs that this deadline would not be met. Despite Government insistence that it would not delay the starting date, in January 1998 it bowed to the inevitable, and a six month delay was announced. The delay was accompanied by fines on the RECs and the two Scottish suppliers to be passed on in the form of lower bills to customers. However, the fines represented a reduction of only £2 per customer, and were not due to be paid until 1999.[66] Competition was finally introduced in September 1998, phased in over a nine month period, ending in June 1999, fifteen months after the original deadline.

The delay was caused by the technical difficulty of designing and introducing the new computer systems required, and occasioned a dispute over who should bear the cost of the process, the suppliers or the customer. Although the suppliers differed in their estimates of the costs - varying widely from £300 millions to £1 billion (from £16 to almost £50 for every domestic customer), they were united in insisting that could not bear the costs themselves. Jim

[65] Ed Wallis, the Chairman of PowerGen, writing in *The Independent* 2.10.97.

[66] Centrica, which had announced its intention of entering the electricity market with substantially lower prices than the RECs, argued for a fine equivalent to £20 per customer, the amount it calculated customers would have saved had competition begun on time.

Forbes, chief executive of Southern Electric, adduced moral grounds for this position: it was fair that customers should bear the cost because they were going to benefit from cheaper prices,[67] an argument which has all the attraction of virtue coming to the aid of self interest. OFFER was urged to allow for the costs of introducing competition in the next price review. These points fail to take account of the enormous profits made in the first five years, largely dissipated in defending take-over bids, often in the form of special dividends to shareholders. Now these shareholders, who had already enjoyed much greater benefits from privatization than customers, were looking to be protected from the implementation of an essential element in the original scheme which they had known about when they acquired their shares. However, in the end the customer paid two-thirds of the cost, estimated at £726 millions, or £33 per household. If it shows nothing else this episode illustrates clearly the imbalance of power between, on the one hand, the companies and their shareholders who are well organised with an effective voice, and on the other the customers who are an incoherent group with no real power. If the Regulator does not speak for them no one else will. OFFER justified the increased amount of the cost that could be passed on customers on the basis that the original proposals would have cut profit margins so close that new entrants would be discouraged from entering the market. While this is a legitimate consideration, in reality the new deal represented the price necessary to ensure that competition began on time. In a report sharply critical of the whole process, the House of Commons Trade and Industry Select Committee urged the Regulator to use the price review due in 2000 to re-assess how much of the cost should be passed on to consumers.

The result of introducing competition in electricity supply was expected to be price reductions of between 5% and 10%, which some said would have happened anyway as a consequence of the termination in April 1998 of the high-price coal contracts which the generators had made with British Coal. The reductions were modest because supply accounts for only 7% of the cost to the customer. Generation accounts for 56%, and it is here that the greater scope for price reductions exists.[68/69] Introducing greater competition in generation

[67] *The Independent* 29.11.96.

[68] The remainder of the cost comes from the two natural monopoly elements, transmission and distribution, accounting for 7% and 30% of the cost respectively.

[69] Compared with the liberalisation of the gas market, the introduction of competition in electricity saw few new entrants. In October 1997 Centrica, the gas supply business, announced its intention to enter the market with a promise of initial discounts of 15% on current prices, a price cut of more than double that allowed for in the 1997 price review. If price reductions of this scale are maintained, a further restructuring of the supply industry seems inevitable. A study by the accountants Coopers & Lybrands published in June 1998 suggested that the RECs would become unprofitable if they lost more than 15% of their customers. The most likely development would be mergers between the supply companies, reducing the number to around half of the present 15.

remains the key to a better deal for the customer.[70]

❑ WATER

Introducing effective competition in the water industry is hard to envisage for two main reasons: (1) the barriers to entry are, for all practical purposes, insurmountable; building new facilities is not a realistic option, and the cost would be prohibitive. (2) Constructing a network of pipes to provide for a national water 'grid' with rights of common carriage is also impractical, on both financial and ecological grounds. However, the principle is enshrined in the Water Industry Act 1991 which requires the DGWS to 'exercise and perform his powers and duties...to facilitate effective competition.'[71] In 1992 the National Rivers Authority (as it then was) considered whether the network of canals could be used in this way. They concluded that it was, quite simply, too expensive.[72] Nevertheless, in 1995 the Government announced that it wanted to consult on proposals to introduce more competition into the water industry, including common carriage for both water and waste water, to introduce time-limited inset appointments,[73] and to facilitate cross-border competition.

Ofwat's preferred method of competition is for companies to seek new water sources, including exploiting the rising water table in cities, as in Greater London, or developing new methods of treating and disposing of effluent.[74] This would give competition in a defined area, but not nation-wide as with gas and electricity. In December 1997 the DGWS announced his intention of promoting common carriage arrangements. In August 1998 Water UK, the body representing the water companies, opposed these proposals on public health grounds. Allowing other companies to pump water into a rival's pipelines could lead to a deterioration in water quality, and the risk of the outbreak of diseases would be increased by the mixture of different types of water in the pipes; it would also be impossible to identify the guilty party in the case of a public health incident. Another anxiety was that competition could lead to lower standards in the treatment of waste and sewage - problems which simply do not figure with electricity and gas.

In 1997 Enviro-Logic, a consultancy company, discovered a way of competing with the Water companies by exploiting a provision in the Water Act permitting

[70] It seems likely that one motive behind the tough proposals for supply prices following the introduction of competition was a reduction in generation costs. This would have been achieved by the suppliers putting pressure on the generators in order to meet their new targets. This was resisted by the generators as 'back door' regulation, and this resistance was largely successful, because as noted above, the price reductions eventually to be obtained are no greater than those which would have occurred anyway through the new coal contracts.

[71] Water Act 1991, section 2(3)(e).

[72] To supply 100 million litres of water a day through a national grid would take £400m to £600m in development costs. Building a reservoir to supply the same amount would cost £50m to £200m. NRA, *Water: Nature's Precious Resource*, 1994.

[73] Inset appointments are considered below.

[74] Ofwat 1997, p.37.

inset appointments.[75] Under this provision a company can buy existing supplies and services from a water company at wholesale prices to be determined with the agreement of Ofwat. Acting under this provision Enviro-Logic made fifteen bids to Ofwat to take over the water supply of companies which use large quantities of water. Its most ambitious scheme was to provide water to a new estate being built at King's Hill, near Maidstone in Kent. A new water company would be created to buy bulk supplies from Mid-Kent Water and be responsible for supplying the estate and for installing new infrastructure as the development expanded. The proposal included the use of recycled water (so-called 'grey water') for lavatories and watering gardens, catching rainwater supplies on the site, offering discounts to households who install appliances which use less water, and reducing leakage rates to zero. Savings from 5% to 50% above inflation were anticipated as a result of the scheme. Ofwat viewed the King's Hill scheme as potential competition rather than actual competition, Enviro-Logic acting as a water broker rather than as a rival supplier. While this may be true, the scheme offers many attractive features as well as lower prices, and should not be rejected simply because it does not comply with Ofwat's preferred competitive model. At the end of 1997 South West Water took a 50% stake in Enviro-Logic, a deal designed to improve its credibility with the Regulator.

For the time being, while competition is the best way to protect against abuse of dominant position and to secure the best prices in the other utilities, for water tough and effective regulation is the only realistic option. This was recognised in 1997 in the new Competition Bill which contained proposals to strengthen the DGWS's powers and to prohibit anti-competitive agreements and abuses of dominant market position.

5. Energy Efficiency

Both Ofgas and OFFER have been concerned to improve the efficient use of energy, and although progress has been made there is still a long way to go. In March 1996 Government figures showed that British homes had made no real progress in energy saving over the last quarter century. Hopes had been raised that privatization would have encouraged new energy- and money-saving deals, *e.g.* cheap loans to buy insulation and draught-proofing which would have been paid off through extra payments on their quarterly bills. In both the gas and electricity industries energy saving packages have been introduced, but they have not been aggressively marketed. By and large information has been provided and the customer left to take the initiative, *e.g.* in 1991 codes for electricity efficiency were approved and a 'hotline' for enquirers set up. To secure more effective action OFFER (which has made the running) made changes to the price formula in 1993 to assist fuel efficiency by removing

[75] Water Act 1991, sections 7 & 8; Competition and Service (Utilities) Act 1992, section 40.

artificial incentives to increase electricity usage,[76] and by incorporating an allowance of £1 per customer per year to fund electricity efficiency schemes. Schemes approved range from compact fluorescent lamps to complete home energy insulation packages. In 1994 Energy Efficiency standards were set requiring companies to save 6GWh before April 1998. Progress was good and in 1997 the target was exceeded with 7.2GWh saved.

Gas has shown a rather different story. In 1991 Ofgas stated that expansion of the gas market was not adverse to the environment because gas is the cleanest fuel - indeed Ofgas pointed out that it had no duty to the environment![77] This hardly seems to be something to shout about, and although regard must be had to the statutory duties actually placed on the regulator, the absence of a statutory duty to promote good stewardship by conserving supplies has not prevented OFFER from pursuing this aim. However, Ofgas has been more content to rely on market forces, arguing that competition will improve energy efficiency since it is part of supplying gas to customers at least cost to the consumer (the less you need the less you pay). Nevertheless, it is difficult to hold together the need to maximise profit and to sell less product, which is what energy conservation in fact requires.

Energy efficiency has not been one of the successes of privatization; indeed utility privatization was carried out in an atmosphere inimical to good environmental stewardship. In 1979 the new Conservative administration advised the members of the Government's Advisory Council for Energy Conservation to stop using the term 'energy conservation' and instead to speak of 'energy efficiency'. According to Robert Jones[78] that soon became '*cost-effective* energy efficiency', and in time the ACEC was wound up. Eighteen years later, Jones maintained, the United Kingdom 'languishes at the bottom of the world league in "energy efficiency", let alone in "conservation",' and that environmental protection necessitates requiring the fuel companies to sell less energy tomorrow than they do today.

6. Environmental Protection

Adverse impact on the environment was one of the major fears of opening up the operation of the utilities to market forces, and a major criticism of the original schemes was the failure to place on the Regulators duties towards the environment. The example of Ofgas has just been noted - and in view of this it is scarcely surprising that no environmental issues have been raised in its reports. When OFFER was set up there was an improvement, but it did not amount to much. The DGES was not required to develop policy in relation to the impact of the electricity industry on the environment, but he did have to take account of it. The situation with water was different, principally in two

[76] By reducing to one-fifth the element in the formula relating to units sold.
[77] Ofgas 1991, p.38.
[78] Letter to *The Independent*, 21.5.97.

ways: environmental issues were very much to the fore, but they were dealt with principally by the creation of a separate agency, initially the National Rivers Authority, later the Environment Agency. There are also a number of other regulatory agencies with duties towards the water environment, among them the Drinking Water Inspectorate. This section deals with the electricity and water industries.

❑ ELECTRICITY

Environmental concerns seem to have figured only marginally since privatization. Despite commitments to introducing more environmentally sensitive means of generation, only one scheme was launched. Eastern Electricity committed itself to source 10% of its generating capacity from renewable energy resources by 2010. At the end of 1997 it offered its customers the opportunity to fund 'green' energy projects through a surcharge of 5% to 10% on average bills, which would be matched by an equivalent figure from the company. Between 3% and 5% of customers were thought likely to participate in the scheme, providing up to £1 million for renewal projects over two years. The money would be paid into a trust to administer the scheme independently of the company, and none of the funds would be applied to Eastern's own projects. This scheme is clearly no more than a pilot project, and the money available is very small compared with the actual cost of building generating plant; nevertheless it is to be welcomed as a step in the right direction. However, a serious commitment to renewable energy resources will only be apparent when the major generators are willing to put the environment above profit in the their order of priorities and include a substantial element of 'green' generation in their output, with the costs equitably borne by shareholders and customers alike, and not just by those willing to make a donation to the cause.[79]

The sort of initiative required was institutionalised in the Non-Fossil Fuel Obligation announced in 1989. It prescribes the amount of electricity which RECs have to buy from non-fossil fuel generators and allows them to pass on the costs to consumers. (The amounts are specified in Non-Fossil Fuel Orders, NFFOs.) The original Order specified 102.5MW by 1998 comprising 75 schemes covering five different technologies: landfill gas, hydro, bio-gas, waste incineration, and wind. A second Order for 150MW - 200MW followed in 1991. At the end of 1997 198 of the contracted schemes were operational with a combined capacity of 464MW. In September 1998 the Government approved 261 new non-fossil fuel projects involving almost 1,200MW of capacity (equivalent to a good-sized power station; one big power station produces

[79] In February 1998 environmental concerns surfaced in the battle to acquire Energy Group, the owner of Eastern Electricity. One of the bidders, Texas Utilities was criticised by a group of Labour MPs on the basis of its safety record. Nothing seems to have come of the affair, but maybe it is an indication of the sort of concerns that companies will have to address in future. Environmental record could be added to the criteria used by the Regulator to judge the appropriateness of take-over bids.

2000MW). The extra cost of the scheme in both 1997 and 1998 was around £116 millions.[80] Another energy saving measure is the development of combined heat and power schemes (CHP). In 1993 the Government set a target of 5000MW for CHP schemes by 2000. By 1997 CHP output was up to 3100MW.

❑ WATER

As already noted, at privatization it was made clear that massive investment was required to not only to bring the water infrastructure up to standard, but also to meet national and European water quality standards and to make other environmental improvements. This was one of the acknowledged reasons for privatization, although it did not figure in the public statement of aims. The sums of money involved ran into billions of pounds, and early on the DGWS expressed concern at the cost of environmental improvements and the impact they had on customers pockets.[81] Two issues have caused most concern: water quality and resources and leakage rates.

❖ *WATER QUALITY & RESOURCES*

In 1991 Ofwat commissioned a survey which showed that customers are much more concerned about water quality and the environment (*i.e.* higher standards for effluent discharged into rivers and seas) than they are about hose pipe bans or the arrangements for paying bills. Ofwat therefore monitors closely expenditure on environmental improvements: drinking water, bathing water and control of pollution; responsibility is shared with the Environment Agency. At the end of 1997 the Agency published a consultation paper calling for greatly increased expenditure on a range of environmental measures in addition to their statutory obligation to improve waste water treatment works. The proposals included reducing discharges from sewage overflows, improving wetlands and improving water quality.[82] The Agency also began a new review of water resources focussing on the amount of water abstracted from rivers and streams during drought periods. The improvements proposed were expected to run into

[80] The difference in price between fossil and non-fossil fuel generation is not great, and has fallen enormously since the NFFO began. At its inception the price of non-fossil fuel electricity was as much as 9p per unit; for the new projects announced in 1998 it was 2.71p compared with a pool price of 2.67p. (Source: *The Independent* 25.9.98) As renewable technologies developed the unit price reduced. In the first Order the average price was 4.4p/kWh; in 1997 it was 3.46p/kWh.

[81] Ofwat 1991, p.9. *E.g.* South West Water was granted a large increase in its K factor from 1992/93 to 1994/95 from 6.5 to 11.5 in order to pay for the improvements necessitated by the acceleration of the Bathing Waters Programme. The estimates submitted to Ofwat were considerably in excess of those made by the Secretary of State, and the DGWS criticised the Government for making a decision on environmental policy before the full costs were known. Following pressure from Conservative Members of Parliament, alarmed both at the rise in water charges which this would require, and the resultant effect on their political fortunes, the Government found a way to spread the expenditure over ten years The Department of the Environment advised Ofwat that the schemes were no longer needed to comply with the EU Bathing Water Directive. Instead they were needed to comply with a more recent Directive on sewage treatment, with a later completion date of 2005.

[82] At much the same time Granada Television's *World in Action* programme on 24.11.97 carried a report on the large increase in the rat population, and therefore in health risks to humans. Rats breed in sewers, and the report suggested that cost-cutting measures by the privatized water companies was the cause of the increase. *E.g.* in 1995 Yorkshire Water reduced its sewer-baiting budget by one-third.

billions of pounds over the five year period from 2000 to 2005, raising a doubt over the substantial price-cut which Ofwat had signalled its intention to achieve in the same period. The Agency also demanded much higher levels of fines for persistent pollution offences. Ed Gallagher, the Chief Executive, described the environmental record of the water companies as 'appalling, and getting worse'.[83] The average level of fines was £4,300, an insignificant amount compared with the level of profits, which in 1998 were expected to amount to £2 billions. Mr Gallagher suggested that fines should run into 'six figures', going up to £500,000 for the worst offenders. By mid-1998 prosecutions for pollution offences brought by the Agency were running at one per week, a level described as 'absolutely unacceptable'.[84]

The droughts of 1995 and 1997 had a serious effect on river flows. In 1995 half the rivers in England were reported to be reduced to 50% of their normal flows, with some drying up completely or to being reduced to a mere trickle. The water companies were accused of failing in the proper management of water supplies and in their care of the environment. In particular, extra abstractions from rivers and boreholes was said to be putting as many as forty Sites of Special Scientific Interest at risk.[85] The RSPB, among others, called for the development of a long-term approach to demand management, and in 1997 the DGWS stated that he believed that to protect the environment excessive abstraction should be avoided.

In 1998 the Government announced new measures to protect river levels. The main proposal was to end the present system of abstraction licences which are indefinite in duration, and which were introduced in the 1960s when there was no understanding of climate change and drought was virtually unknown. A new system of time-limited licences is to be introduced and the right to compensation for the revocation of a licence withdrawn. Additionally, water companies are to be made civilly liable for damages for injury to rivers and wetlands caused by over-abstraction. The removal of the right to compensation was attacked by the companies, who pointed out that millions of pounds of investment had been tied to the licences in the form of pipe networks and treatment installations; they could not afford simply to write them off and also invest in the alternative facilities which would be required. The Government rebutted this argument saying that the companies were responsible for the situation which had arisen; they should reduce the need for abstractions by better demand management and leakage control. Michael Meacher, the

[83] *The Independent*, 29.5.98.
[84] Most prosecutions were for illegal discharges of raw or partly-treated sewage or sewage effluent into rivers, streams and bathing waters. The highest fine was of £175,000, levied on Severn Trent Water in 1996 - the equivalent of fining a person earning £30,000 a year £15. The solution lies with the courts which, under the Water Resources Act 1991, have powers to impose unlimited fines for pollution offences.
[85] The anticipated effect on wildlife was also particularly severe. The whole food chain seemed at risk with insects and micro-organisms severely depleted affecting fish, otter and bird populations.

Environment Minister, also attacked the sanctity of property rights: 'I don't think anyone can believe that property rights should be continued into perpetuity irrespective of environmental damage.'[86]

❖ *LEAKAGE*

The droughts also served to highlight the problem of leaks. The NRA, in its report to the Government in 1995, was sharply critical of the failure of the water companies to reduce leakage; the lack of expenditure contrasted badly with combined annual profits of £1.8 billions. In 1991 Ofwat reported for the first time on water delivered, *i.e.* the amount reaching the customer (before this companies had measured water supplied, *i.e.* the amount leaving the treatment works); the figures showed a national leakage rate of 23.7%. In 1994 the DGWS said that he wished to see a duty placed on water companies to promote water conservation and the efficient use of water by their customers, and that he should have power to set standards of performance.[87] This duty was imposed in the Environment Act 1995, and water efficiency plans were put in place in 1996, the key elements of an acceptable strategy being: a well advertised and attractive meter option scheme;[88] a metering programme which reflects the balance between supply and demand in the company's region; an active approach to leakage control, on both the company's and the customer's pipes, and help for customers whose supply pipe is leaking; a comprehensive public education/customer information programme. Ofwat also maintained that 'leakage reduction should be based on economics while taking account of environmental objectives', which meant that companies should not have to exceed 'the economic level of leakage, *i.e.* the point at which it becomes cheaper to develop new sources of supply than to plug the leaks in the network.'[89] In 1996 leakage targets were set for the first time (for 1997/98), with the expectation of reductions of at least 15% compared with 1995/96 leakage rates. However, only a few companies had made progress in developing a methodology which would enable them to apply economic principles to the

[86] *The Independent*, 20.6.98. An accompanying story illustrated the problem. The Portsmouth Water Company owns the right to abstract water from a borehole near Bishop's Waltham in Hampshire, which also supplies The Moors, 75 acres of wetland, a local beauty spot and a SSSI. If the company exercised its right to abstract 11,000 litres a day for two weeks The Moors would cease to be a wetland. Although the company had been sparing in their abstractions, the Environment Agency was concerned that pressure to supply their customers in times of water shortage would mean an end to restraint. They wanted the borehole not to be used at all. The company estimated the cost of providing alternative sources at £3.5m, which, they said, they could not afford unless they were allowed to pass the cost on to their customers; if not, the borehole would have to be used. A few months later Mr Meacher warned that the Government expected the companies to invest £8.5 billions in environmental programmes while still making substantial cuts in the average water bill when the new regulatory review was introduced in 2000. The figure of £8.5 billions is almost double the investment planned by the companies in the period 2000 - 2005; company shares fell sharply with the news.

[87] Ofwat 1994, p.9. The DGWS also proposed that sewerage companies should be under a statutory duty to promote the efficient use of sewerage services, and that companies should not be allowed to build new reservoirs before they can show that they have reached their economic leakage rate. (Ofwat 1996, p.27.)

[88] Ofwat argues that metering has environmental benefits because it plays 'an important part in water conservation as an alternative to resource development such as reservoir construction... Metering also helps to detect leaks...' (Ofwat 1994, p.36.)

[89] Ofwat 1994, p.8.

reduction in leakage.

New leakage targets were set in 1997 against the changed political background following the election. Among other things, the new Government called for repairs to leaks to be carried out free of charge.[90] Ofwat and the Environment Agency called separately for the compulsory metering of affluent households with high water consumption in drought-prone areas. The new political regime gave powerful support to Ofwat which imposed new, mandatory and more exacting leakage reduction targets, requiring reductions of between 10% and 20% compared with 5% in previous years;[91] Thames Water, the worst 'leaker' was required to reduce leaks by 26%.[92] The DGWS rejected the argument that the companies were near the economic leakage rate, and in 1998 reported that most of them had exceeded Ofwat's targets achieving an average reduction in leakage of 12% over the figures for 1997.[93] In 1998 the DGWS required all companies to devise strategies for the efficient use of water in their areas.[94]

These targets need to be seen against not only the new political background, but also against the continuing high dividend rates paid by the companies, in most cases outstripping increases in pre-tax profits. Not surprisingly, therefore, the DGWS warned that the companies should not expect to recover the cost from customers under the new five-year price control period due to begin in 2000. The companies all pledged themselves to meet the targets, though the finance director of Anglian Water criticised them as uneconomic: 'We've been hit by a target which is pushing us faster than it's economic to go.... We will meet these targets but we're questioning whether this is sensible. It seems to be inspired by political considerations rather than rational considerations,'[95] a comment apparently unaware of the political and economic assumptions which lie behind it - rationality being identified with the interests of the company rather than the environment.[96] The point was not argued, of course, but there must become a time in dealing with a finite source when the economic argument looses its relevance. New sources of supply simply will not be available, and we either reduce consumption or die of thirst. Looked at from

[90] Between April 1995 and March 1966, the year of the record drought, the industry lost 4,979 million litres per day. In the following year the figure was 4,502 million litres, most of the reductions coming from the big privatized companies. The Government let it be known that Ministers accepted that a totally leak-free water system was uneconomic, but that they believed that that point was reached when only 10% of water pumped into the mains was lost. Few companies met that target.

[91] These targets were 16% lower than those proposed by the companies, and represented the water needed to supply the whole of the Yorkshire area. Total leakage fell by nearly 10% between 1995/96 and 1996/97, and a further fall of 16% in 1998/99 will be necessary to meet Ofwat's targets. (Ofwat 1997, p.32.)

[92] Thames Water lost 25% through the mains; leaks on the customers' side brought the total Thames' leakage rate to 38%.

[93] Ofwat 1998, p.23. *The Independent* reported that over the two years 1996 - 98 the total leakage reductions achieved had saved enough water to supply Birmingham three times over. (15.7.98.)

[94] Ofwat 1998, p.24.

[95] *The Independent*, 31.10.97.

[96] Another example of the narrow economic model taking precedence over the wider social (or in this case, environmental) model.

this perspective it is immoral to cavil at the cost of making the system leak-free.

B. THE BALANCE OF BENEFITS

All commercial companies face the need to balance their duty to their shareholders to secure a rising, or at least a reasonable, return on capital invested with their duty to their customers to provide good and rising levels of service at reasonable cost. With the utilities, striking the right balance is more important because of the basic nature of the products and services provided. One reason for nationalisation was to ensure that the customer's interest in the provision of essential services was not subordinated to that of the shareholders, and part of the anxiety over privatization was that this social concern would be lost. By 1995 there was widespread dissatisfaction with the performance of the electricity and water industries, and the regulators were accused of getting the balance between customers and shareholders badly wrong. This part offers an assessment of how the balance lay at the end of 1998, and concludes by examining the proposals for the reform of regulation.

1. Executive Remuneration

The issue which dominated the headlines and which focussed public dissatisfaction with the post-privatization industry was that of executive pay. The event which triggered the outcry was the bonus of £400,000 paid to Cedric Brown, the Chief Executive of British Gas, and there was a general and sustained protest against huge increases in boardroom pay in all the privatized utilities. In 1996 it was revealed that directors' remuneration had increased six-fold since privatization; during the same period average pay had not even doubled.[97] It seemed unprincipled and selfish; a group of aggrieved British Gas shareholders made the point by going to an AGM with a pig called Cedric.[98] To no avail did the directors argue that they were merely bringing their pay in line with salaries in comparable industries.[99] Sir Desmond Pitcher, the chairman of North West Water, giving evidence before the House of Commons Select Committee on Employment, rejected the idea that the public had the right to know the earnings of senior executives in the privatized utilities; it was a matter for the shareholders alone.[100] The comparisons with the private sector are inaccurate. There is a substantial difference between a normal joint-stock company operating in a competitive market and a private monopoly, moreover,

[97] Source: *The Independent* 21.10.96. The figures include salary, taxable benefits, performance bonuses and pension contributions, but exclude share options. The biggest increases by far were in British Telecom and British Gas.
[98] In the electricity industry PowerGen was the chief target, and when in 1995 it announced that the directors had made a profit of £5.2m by exercising share options, despite the widespread criticism which past arrangements had drawn, there was a further outcry from press and politicians, Gordon Brown, the Shadow Chancellor, accusing the company of 'piling excess on to excess'. (*The Independent* 22.6.95.)
[99] One view is that the explosion in executive pay was the result of 25 years of deliberately holding back public sector board salaries. The prospect of rich pickings ahead was used, none too subtly, by ministers to gain board co-operation in getting privatization through.
[100] Sir Desmond had a pantomime 'fat' cat named after him!

in the case of water, with substantial 'public' functions.[101]

Similar criticisms followed the decision of the directors of the National Grid to retain their dividends on shares when the Grid Company was floated. The dividends resulted from the decision to float the company, and not from its performance record for which the directors could have taken the credit. Nevertheless, the chairman, David Jeffries (who stood to gain £190,000) insisted that he was free to do what he wished with his money, adding that he felt 'very strongly' that the freedom of the individual shareholder was at stake. Whatever the size of their holding, shareholders were entitled to their dividends: 'If this principle were to be bridged it would have horrendous consequences for the future.'[102] Despite the attempt to raise the matter to one of high principle, the impression remained that the main beneficiaries of privatization were to be found in the boardrooms. It all seemed a long way from the public service ethic which originally inspired the nationalised industries.

The same distaste characterised the spate of mergers and take-overs which occurred in the mid-1990s, with the substantial sums paid to directors as compensation for loss of office or received through the exercise of share options. While this would not cause surprise in a normal take-over, and indeed was to be expected when the utilities became quoted companies, it added to the impression that for those who had managed the nationalised industries, and had been closely involved in negotiating the privatization scheme, the whole process had worked to their advantage rather than to the advantage of consumers; for the managers privatization had been a rich 'gravy train'.[103]

The issue of executive pay was emotive precisely because it provided a clear focus for the public disquiet about the ethics of privatization. Whose interests were the privatized utilities actually serving? The focus was clear because the issue was personalised - the 'villains' could be identified, the disquiet was quantifiable, and it involved money, the deity of the age, as Peter Selby terms

[101] A further grievance was that while executive pay soared others in the industry were losing their jobs. National Power, for example had cut its work force by almost three-quarters (from 16,000 to 4,500) since privatization. National Power defended its action arguing that the job losses had been carried out against a background of increasing competition in electricity generation; the savings had been passed on, typical industrial customers had benefited from a fall in prices of around 23% since privatization.

[102] *The Independent* 3.10.95. Unusually, the deal was criticised from within the industry, notably by Geoffrey Wilson, chairman of Southern Electric. It was even 'a deal too far' for the Government. The same report said that Tim Eggar, the Energy Minister, was 'incensed' at the decision of the grid directors not to waive their dividends. This was a sharp contrast with his remarks in the debate on the Gas Bill 1995. Then he attacked the suggestion that the Government should use its 'golden' share in the utilities to curb board-room pay and 'perks'. He was reported as saying: 'This flip idea that government can intervene to overturn decisions taken by companies is naive. The whole purpose of flotation and privatization of the utilities was that they should be got out from under the Government.' *The Independent* 31.1.95.

[103] It is probably true that the utilities were only part of a general pattern of corporate excess in Britain. If it was attacked in the utilities and not elsewhere, the result would be to drive the best managers out of the industry. The impotence of the Greenbury Committee (on boardroom pay) showed that the general problem was very hard to deal with.

it.[104] In time the issue subsided and cynicism took the place of anger and indignation. The question, however, remained unanswered, but in 1998 the Government proposed that boardroom pay be linked to service quality.[105]

2. Financial Performance

The take-over fever which gripped the electricity industry in the mid-1990s showed just how profitable the RECs were, and how effective they had been in concealing this from the regulator.[106] Manifestly, the benefits of improved efficiency had not been passed on equitably between customers and shareholders, and the benefits were considerable. Five years after the last utility was privatized virtually all the RECs and regional water companies had shown substantial increases in their returns to shareholders. The best performance was recorded by Northumbrian Water which gained 64% in 1995, making a total gain since privatization of 591%. All the water companies did well, recording gains varying from 236% to 591%,[107] as did the electricity industry, although the variation was wider, from 78% to 570%.[108] Utility stocks continued to perform well even during the downturn in the market in 1998. Against a general fall in the FTSE 100 index of 25% between July and October, gas stocks rose 5%, the twelve water stocks gained almost 5%, and the eight listed stocks in the electricity sector gained 2%. Water stocks were described as the 'ultimate defensive stocks', having almost no exposure to world markets and no exposure to a fall in demand during a recession.[109] In its Annual Financial Review for 1966 Ofwat severely criticised the imbalance, which added to a growing body of evidence that the companies were generating excessive profits at the expense of customers.[110] In 1998 the DGWS noted that over the period 1993 - 1998 operating costs had fallen by 9%, and that companies were

[104] Peter Selby, *Grace and Mortgage* (London: Darton Longman & Todd, 1997).

[105] *A Fair Deal for Consumers*, Cmd. 3898 (1998).

[106] See section 3 below.

[107] The gains were as follows: South West 236%, Thames 239%, Anglian 270%, North West 272%, Wessex 298%, Severn Trent 313%, Southern 313%, Welsh 355%, Northumbrian 591%. (Source: Datastream. Figures for Yorkshire were not available.)

[108] The range includes generators, RECs, and the Scottish combined generating and distribution companies, making comparison more complex. The figures were: Scottish Hydro 78%, Scottish Power 83%, Northern Ireland Electric 118%, National Power 222%, PowerGen 277%, Yorkshire 349%, East Midlands 361%, London 373%, South West 382%, Midlands 390%, Southern 392%, Eastern 428%, Manweb 447%, Northern 481%, South Wales 507%, Norweb 547%, Seeboard 570%. (Source: Datastream.)

[109] Clifford German, *The Independent*, 8.10.98. This situation could change as a result of regulatory pressure. If the price review was too tight, water shares would be converted into virtual fixed-interest stocks with limited growth prospects.

[110] Over the first qinquennium investment fell by almost one third from £3.6 billions to £2.57 billions, while dividends doubled from £0.8 billion to £ 1.6 billions. Customer rebates promised over the period totalled a meagre £0.22 billion: (*The Independent*, 30.10.96.) Four water companies had paid special dividends to their parent companies, reflecting what were described as 'windfall efficiency gains' over the first price control period from 1989 to 1994. The 1997 review showed that investment spending fell 14% below the target set by Ofwat. Thames Water defended its record saying that it had achieved the outputs required by Ofwat with lower investment levels. There were also some positive outcomes. Most companies explained the failure to spend the allowed levels of investment was the result of re-phasing their investment programmes. Where such re-phasing could benefit shareholders at the expense of customers the DGWS suggested to the companies that they should not take up their full price increases the following year. All but one agreed.

continuing to show greater than expected efficiency gains.[111]

However, these financial results were gained partly at the expense of proper investment in the modernising the infrastructure. Over the initial period following privatization the combined investment by all three utilities fell by around £2 billions, although the reductions were concentrated in the gas and electricity industries. This is one of the effects of price regulation which creates an incentive to skimp on investment. Although some city analysts believed the companies had become more efficient, thus permitting a reduction in investment levels, the regulators took a different view, suggesting that the reductions were real and not simply relative.[112] It hardly supports the pre-privatization argument that, freed from Treasury controls, investment levels would rise. Instead large repayments of capital were made to shareholders through share buy-back schemes or special dividends. In the case of monopoly utility there is a good case for arguing that the money should be ploughed into investment whether or not it is commercial to do so, for there is a clear public benefit in renewing the infrastructure.

3. Take-overs and Mergers

The relaxing of controls on the ownership of RECs[113] led to an unprecedented 'buying spree'. Both the number of bids and the ease with which they were mounted indicated clearly that the companies had been sold far too cheaply at privatization, and that the regulatory regime had not been strong enough to prevent them from making excessive profits; they also pointed up the failure to introduce effective competition into the industry. Perhaps most tellingly, it was clear that the shareholders rather than the customers who had done best out of privatization. Hanson plc's bid for Eastern, the largest of the RECs, valued the company at nearly four times the amount the Government received at privatization, and the total value of all twelve RECs in August 1995 was estimated at £16 billions, over three times the privatization value of £5 billions. However, these figures, scandalous enough by themselves, concealed the true extent of the underpricing. The RECs were given ownership of the National Grid, thought to be worth about £1 billion at the time. When sold on the stock market their shares proved to be worth £4 billions, or nearly as much as the Government received for the sale of all the RECs together. On grounds of equity some form of profit sharing or other arrangement to give customers a share in the spoils seemed unarguable. Not surprisingly, in this critical climate, the Government was urged to refer the first three bids[114] to the MMC, but this

[111] Ofwat 1998, pp.22 & 25.

[112] *The Independent*, 5.6.96. The report is based on information published by the Office for National Statistics. It shows a decline in investment between 1994 and 1995 of nearly one fifth, 19.3%. Investment in the Water Industry was considered adequate, but, of course, the water companies had been allowed to *raise* their prices.

[113] For the first four years after privatization the RECs were protected from take-overs by the Government's 'golden' share to enable them to become established in the market.

[114] Hanson's bid for Eastern, Southern Electric International of the USA's for SWEB, and Scottish Power's for Manweb.

was refused, mainly on the grounds that the RECs, as private sector companies, should be subject to the normal disciplines of the market. While this justification seems reasonable, it is only superficially so. It fails to take account of the monopoly situation of each REC and the basic injustice of the original flotation; they are not ordinary private companies operating according to the full rigours of the market.

The creation of multi-utilities is also of questionable value to the customer. When United Utilities was created through the merger of North West Water and Norweb in 1995 savings were not expected to show until after 2000, and the initial returns from the combine were disappointing.[115] The delay in benefits to customers was defended on the basis that as the shareholders were financing the deal they were entitled to receive a return first. The deal was accompanied by the usual side-show of substantial windfall profits for board members and job losses for the other employees. There are also other reasons to be cautious about multi-utilities. These mergers reduce competition and so erode pressure on managers to improve efficiency and deliver a better service to consumers. It also has implications for regulation. Companies who want to make profits for their shareholders have an incentive to disguise their future profitability, which will be much easier if they have diversified into other utilities.

The water industry illustrates both these concerns. Mergers between companies reduce the DGWS's ability to make comparisons between them. Where valuation of the assets of the companies is over £30 millions a reference to the MMC must be made, and in 1996 the MMC blocked the merger of South West Water with either Severn Trent or Wessex, and the take-over of Mid Kent by Saur and General Utilities on the grounds of the prejudice which would be caused by the loss of comparators.[116] Take-overs are also often accompanied by diversification into other activities,[117] and hidden subsidies from the non-water business can be used to achieve artificial price reductions, or in other ways to obscure the financial state of the water business. In examining these deals Ofwat has been much concerned to ensure transparency in the resulting structure, and was assisted in this by the Competition and Service (Utilities) Act 1992 which requires transactions between the appointed water business and all other activities to be at arm's length.

[115] In the first year shares in the new company put on a pedestrian performance, and pre-tax profits fell by 4%. However the company remained optimistic that by 2000 a substantial improvement in performance would be forthcoming.

[116] In ruling on the proposals the primary public interest test is that the DGWS's ability to make comparisons between companies should not be prejudiced, unless other public interest benefits are substantially greater, *e.g.* significant price reductions. A number of mergers between small water companies were allowed to go ahead on the undertaking that prices would fall as a result.

[117] An investigation by Ofwat in 1996 disclosed a very unsatisfactory state of affairs. Payments were made for services, *e.g.* computer consultancy, by the regulated business to the unregulated business at fees far in excess of the market rate. In most cases the contracts were awarded without competitive tendering, and some of the associate companies relied on the regulated business for more than half their turnover. Usually both the regulated and unregulated businesses were all owned by a parent company.

This all seems a long way from the old ideal of public utilities providing a public service, content to make a reasonable return on their assets. The immediate aftermath is not the right time to make a final judgement; but deals on this scale rarely deliver their claimed benefits. However, they can have financial advantages even if they take time to show, and these will be important in a society which accords a greater priority to lower prices and maximising financial returns on investments than to full employment - job losses being the inescapable result of lower prices. It is also difficult to object to multi-utility deals on competition grounds because there is no reduction in competition as water and electricity do not compete. The real concern is whether the regulatory system is strong enough to cope with multi-utilities. As *The Independent* asked, '[C]an we trust the existing regulators to guard the consumer interest against the monopoly owners of a super-utility?'[118] The paper argued for either a super-regulator or at least for greater linkage between the regulators,[119] a point taken up in the 1998 Green Paper on Utility Regulation.[120]

4. The Windfall Tax

One answer to the problem of the perceived imbalance in the distribution of the benefits of privatisation was the so-called 'windfall tax', a one-off tax on the profits of the utilities. It was urged on the Conservative Government at the height of the outcry over executive remuneration, who rejected the idea, but it was embraced by the Opposition, and became a central policy of the new Labour Government.

The policy raised ethical issues. Some argued against the tax on the basis that there was no equitable and practicable way of imposing it, and that in any event the utilities would find ways of passing it on to the customers. (Anticipation of the tax was said to lie behind the flurry of special dividends, share buy-backs and other capital restructuring schemes undertaken before the election.) It was also said to be a substantial breach of faith: the tax would be retrospective, and would amount to a rewriting of the prospectus upon which the companies were originally sold. It was wrong for the Government to recoup the loss it incurred by selling the companies at an undervalued price. This seems to push the contractual analogy too far, and to ignore the claims of social justice. Any remedy to an injustice can be argued to be retrospective, especially when, as frequently happens in the courts, the law is changed as part of the remedy. Generally it is accepted that the fact of the injustice cries out for a remedy, and it cannot lie in the mouth of the perpetrator to complain of retrospection. In the case of the utilities, the imbalance of benefits was widely accepted, and the tax seemed an appropriate, if rough and ready, means of correcting it. It might be objected that the injustice was the fault of the government in underpricing the utilities, and therefore they, rather than the utilities, should bear the

[118] *The Independent* 9.5.95, p.16.
[119] 'Super-utilites need super-regulators to keep them in check.' (*The Independent*, 30.5.96.)
[120] See section 5 below.

punishment. Again this ignores the reality of the situation. In the first place those who bought the shares were aware of the underpricing, and that they were the beneficiaries of the unfairness of 'selling the family silver' short, and secondly it was their decision to pocket the proceeds of their windfall rather than share it with their customers. The justice may be rough, but so was the original policy.

In the event the tax was imposed without much protest. It had considerable public support, being seen as an appropriate imposition for the profligacy of previous years. The formula for the tax was designed to focus on excess profits, comparing the valuation at privatization with an average market value for the companies based on annual profits over four years after sale. The tax was levied at 23% of the difference between the two figures. The total revenue raised from the tax was expected to be £5.2 billions, and it was earmarked to fund the 'welfare to work scheme'.[121]

5. Regulatory Reform

The need to reform the regulatory system was evident by 1995 when Northern Electric defended itself against an hostile take-over bid from Trafalgar House by promising a large and unplanned dividend to its shareholders, and this was by no means the first such dividend. It was clear that the RECs were far more profitable than had been realised, and the regulator had failed to detect this. The regulatory process was also criticised as lacking openness and accountability, and the political Right objected both to the gradual change in approach from the intended 'light' regulation to something more substantial, and to the perceived political influence behind the regulator's decisions, as in the case of the decision by the DGES to announce two successive reviews of electricity prices within six months when the first proved to be too lenient.[122]

In part the problem results from the initial policy to complete the sales as quickly as possible and for as much as possible. The regulatory system had to be lax to attract investors, but the problem also results from the regulatory formula itself. Price regulation depends on information provided by the company. Once the price cap has been set it is inevitable that the company will find that not all its planned investment is as essential as first thought, or that more efficiency savings can be made, in each case with a consequent increase in profits. Various reforms have been proposed. One is to augment price regulation with a 'claw-back' (or profit sharing) mechanism whereby once a

[121] The Treasury estimated liability as follows: British Gas £700m; the Water companies £1.65bn, the electricity industry £2.1bn, and other companies (BAA, BT & Railtrack) £750m. (*The Independent* 3.7.97.) The tax was payable in two instalments, December 1997 and December 1998. In February 1998 the possibility of a 'permanent' tax on excess profits was rumoured as part of the Government's review of regulation. This would breach the one-off nature of the windfall tax, and would also change the basis of regulation which applies to prices not profits.

[122] This was the direct result of the Trafalgar House bid.

reasonable rate of return has been earned, the excess is divided equally between shareholders and consumers. Another is to replace the single regulator with a panel, maybe on the lines of the monetary policy committee of the Bank of England. A third is to merge the Ofgas and OFFER to achieve both consistency of policy and to cope with mergers between gas and electricity suppliers and so-called dual fuel deals.[123]

The 'claw-back' mechanism was supported by the Claire Spottiswoode, the gas regulator, but opposed by the Ian Byatt, the water regulator, who argued that it would reduce the power of incentives and could result in higher prices over the long term. The regulatory formula reduced costs, and 'incentives to increase profits as a result of cost-saving within the price cap in a stable medium-term regime' have played a major part in this.[124] Jeremy Warner took the same view. The present system of price regulation is, he argued, set up to allow excess.

> Setting prices for a period of time challenges the company to improve on the Regulator's assumptions about the scope for cost-cutting. If they succeed the gains go to the shareholders, but if the system works as it should, then at the next price review the gains are realised on behalf of the customer through a significant reduction in prices. It will take time for both the regulator and the companies to get the measure of the process, but to change to annual reviews, as some have argued, and to have a profit sharing mechanism between shareholders and customers would remove the incentive upon which the system depends. It might even prove counter-productive with the utilities failing to meet assumed rates of return and customers having to share in the consequent losses.[125]

On another level it has become clear that politics simply cannot be taken out the utilities, and the regulator cannot be expected take the difficult decisions. In 1998 the Environment Agency signalled alarm over Ofwat's proposals to introduce a substantial, one-off price cut to counteract the excessive profits of the mid-1990s. It feared that the overall level of investment would decline and much-needed measures to ensure better control over sewerage overflows and to limit the amount of drinking water that can be abstracted from rivers would be prejudiced. It had urged that same argument in the earlier review, demanding that 'excess' profits be spent on the environment rather than be returned to customers in the form of lower prices, and in 1997 conducted a consumer

[123] Another suggestion was to open the regulatory process, as in the USA, by making it subject to public inquiry. Although slow, this does help to establish consensus, and should avoid major mistakes. The problem, though, is that the process can become adversarial, even if it is not intended to be, resulting in obfuscation rather than illumination.

[124] From a letter to the DGGS quoted in *The Independent*, 3.8.95. The 'medium-term regime' referred to is the five-year price control period - the DGGS had questioned whether five years was too long a period between reviews. In his submission to the Government's review of regulation the DGES also opposed profit sharing schemes.

[125] *The Independent*, 4.1.97.

survey which supported its case showing that overwhelmingly consumers wished to see more being spent on improvement schemes. In response the DGWS stated that he was required to ensure that the new price formula was related to efficiency gains over the previous review period. If that requirement was compromised, then independent regulation would be forfeited. However, the House of Commons Select Committee on the Environment challenged this narrow interpretation of the Regulator's duty, and believed that he should concentrate on the 'bigger picture'. The effect of this argument is to force the environment and the consumer to compete, which misses the point that unless the environment is protected consumers will, sooner or later, be the losers anyway. The real issue is how environmental improvement schemes should be funded, and this is essentially a political decision. If it is to be via the price formula then that needs to be stated clearly in legislation.[126] In September 1998 the Government made clear its policy in the form of official guidance to the Regulator. It wanted to see both substantial price cuts and substantial investment in environmental improvements. The Environment Agency's proposals were largely accepted, and the measures approved included accelerated sewage treatment schemes, higher drinking and bathing water standards, and protection for a considerable number of wildlife sites threatened by sewage or water abstraction licences. The political nature of the policy was clear from the Secretary of State's statement in which he accused the previous Government of giving away public assets and creating ideal conditions for making a lot of money: 'This is our first chance to get back some of that public investment.'[127] The proposals also made it clear that mergers were not envisaged as away of achieving the necessary cost reductions.

In March 1998 the Government published a Green Paper setting out its proposals for utility regulation.[128] The underlying aim is to bring regulation under a greater degree of political control because 'the present regulatory framework does not reflect the importance of the utility industries to the achievement of wider social and environmental objectives.'[129] To this end each office will receive statutory guidance on the Government's wider social and environmental aims so that they can be taken into account when decisions are

[126] The position did improve. In 1997 Ofwat reported that 'capital investment during 1996/97 had recovered and was 22% upon the previous year. Infrastructure renewals expenditure had also increased by 29% in real terms compared with 1995/96 and was at its highest level since privatization.' (Ofwat 1997, p.40.)

[127] *The Independent*, 24.9.98. Ministers suggested a 10% reduction in prices; however, when announced, the proposed price reductions were much larger than expected, averaging around 17.5%, and with an assumed rate of return on capital of 5.25% - slightly lower than the previous rate. After the initial cut, prices were expected to rise in subsequent years to cover the cost of the extra investment. Although tough, these proposals were not unrealistic as in the past the companies had achieved much more, and, in any event, as their licence provisions allow them to retain any gains above their defined rate of return on investment, they have a good incentive to better the Regulator's assumptions. The proposals were published at the end of October 1998. At the time of writing they were subject to consultation; final proposals were due in July 1999, to take effect in April 2000.

[128] *A Fair Deal for Consumers*, Cmd.3898 (1998).

[129] *Ibid*, para. 1.14.

made.[130] Specifically the Government voiced concern that the disadvantaged had benefited least from privatization, and stated that 'the disadvantaged' should include those on low incomes.[131] This could translate into an explicit obligation to protect the interests of poorer consumers and other disadvantaged groups, but the cross-subsidisation of prices was ruled out.[132] Another basic aim was to redress the imbalance between consumers and shareholders and between commercial and environmental interests. The Green Paper proposed a new primary duty to protect consumer interests, and to strengthen the voice of the consumer within the regulatory process by the creating independent statutory consumer bodies for each industry. Duties towards the environment are to be strengthened, placing them more on a par with commercial duties. The RPI - X formula is to be retained, but an 'error correction mechanism' was proposed whereby profits would have to shared with customers when companies benefited from circumstances outside their control, like a sudden drop in the costs of supplies, or when they accrued from incomplete or misleading information supplied to the regulator. The Green Paper also proposed merging the gas and electricity regulators into a single energy regulator (which has now been done); separating electricity supply from distribution (*i.e.* separating out the natural monopoly); and improving openness and accountability by requiring regulators to justify their key decisions. The possibility of providing regulators with advisory panels was not ruled out, and joint action between the regulators in dealing with multi-utilities was called for. In general the reforms received a positive reception, but the proposal for the 'error correction mechanism' was attacked as likely to increase uncertainty and raise borrowing costs for all utilities; some viewed it as a second windfall tax.[133] It illustrates the problem of finding an effective way to make the market operate fairly while at the same time preserving the incentive to make profits which is its driving force.

6. Striking the Balance

The balance of benefits tends to be seen as a two-way issue between shareholders and customers, but it should be viewed as three-way to include the environment. Customers have benefited from lower energy prices and better standards of service, and, notably, much better protection has been put in place for poor and vulnerable customers. The virtual elimination of

[130] The Government stopped short of taking powers to to issue mandatory guidance because of fears that such powers would add to market uncertainty and raise the cost of capital to the industries.
[131] *Ibid*, para. 5.3.
[132] The particular concern is for customers with pre-payment meters who 'have benefited least from liberalisation.' (Para. 5.12). While the Government is clear that something must be done to give them a better deal, it not clear how this objective is to be achieved - a clear example of the difficulty of securing egalitarian social objectives within a market framework.
[133] This proposal has now been withdrawn because it was realised that the mechanism could work in the other direction and result in higher bills if input costs unexpectedly rose. Instead regulators will be expected to refine how the RPI-X formula applies in 'exceptional circumstances. (*The Independent* 28.7.98) As an alternative the new Energy Regulator, Callum McCarthy, has proposed an 'additional incentive mechanism'.

disconnection for debt is a major advance, surprising the pre-privatization critics who expected an increase in fuel poverty under a more commercial regime. The advent of competition has considerably increased choice in energy supplies, and has brought about further decreases in prices. Nevertheless, it is clear that even the toughest price reviews have not been tough enough, and it is the customers who bore the major part of the cost of introducing competition. There have been improvements in the water infrastructure and in water quality which benefit customers, and measures to protect the countryside are being imposed even at the cost of property rights,[134] but water prices have risen steeply to pay for them. These improvements are also a major environmental gain, but even so the impression is that the environment is a poor relation in the distribution of benefits, with much more needing to be done, especially in promoting electricity generation from renewable sources, cleaning up atmospheric pollution from fossil fuel generation, protecting river levels and wildlife sites, curbing noxious sewage discharges, and cleaning up coastal waters. Progress in energy efficiency, let alone energy conservation, has been minimal, and water leakage rates remain at an unacceptable level. Against this there has been a sustained increase in profitability with huge sums paid in various ways to company executives and in dividends to shareholders. The re-organistion of the industries through take-overs and mergers seems to have more to do with 'empire building' than with providing benefits to customers, especially when the anti-competitive nature of these schemes is appreciated. Quantifying the balance of benefits is impossible, and a judgement will be largely a matter of opinion. While there have been improvements for customers and the environment, the impression remains that, at the end of the review period, it is the shareholders and directors of the utilities who have been the principal beneficiaries.

C. MEETING THE OBJECTIVES

In chapter I it was noted that privatization did not spring from a coherent set of objectives but that the aims developed in a pragmatic way.[135] Commentators compiled different lists of objectives, but all lists contained the three 'cardinal virtues': reducing the level of public sector borrowing, increasing efficiency, and widening the level of share ownership. Improving efficiency was a clear economic aim and comprised improving productive efficiency by bringing in private sector approaches to the management of assets, and improving allocative efficiency by substituting competitive free-market pricing for administered prices. Both these were ways of reducing the role of the State in the economy. This part reviews whether the basic objectives set for the privatization of the utilities have been achieved, and the way the political and

[134] *E.g.* the revocation of abstraction licences without compensation: see pp.155-6 above.
[135] *Cf.* Veljanowski: 'The remarkable thing about the whole process was that it was unpredictable, and it followed no coherent over-arching strategy. Privatization...was *ad hoc*.' (*Privatization and Competition* (London: Institute of Economic Affairs, 1989), p.vii).

economic arguments for privatization (considered in chapters IV and V) have worked out in practice. The five ethical issues[136] identified in Chapter I are discussed in the final chapter.

1. Revisiting the Political Debate

By the end of 1998 privatization had ceased to be a big political argument. Maybe the major reason was that it was a *fait accompli*, and the cost of reversing the programme (as the Labour Party when in opposition had pledged to do) was simply prohibitive.[137] There were other reasons. Despite the negative aspects of privatization noted in the last section, the privatized industries were, by and large, performing satisfactorily, offering better service than their nationalised predecessors, and many of the problems predicted by the opponents had not come to pass. Managerial independence was working well, even if the cost was inflated salaries, and the arm's-length relationship, which the nationalised industries were meant to enjoy, had actually been achieved and was working to the advantage of the Government, not least in that it had escaped criticism for the sharp rise in prices in the water industry. The imposition of an independent body in the form of the Regulator between the industry and the Government has actually meant more effective supervision of the industries, not only in terms of price control but also in improving their social obligations. Most notable here, as mentioned above, is the virtual elimination of disconnections for debt, an outcome contrary to that predicted in the Parliamentary debates. There is also a welcome openness in the way the industry is regulated, and it seems that reliance on 'breakfast table directives' has ended - the formal advice to be given under the new regulatory regime bears this out. The fear that price regulation would cause a lowering of levels of service has also not materialised, nor have there been massive disposals of land by the water companies,[138] or scares over levels of safety. Public service and profitability have not been shown to be necessarily opposed as Tony Benn argued, and, *per contra*, Cecil Parkinson's comment that the concept of public service is not helped by insufficient pressure on costs, efficiency and prices has been borne out. Both these objectives may be pursued together, but there will be a tension between them. This tension needs to be creative, and this has been helped by the regulatory insistence that cost and resource issues cannot be allowed to defeat vulnerable customers' rights and entitlements.

[136] *Viz:* the proper role of the state, controlling the abuse of power, incentives, stewardship, and Who benefits?

[137] It is notable that not even with Railtrack and the rail franchisees, where the commitment to return to a publicly owned railway was strongly made before the 1997 election, is re-nationalisation mooted despite the manifold problems with the system.

[138] At the time of privatization concern was expressed about the potential for commercial exploitation of companies' land holdings. In 1991 Ofwat reported that most of the land was required for the core business, and only a small proportion had been identified as surplus. (Certain proceeds of land sales were assumed when the K factors were set.) Where companies have transferred land out of the core business into an associated business with a view to making much larger profits on a later sale (*e.g.* when land prices have risen), Ofwat has required claw-back conditions to ensure that an appropriate proportion of those profits is returned to the regulated business for the benefit of customers.

On the other hand some criticisms have been vindicated. The absence in the original scheme of provisions for competition in gas was clearly wrong, and in the light of subsequent events, Peter Walker's statement that it was unrealistic to expect lots of competition in gas seems extraordinary. The promise that real competition in electricity generation would develop was vitiated, as the critics predicted, by the National Power/PowerGen duopoly, and it is only regulatory and political pressure that has brought about the plant disposals needed to open up the market; but even so a thorough reform of the workings of the electricity pool is still required. Lord Carver's prediction that energy conservation would not be attractive to an industry trying to sell energy has, sadly, been fulfilled; similarly progress has been poor in developing environmentally friendly means of electricity generation,[139] and the missed opportunity (pointed out by David Owen) of using privatization to impose stringent environmental standards on generation has still not been remedied. The widespread concern about excessive profit-taking has been justified, and this has undermined those who argued that privatization would see a shift in emphasis from the producer to the consumer: while that has happened the more noticeable shift has been to the shareholder. The fears for the future of the coal industry have also been vindicated, and this is considered at the end of this chapter.

2. Economics and Regulation

Vickers' and Yarrow's opinion that it is much easier to control a profit-maximising monopoly through public ownership than through competition and regulation has been illustrated in the difficulty experienced by all three regulators in getting the price formula right, and their criticism that the regulatory regime for gas was far too light was clearly correct. The fact that significant price reductions only occurred with the advent of competition justifies their reservations about the merits of privatization without liberalisation, and this, of course, casts doubt over the rightness of privatizing the water industry where in the core business competition is a non-starter. Their criticism of vesting the National Grid Company in the RECs also was justified, and although making it a separate company is an improvement, it must be an open question whether such an important part of the national infrastructure should be owned by a private monopoly.[140] Public ownership is not inconsistent with economic efficiency,[141] and it seems appropriate that major public facilities should be publicly owned, particularly if, as in the case of the Grid, it has to ensure equality of access to competing customers. The same argument applies to other true natural monopoly elements, namely the local

[139] Whilst the initiatives under the NFFO have been welcome, the whole matter lacks the urgency which it needs.

[140] In 1995 the Government announced its intention to float the National Grid Company. Since then the privately owned Grid has diversified its operations, the most successful being Energis, the telecommunication service attached to its high-voltage transmission lines. Energis earned the grid a huge windfall when it was floated as a separate company in December 1997, the net proceeds being £203 millions.

[141] See the comment by Vickers & Yarrow p.115, above.

electricity distribution network, the gas pipeline system, the water mains and sewerage system. 'Where monopoly exists...the case for preferring private ownership to public ownership weakens considerably: privately efficient profit seeking can no longer be expected to lead to socially efficient results.'[142] However, as Vickers and Yarrow point out, the problems of organisation and control in the utility industries are among the most difficult in the field of micro-economics, and although in their view public ownership is to be preferred where there are massive economies of scale and scope, high entry barriers, or externalities, it is likely to perform far from perfectly.[143]

The weakness of the economic case for privatization has been brought out by the need to strengthen the regulatory regime. Indeed, the key element of the whole process has been regulation. It is unlikely that any of the advances would have come about without pressure from the regulator, and it is notable that over the years all three regulators have extended their reach, changing the original light regime into something more robust. A good example of the effects of regulation is the 'environment-friendly' developments in electricity generation. It is possible that they would have happened anyway, but the likelihood is that privatization gave them an impetus which they would not otherwise have had. This is not because private enterprise is, of its very nature, more environment-friendly, but because privatization provided an opportunity to restructure the industry in a way in which these obligations could be imposed. The existence of an independent body in the form of the Regulator interposed between the Government and the industry, whose statutory duties are discharged free of political pressure, seems to be the device which made change possible. Regulation has, in short, been the means of constructing an ethical framework around the utilities. Those who, like Robert C. Brown, lamented the absence of the restraining influence of the ethics of public service, have in fact been proved wrong. Regulation has supplied a stronger ethic of public service than was apparent under nationalisation.

3. The Wider Aims

Of the the three 'cardinal virtues', reducing the level of public sector borrowing, and increasing efficiency may fairly be said to have been achieved (although Vickers and Yarrow consider that the PSBR was not reduced as much as it could have been[144]), but widening the level of share ownership probably has not. Studies have consistently shown that while share ownership is more widespread, the increase has not been significant. Most private investors saw their utility shares as an opportunity to make a quick capital gain, and sold them soon after acquiring them. The result has been a further concentration of

[142] Vickers & Yarrow, *op. cit.*, p.426.

[143] *Ibid*, p.428.

[144] See p.123 above. They also conclude that privatization has not been a resounding success when measured against the Government's criteria, *viz:* maximisation of proceeds and widening share ownership. They describe the redistribution of wealth involved as 'arbitrary' and to have resulted in higher taxation than was necessary: *op. cit.*, pp.192-3.

institutional shareholding.[145] The even wider aims of creating a property-owning democracy and increasing support for the Conservative Party have not been realised. On the contrary, although utility privatization was initially popular (partly because of the chance to make quick capital gains), in time the excesses of boardroom pay were seen as further examples of 'sleaze', and contributed to the Conservative defeat.

Perhaps the most important wider aim was to remove the politics from utility management, as part of the general New Right approach to economic policy. Here, there has been a partial success. Day-to-day management decisions are free of political pressure, but in important areas it has re-entered through back door of regulatory pressure. Policies on customer service, social justice issues and disconnection for debt are management matters, but the regulators have been active not only in shaping these policies, but in approving them in detail. It has proved impossible to keep the Government out of water management, whether in the commercial matter of water metering, or in the environmental matters of river levels and bathing water standards. Perhaps the best example are the proposals in the review of regulation to redress the imbalance between consumer and environmental interests on the one hand and shareholder and management interests on the other. What can be said, however, is that privatization has brought about clarity in the extent of Government involvement, and that is a major advance.

4. Summary

The operation of the privatized utilities in practice has modified the arguments both for and against privatization. Important aspects of the original aims have not been achieved, among them establishing a culture of popular capitalism. The policy of light regulation has proved impossible to maintain, and partly as a result of this the predicted adverse social effects have not come to pass. It has not proved possible to keep the Government out of utility management, although its role has been reduced. While in general the customer receives better value for money, the benefits of privatization have gone more to managers and shareholders, but far more serious is the slow progress in improving energy efficiency and environmental protection. Assessed against the Biblical criteria the record is patchy.

1. COMMUNITY The management of the utilities has been directed to individual benefit. Some of these, *e.g.* improved standards of service, may be regarded as beneficial to the community in the sense that the benefits are widespread, but

[145] See Vickers & Yarrow, *op.cit.*, pp.188-191. They comment that as a method of widening share ownership the privatization programme was inept: it was inordinately expensive, and it only encouraged share ownership in relatively few companies. In their view it would have been better to remove the incentives which exist for other forms of personal savings, *e.g.* tax relief on mortgage interest, and schemes for investing via institutions, *e.g.* life assurance. See also: Bishop Kay & Mayer, *op.cit.*, p.290ff; and Ken Heather, 'Privatization and the Distribution of Economic Power' (Association of Christian Economists Journal, No. 5, 1988).

essentially they are directed towards improving the *consumer* interest which is by no means the same as the *community* interest. Treating people as consumers leads to a society designed to satisfy wants - which are limitless. The community interest exists in part to preserve us from the hell of unlimited wants. Other benefits, *e.g.* increased executive salaries, serve no community interest at all. As private companies the utilities are run primarily in the interests of their shareholders, the community interest being incidental, and assumed to result from more efficient management. However, proposals in the review of regulation will go some way towards promoting the community interest, and if environmental targets are demanding enough, may help to secure appropriate communal goals.

2. *JUSTICE* Although social goals were, in general, not provided for in the enabling legislation they have been imposed through regulation. There has been an impressive concern for the poor, and companies have been reminded that their monopoly position is a privilege imposing on them duties which a normal competitive situation might not, especially in meeting vulnerable customers' rights and entitlements. As a result the needs of the vulnerable and disadvantaged have been recognised through special arrangements. This represents a substantial improvement over the situation under nationalisation.

3. *GIFT* There is no recognition of the special status of land or water; both are tradeable and a source of private profit. The need to conserve energy and protect the environment is accepted, for example in reducing water leakage, but practical measures are slow to take shape and almost invariably are too few too late.

4. *EGALITY* A competitive market is inimical to notions of equality, thriving as it does on inequality, a moral premis supported by the economic conception of efficiency. With the abandonment of uniform pricing, utility privatization shows that the principle of egality has been rejected, but the moves towards the equalisation of prices for pre-payment and credit customers has ameliorated the situation, but it is clear that market principles are to remain paramount, ruling out any direct subsidy to the poor from the rich.

Overall the early history of utility privatization illustrates the difficulty of achieving the fundamental aim of securing public social and environmental goals through a market system where the incentive is private profit. The problem of dealing with the effect of electricity privatization on the coal industry illustrates the point well, and encapsulates the issues in the whole of the ethical debate. It is a cautionary tale on which to end this chapter.

❑ DOING SOMETHING FOR COAL

Under nationalisation the coal industry enjoyed a special status, in fact if not in law, and the CEGB was required to buy a large proportion of its coal from British pits. Clearly this arrangement could not survive privatization, and in the Parliamentary debates the adverse effect on the coal industry was advanced as a major argument against the whole scheme. Apart from the effect on jobs and social cohesion in the mining communities, there seemed to be something morally wrong about abandoning the remaining coal reserves, estimated to amount to 300 years supply. Coal was also the first industry to be nationalised, and its demise was a powerful symbol of the passing of a whole approach to economic management. Coal symbolised the clash of social and moral values which the privatization programme generated. Jobs, community life, social cohesion, and stewardship of the earth's resources seemed clearly to count for less than notions economic efficiency based solely on price and the values bound up with monetarist economics. More particularly, coal gave a focus to the arguments in favour of a national energy policy, which were discounted in favour of the unfettered operation of market forces.

The problem was that British coal was expensive compared with imported coal, and companies entering the generating market tended to favour gas as a fuel, leading to the so-called 'dash for gas' as new generating plant was constructed in the immediate aftermath of privatization. In October 1992 the Government announced a pit closure programme which caused a huge outcry in protest. The Government did announce a package of measures to help the coal industry, but it was widely acknowledged as simply delaying the inevitable. The future of coal was brought into even sharper focus in 1997 as the industry anticipated the end of the so-called 'back-to-back' contracts in April 1998.[146] The three major generators announced substantial reductions in their purchases of British coal, prompting fears that as many as eight pits would have to close with the loss of 5000 jobs. In a related move, RJB Mining, owner of most of the privatized coal industry, had earlier challenged the validity of the so-called 'take or pay' contracts which the RECs had signed with gas-fired stations. These contracts obliged the suppliers either to buy a given quantity of power or to compensate the generators. They had been entered into to provide competition to the two main generators, but RJB argued that the contracts were anti-competitive because coal was a cheaper fuel for generation than gas, and denied them an opportunity to compete on a level playing field. OFFER had declined to intervene taking the view that the contracts promoted competition, and the dispute was referred to the European Commission. It was part of a much wider argument about prices in the electricity pool, which was widely held to be 'rigged' against coal.

[146] These contracts, signed in 1993, allowed the generators to pass on to customers the costs of having to buy higher-priced British coal.

Christian sympathies were often with the miners, and powerful theological arguments were adduced in aid. Nigel McCulloch, the Bishop of Wakefield, argued for wise stewardship of the resources with which God's creating power had provided: 'Such precious gifts are there to be used in a responsible and complementary way. It is utterly deplorable that no Government in this country has yet produced a long-term strategy which balances the use of fossil fuels and renewable energy.... [W]hat is required...is a thought-out vision for the future rather than a short-term political fix.'[147] He also argued for a wider vision of economic policy, reiterating a point made by the Churches Energy Group that economic policy is about people, and not just about money. The effect of pit closures on mining communities and families showed that something was wrong at the heart of the policy.

The Labour Government was reported to feel that 'something should be done for coal,[148] and a moratorium on further gas-fired plant, often mooted but never pursued, was now seriously considered. The main problem was that 'doing something for coal' gave generators with coal-fired plant (*i.e.* the tri-opoly) an advantage in the generating market, and it was this market which needed to become more competitive if electricity prices were to fall. Allowing new entrants into the market meant either permitting the construction of new gas-fired plant, or making the coal-fired plant which had been closed available to other generators. Critics argued that the result of 'doing something for coal' would be not only higher electricity bills, but also the loss of 300,000 jobs in the gas and construction industries. Both OFFER and the House of Commons Trade and Industry Select Committee opposed a moratorium because it would be anti-competitive, ministers argued that it would help to ensure security and diversity of supply. The measures were announced at the end of June 1998, and fell well short of securing a long-term market for coal; at best it was an attempt to level the playing field so that coal had a chance to compete fairly against other fuels. The package comprised pressure on National Power and PowerGen to sell some of their coal-fired plant (which has been done[149]), a halt in the construction of most new gas-fired power stations; fitting de-sulphurisation equipment to coal-fired stations to meet the Government's environmental targets; reform of the electricity pool; and a temporary moratorium of just over a month on all new power station consents to allow consultation on the plans. The measures seemed to represent a dual admission: that the market had been moving slowly against coal - maybe for

[147] The Church Times, 5.3.1993.
[148] *The Independent*, 5.5.1998.
[149] On the day after the measure were announced, PowerGen was reported to be on the point of agreeing a sale of 4.000MW of capacity (the equivalent of two big coal-fired stations) in return for Government approval of its bid to take over Midlands Electricity, and Eastern Electricity announced that it was fitting de-sulphurisation equipment to allow its power station at West Burton to continue to burn British coal.

twenty years,[150] and that attempts to 'buck' the market were likely to be ineffective. Free market purists, who were sharply critical of the measures, seemed to have overlooked two points: the fact that coal is a cheaper fuel than than gas for electricity generation, and that the original privatization plan had inevitably skewed the market in favour of gas. Michael Harrison put the point thus: 'By allowing generation to be sold off as a duopoly between National Power and PowerGen, it gave the regional electricity suppliers every incentive to build their own generating capacity so as not to be held to ransom.'[151] The key element in the package is the reform of the electricity pool so that it operates like a normal market with prices being established through direct bargaining between sellers and buyers. In this way coal plants with low marginal costs will be called on more often, producing a larger market share for coal and cheaper electricity. Something like three years is required for this system to become established, and in return for longer-term gains, the Government has been willing to forego an immediate improvement in competitiveness and to delay environmental benefits. The result, therefore, may be seen as an appropriate use of Government power to make the market operate more justly. In October 1998, the new Secretary of State confirmed the ban on gas-fired plant, refusing to put a date on when it would end - a clear sign that he wanted to give the transitional arrangements enough time to work. Politically, it appeared an astute use of market forces to end the dash for gas and preserve the remains of the coal industry. However, the point which the debate never addressed was the really long-term situation. Gas supplies are finite, and closed pits cannot be re-opened, except some, possibly, at massive cost; when the gas supplies run out will the abandonment of so much of the coal reserves seem to have been the path of wisdom?

[150] This movement had accelerated considerably since 1992 when coal still commanded 66% of the market with gas a meagre 1.4%. Only five years later in 1997 coal's share had slipped to 33%, and gas had risen to almost 30%. At the time of the announcement 10.000MW of gas generation capacity were already under construction, enough to increase the market share for gas to 50%. The measures were designed to prevent that share rising to 75% by 2001. (*The Independent* 26 & 27.6.1998.)

[151] *The Independent*, 26.6.1998.

VII

An Ethical Assessment

Chapter I identified five ethical issues raised by the privatization of the utility industries: the proper role of the state, controlling the abuse of power, incentives, stewardship, and the balance of benefits. The following chapters examined the case for privatization and assessed it against the ethical criteria developed in the review of the social teaching of the Church. This final chapter returns to the five issues and discusses them in the light of the previous chapters, considering especially the theoretical arguments in the light of the performance of the industries since privatization. The chapter concludes by linking the conclusions of this discussion with the three basic moral tensions noted at the end of chapter I, *viz.* between value and truth, conservation and exploitation, and the individual and the community.

1. The Moral Context

The utilities were privatized for reasons which were more political than economic, and this means, as was argued in chapter I, that privatization was essentially a moral programme. Indeed, privatization was part of the 1979 Government's aim to bring about a cultural revolution - to change the soul of the nation. The values motivating the programme are brought out clearly in the Parliamentary debates, and the fierce argument between the proponents and the opponents of the programme is part of the ongoing debate between conservative and progressive opinion. However, in the 1980s that debate took a new turn as radical conservative ideas were presented as the truly progressive option, particularly in the form that those ideas were implemented by the New Right. This grouping - a loose, right-wing coalition rather than an organised party - was distinguished by the way it used liberal economic ideas to justify its moral positions. A change in the value system, one of the 'heavy structures' of society, was being brought about by allowing economic criteria to determine matters which until then had been determined by cultural, social or religious considerations. The hallmark of the new morality was an uncompromising emphasis on efficiency, competitiveness, monetary incentives and private gain as opposed to equality, community and public service; and one of the great fears which the privatization of the utility industries aroused was that they would be run simply for profit, in the interests of the shareholders, and that proper provision for the poor and vulnerable together with jobs, community and environmental interests, would be sacrificed on the altar of economic efficiency. These fears were heightened when it became apparent that large monopoly undertakings, hitherto in public ownership - to ensure they operated in the public interest - were to be converted into private monopolies cut loose from political control.

Privatization took place in the context of a change in ideas about economic management, namely the move away from Keynesian to monetarist theory. On the surface this change represented a new understanding of the way the economy works, but at deeper level it was about the values which should shape society. Keynes favoured Government intervention in economic management to bring about social change, notably reducing unemployment and producing greater equality. While Friedman also favoured greater equality, he insisted that intervention was not the way to achieve it; market forces would do the job better. But market forces are blind to inequalities in market power, with the result that in a free-market economy inequality actually increases. Although this outcome may not be what monetarists personally desire, it is notable that a preference for market solutions goes hand-in-hand with a preference for the private provision of welfare and other social needs, for limited government, and for limiting the power of worker interests - in other words for individualist rather than collective values. In practice it is impossible to reconcile Christian notions of social justice with a free market economy. The debate between Keynes and Friedman about the way the economy works thus turns out to be a debate about the sort of society we wish to live in. Monetarism's spiritual home is the liberal economics of classical theory and its belief in the market as part of the natural order. This belief had a powerful effect, because if the market is part of the natural order, then certainly in the long-term - and maybe sooner - it is impossible to resist the working of market forces. The result is to raise the market to the status of a demi-god. Thus theological as well as moral and economic foundations underlay the new approach.

Using economic criteria to determine moral and social questions means, in practice, giving free rein to utilitarian values. Economic analysis may look objective when it asks What are the objectives set for this enterprise, social as well as commercial? and then goes on to consider how those objectives may be achieved most economically, but it rests upon certain assumptions which are far from being value-free. For example, Vickers and Yarrow assume that the objective of the utilities is profit-maximisation, an assumption which rests upon a congeries of values. Moreover, the economic system upon which their analysis is based is that of the free market, and this in turn rests upon certain axioms or beliefs which are value-laden.[1] One belief is that optimum economy in the operation of a business will be achieved through competition with other businesses; a second is that people are motivated by incentives, the chief of which is the prospect of personal financial gain; and a third is that welfare is to

[1] The fact that these beliefs may be supported by empirical research does not alter their character as value-laden. The empirical is not, *ipso facto*, excluded from the moral.

be assessed by utilitarian, Paretian concepts. Thus, despite its apparent objectivity, economic analysis brings to bear its own set of values upon the privatization debate.

These political and economic views are a direct challenge to those developed by Christian social teaching with its emphasis on the well-being of the community as the primary criterion for economic activity, and its denial that competition is an adequate basis for ordering human society. Instead the Bible points to solidarity as the fundamental social principle, the rich accepting a duty to help the poor, and to the condition of the poor, the outcast and the marginalised as the acid test of the justice of an economy. Moreover, Christian social teaching insists that there are some goods which cannot be subject to market transactions: it *is* literally true that some commodities are beyond price. The Social Encyclicals and other official statements have been sharply critical of liberal economic theory, insisting upon the subordination of economics to ethics, the priority of labour over capital, and the duty of Government to regulate the operation of the market. The doctrine of the common good stands as a counter to all individualist ideas of economic management, and is understood to require a 'preferential option for the poor.' Questioning the dominance of economic ideas, Paul VI asked rhetorically, whether there was not 'a radical limitation to economics' which rendered it inappropriate to determine social structures? And John Paul II pointed to the flawed conception of the human person which underlay both capitalism and communism, namely one which reduced people 'to the sphere of economics and the satisfaction of material needs'. He also insisted on the duty of the state to defend the provision of collective goods essential to human flourishing, and the duty which God has placed on humans as stewards to protect the earth from excessive and disordered exploitation.

Against this other Christian commentators have argued for a more sympathetic position. For example, John Atherton believes that Christian teaching must move with the times and take full account of the fact that the free-market is the only economic option now available and accord recognition to its virtues: self-interest, efficiency, competition and individualism. Social doctrine, he argues, must be more open to the provisionality of human constructs, abandoning the 'map-making mindset' which seeks to resolve all conflicts in a single Christian order or understanding of the world.[2] Both he and Wogaman accept a limited autonomy for economics, suggesting that the subordination of economics to ethics cannot be absolute. Liberals like Preston, while sharply critical of New Right thinking, also criticise papal and ecumenical statements for putting doctrine above evidence, believing that there is no distinctively Christian answer to social and economic problems. Intriguingly, others from the right,

[2] John Atherton, *Christianity and the Market*, chs.7 & 9.

e.g. Brian Griffiths,[3] seek not only to justify the capitalist case from scripture, but also to establish clear biblical principles which will govern economic activity. Michael Novak develops an approach from a distinctly American perspective, justifying capitalism from papal teaching and reformulating basic concepts like social justice in the process.[4]

The Christian moralist has a wide variety of positions from which to choose. The variety shows that in both the Church and society political affiliation is a prime influence on the way the ethical debate is conducted, and of course, theological stance is also a determinant of moral judgements. If economics and politics cannot be freed from the perspective of the observer, then, it seems, neither can social doctrine. This alone suggests the impossibility of taking any definitive Christian stand, and the comments below are offered in full awareness of the personal perspective they represent. However, all are agreed that at the heart of Christian concern about economic theory and practice - Keynesian as well as liberal - are basic moral and theological issues. This study has identified five such issues, and they are now considered in turn.

2. The Proper Role of the State

Privatization arose out of the rejection of the post-war consensus in economic management, particularly the idea that the state had a role to play in managing industrial enterprise and determining the allocation of scarce resources. Thus it raised directly and fundamentally the question of the proper role of the state in economic management. Chapter V argued that from a Christian perspective the economic role of the state must include action to secure justice by appropriate regulation of the market according to moral criteria. It also argued that it was proper for natural monopoly functions to be state owned. These conclusions draw more on Papal and ecumenical teaching than on the Bible, because the Bible has no doctrine of the state (as was shown in chapter II). It does, however, insist that all authority is carried out under God, and this implies that power must be subject to moral and theological conditions. In modern times this insistence has been developed by the Popes and the WCC into a duty lying on the state to remedy social injustice, especially economic inequalities, and to secure the common good, one of the 'givens' of public life.[5] The Second Vatican Council declared that the fulfilling of social obligations was 'a sacred duty'[6] which could not be left to the free market. Thus the role of the state goes well beyond that advocated by economic liberals. The Papal concern for the proper provision of social goods, an aspect of the common good, requires a strong public sector, Paul VI advocating social programmes for the

[3] Brian Griffiths, *Morality and the Market Place*, and *The Creation of Wealth*.

[4] Michael Novak, *The Spirit of Democratic Capitalism* (London: Institute of Economic Affairs Health & Welfare Unit, 1991); and *The Catholic Ethic and the Spirit of Capitalism* (New York: The Free Press, 1993).

[5] One of the clear emphases of Christian social teaching, catholic and protestant alike, is that the common good is essentially something 'given'; it is prior to democratic decisions.

[6] *Gaudium et Spes*, section 30.

alleviation of poverty, and John XXIII going so far as to argue that the common good might require the state to take over the means of production. There is also a marked concern about the concentration of economic power, and the concept of subsidiarity, which aims to facilitate the proper functioning of the community by placing responsibility for different activities at the lowest appropriate level, has been developed as a counterbalance to this. Allocating responsibility to the appropriate level is part of the state's duty to provide the juridical framework for economic activity, the over-riding aim, according to John Paul II, being to create a community of 'free work, enterprise and participation.'[7] Another response to the problem of power is the development of the concept of structural sin, which presents a demanding critique of the values on which a power structure is actually based.

Privatization *as a concept* amounts to a rejection of much of this; paradoxically *in practice* it shows that it has much validity. The arguments about energy policy are in point. On the one hand it was argued that the Government must retain control over vital national assets like fuel supplies, and must be able to control the rate of depletion. Here value is placed on proper stewardship (a point considered more fully in section 5 below), and upon ensuring that everyone has reasonable access to energy supplies. Thus Lord Lovell-Davis argued in the electricity debate that an integrated energy policy was necessary because energy resources are finite; it was proper for a Government to ensure efficient, safe, reasonably priced energy, while at the same time conserving vital supplies of gas, coal and oil, upon which the economy, society and civilisation depended. Against this it was maintained that supplying gas (and presumably electricity and water too) is a commercial activity like supplying petrol; an energy policy is a chimera, what is important are the needs of customers, and not bureaucratic decisions taken in high places.[8] On this view value is placed on the autonomy of the market, and the need for economic growth; questions of scarcity are not really faced - indeed it was notable in the gas debate that conservation was not among the issues raised. Consistent with this New Right view, the disbandment of the Department of Energy after electricity privatization signalled the end of the need for an energy policy; once it is all in the private sector there is no need for policy co-ordination, the market does it naturally. As Dasgupta has said this is the consequence of the ascendancy of the marginalist school: economics became a matter of distributing given resources among competing claims and eschewed concern with wider issues like managing demand and conserving resources.[9] But these wider issues will not go away. Climate change has made Governments aware that energy cannot

[7] *Centesimus Annus*, section 35.

[8] In the electricity debate Harry Barnes pointed to the equal danger of control over vital national services passing into the hands of equally remote cartels and conglomerates. 'Are we to have', he asked, 'special legislation to prevent interlocking directorships when the barons of industry grow up to control what is being done.?' It is now evident that through the take-overs which have taken place the danger to which Mr Barnes alluded has been realised.

[9] Dasgupta, *op. cit.*, p.77.

be treated like any other commodity (supplying petrol should be treated the same way as supplying gas, and not *vice versa*), and there is now international concern about the harmful effects of of energy production which is requiring action from Governments.[10] In the UK this has resulted in tax changes, stronger emphasis on renewable sources of energy, and the requirement that the regulators co-ordinate their approaches to environmental issues. A minimalist view of the state's role is simply not in keeping with the needs of the times.

The same story is repeated in the development of regulation. The original intention was for light regulation, but this has proved inadequate, and over the years the regulatory regimes have been progressively strengthened, the latest development being the creation of a single energy regulator. The regulators have all moved well beyond purely economic matters, and by insisting that social obligations have priority, have provided a moral framework around the utilities, sometimes occasioning complaints from management that they were being pushed further than it was economic to go. It has also proved impossible to keep the Government on the sidelines; perhaps the best example is the 'water summit' held by John Prescott, and the call for leakage repairs to be carried out free of charge. Thus the actual practice has been more interventionist than economic liberals would want, and is more in line with Christian expectations that the state will use its power to ensure that the poor, including Paul VI's 'new poor', are protected. In the water debate the New Right conceded that there were some functions which the state could not discard, and, in the end, the Government stopped short from privatizing the regulatory functions of the Water Authorities. In a further step down the same road the Government has announced that the power to disconnect water supplies for debt is to be abolished. It is right that such a power, with such severe effects on everyday life should not be vested in a private company answerable only to its shareholders. And is there not merit in the argument that because clean water and sewerage are so important to public health, it is wrong for the Government not to retain an interest, at least, in the management of the water companies? and also in the argument that differential pricing may have an effect on population policy, accelerating the movement from rural to urban areas. Is this a power that should lie in unaccountable hands? The questions multiply; can the view of the limited state really be maintained in today's complex society?

The problem is knowing where to draw the line; it is all too easy to load functions on the state - the ever-present temptation of Keynesian theory - only to discover that it cannot cope. Can it even determine the public interest? Keith Raffan in the water debate maintained that 'one of the fallacies of public ownership is the assumption that because an industry is nationalised it will

[10] *Cf.* David Jones, *Energy Policy Now* (London: IPPR, 1992).

automatically look after the public interest.' The unspoken assumption is clearly that a privatized industry is just as capable of looking after the public interest, but what is omitted is any consideration of precisely how that interest should be defined. The problem is that the interests of the deciding body become equated with the interests of the public. Vickers and Yarrow argue that the problem of the nationalised industries was one of Government failure. They were left to operate with virtually undefined objectives, and many of the innovations brought in with privatization could have been introduced under pubic ownership,[11] but it suited the Government to leave things undefined and fluid because it provided extra means for furthering their political aims.

Market economics views politicians competing in the market for votes. The public interest is not something fixed and objective, but fluid and open to negotiation, so economists would be wary of ascribing its formulation to any one institution, and there is no economic sense in the notion of the givenness of social objectives. Vickers and Yarrow describe as 'heroic' the idea that the government can represent the public interest,[12] but it is implicit in their analysis that the government will set the basic objectives which the utilities are to pursue. If these objectives are to be achieved in free market conditions the proper role of the state is to promote free competitive conditions, in particular by controlling the market power of large corporations. One way in which they believe this will be achieved in utility industries is by the state owning the network, the natural monopoly element; another is for the Government to set the moral framework, including the social obligations, within which the utilities must operate. This is some way from the New Right view; the public interest is not the sum of individual self-interests aggregated by the invisible hand. Controlling market power, in order that the market actually works efficiently, requires that the guiding hand be visible and strong! But that is as far as it goes. Economics has no view on the importance of security of supplies - that is a political decision, an externality in economic terms. It is part of the proper role of the government to decide on conservation policies; if they choose to adopt such a policy then the economist will point out that that will result in a market failure, which will need compensatory regulatory arrangements to restore a competitive environment.

Despite the problems, can it seriously be maintained that the public interest can be determined otherwise than by publicly elected and accountable bodies? And even so, would not Christians say, as the Popes have insisted, that there is

[11] Vickers & Yarrow, *Privatization and the Natural Monopolies*, pp.10-12. The examples are the arms-length relationship, market liberalisation, direct access to capital markets, independent price regulation and new managerial incentives. In chapter 4 they argue that the case for electricity privatization rested essentially on the the likelihood that without it the Government would not make the necessary reforms.

[12] See note 46 on p.116 above.

a higher authority?[13] The early experience of privatization shows that that authority cannot be ignored, even though there is no explicit recognition of its origin. Economic structure cannot be entirely separated from social and moral structures, and an important role of the state is to bring them into alignment. There are, though, matters for concern. As will be argued in section 5 the state has given up any role in the stewardship of natural resources, for example seeking to control the rate of depletion of natural gas supplies or to conserve coal supplies, and has left to private initiative responsibility for ensuring an adequate infrastructure, matters which might be thought to lie within its proper role. Differential pricing, while being economically sound, does not respect the principle of the person-in-community because it penalises those who live in remote or poorer areas. This was, after all, one of the grounds on which the privatization of the Post Office was resisted. Overall, the outcome seems to be that the limited state cannot be maintained in today's complex society. The market as well as the Government may err, and corrective action will be needed to ensure that it serves the common good. A Christian view of society would anticipate this outcome. Human beings and human institutions are finite, and justice is always something which has to be worked for.

3. Controlling the Abuse of Power

Privatization involved creating large private monopolies and, in the case of the water industry, transferring public functions to private bodies. A major concern thus arises about how these powers are to be controlled so that they serve the common good. Christians generally have not adopted the Lutheran willingness to submit to the acts of the Government. More consonant with the spirit of the times is the perspective of liberation theology that political and economic power can be used as an instrument of oppression, and that the Church's prophetic voice, and its prophetic actions, must be used in checking the exercise of such power. From the Bible onwards this has been a consistent theme. The prophets and scribes were concerned to subject the power of kings and priests alike to the Law, and there was an early concern for the dispersal of power as an important element in checking its abuse. Echoing this the Popes showed a marked concern about the concentration of economic power, and developed the doctrine of subsidiarity as a means of countering it. Nor were the Popes content to leave the control of power to the competitive forces of the market. They warned against the greed of unchecked competition, and rejected the liberal ideology upon which it was based as serving the narrow interests of the economically powerful rather than the common good. In particular the common good required a concern for distributive justice, taking everyone's interests seriously, especially those of the poor and disadvantaged, and the doctrine of solidarity was developed to give full expression to this requirement.

[13] This has been a consistent theme in papal and ecumenical teaching, *e.g.* John Paul II's point in *Centesimus Annus* that the earth has a prior God-given purpose; p.66 above.

The transfer of important powers from public to private bodies raises two issues: What mechanisms are proposed to check the abuse of these powers by their new 'owners'? and Have the new arrangements have improved control over the exercise of power by the Government?

Taking the second question first, clearly privatization has brought about an advance, and it was one of the few issues upon which both Government and Opposition agreed. In the Water debate attention was drawn to the way the last Labour Government made changes to the Alkali Inspectorate, Labour members having criticised Conservative Governments for similar interference, the point being that no Government can resist the temptation to tinker with the system, especially when there is some prospect of political advantage accruing from the changes. It is agreed on all sides that this tinkering was easy when the relationships between Government and the utilities were 'in house'.[14] Making the relationship more open certainly offers more protection from abuse of power by the Government, but it is a long step in the argument to say, as many members did, that economic decisions should always be independent of political influence. This was argued strongly by Lord Harris. The overriding objection to the previous public monopoly of water was, he said, that it united economic and political power 'in the same frail hands.' For him, the main benefit of privatization was that it separated economic activity from direct political control; pricing and investment decisions would no longer be perverted to serve short-term political goals.

This view assumes that a clear line can be drawn between economics and politics. This is by no means axiomatic. Seeing economics and politics as separate activities is itself a political choice determined by the sort of society one wishes to bring about.[15] Moreover it fails to be aware of the close connection between economic and political power. As Wogaman has said, 'economic power drifts so easily over into political power', and 'private economic power on a large scale makes it much more difficult for the whole of society to control its own economic destiny.'[16] The contemporary concern about the concentration of media power illustrates Wogaman's point well, and shows that the problem spills over from purely economic policy to political and social policy

[14] Lord Jenkin, a former Secretary of State for the Environment, gave a good example of the wrong kind of interference that privatization will end. During his term of office, the Treasury refused to allow the Yorkshire Water Authority to raise money on the capital market to finance the construction of a new sewage works by a private contractor. The works would have been owned by the contractor and operated on a long-term contract with the authority, but the Authority could borrow money more cheaply than the contractor. The Treasury's obstinacy meant that the project cost more than it need have done. While this example illustrates the point made in the text, it does not support the conclusion drawn by Lord Jenkin, viz. that the whole system needed privatizing. All that needed to be done to meet his point was to change the rules about public bodies raising funds on the capital market - as was promised when the proposal to privatize the Post Office was withdrawn.

[15] The issue is discussed by Wogaman, *Christians and the Great Economic Debate* (London: SCM Press, 1977).

[16] Wogaman, *ibid*, p.160.

also. It is because the Bible has a clear view about the sort of society which promotes human flourishing that economic matters are not placed in a category of their own; all aspects of life are subject to the same overall divine imperatives, and are regarded equally as part of worship.

It was argued in chapter I that a society in which the economic is freed from the political in fact works to the advantage of the economically powerful and against the interests of the economically weak, and inevitably becomes a society in which the economic is freed from the ethical. Supporting the Christian concern at such an outcome, the economic case shows that it is also sub-optimal. With all three utilities there are substantial economic criticisms of their wholesale transfer into private ownership, and in the case of the water industry the economic analysis fatally weakens the argument in favour of a private monopoly. While this neatly illustrates Lord Harris' point that that economic decisions should not be perverted to serve short-term political goals (the political equivalent of Ahab's seizure of Naboth's vineyard), albeit in a way contrary to his intention, more fundamentally it means that economic decisions must reflect the overall vision of the person-in-community. The check on the abuse of power which Lord Harris seeks to achieve by ascribing an autonomy to economics, is achieved better by ensuring that economic decisions comply with theological and moral criteria and are consistent with underlying social policy. The mechanism for doing so poses a problem, but essentially it is the same as in Ahab's day, namely by prophetic pressure. The work of Christian Aid, *CAFOD* and other groups in the Jubilee 2000 Coalition to bring the IMF, World Bank and G8 policies on Third World Debt into line with the Biblical vision of justice is an example of such pressure at work.

On the other hand, there is a proper Christian concern at the concentration of power, and placing political and economic power in separate hands has its part in guarding against this, and it also satisfies the principle of subsidiarity.[17] This is, of course, the basis of the argument for an independent central bank, and it applies with some force to the commercial operations of the utilities. That privatization gave them commercial freedom seems to be something which Christians can welcome, even if questions remain about whether privatization was the appropriate way to achieve this.[18] Nevertheless, Christians would also insist along with the Vatican and the WCC that the exercise of this freedom is constrained by overriding moral requirements. Lord Harris might agree with this in principle, but it is likely that his conception of these requirements would

[17] While subsidiarity operates as a check on the abuse of power, it has its limits. It could be used 'to justify in broad terms the very unchecked liberalism which Pius XI and successive other popes have condemned.' Michael Walsh, 'Laying the Foundations', in Paul Vallely (ed), *The New Politics*, p.37.

[18] As noted above, Vickers and Yarrow believe that this and the other innovations of privatization were all possible under public ownership. (Vickers & Yarrow, *Privatization and the Natural Monopolies*, pp. 11&12.) It is notable that following the withdrawal of the proposals to privatize the Post Office it was announced that the Government would consider ways of giving the Post Office greater commercial freedom within the public sector.

be formal and procedural, whereas Christian social teaching sees them as substantive and distributive, *i.e.* concerned with outcomes.

On the first point (the control of the powers of the privatized utilities) Christians can also welcome the much more open regulatory regimes which now apply to the utilities, particularly following the requirement to give reasoned decisions, and they might argue that similarly open regimes should be put in place for other state functions.[19] And this in turn bears on the point made above about who is to determine the national interest. While it is right that this can only be done properly by publicly accountable bodies, this does not mean that any one such body should have a monopoly. Christians are aware that groups as well as individuals can err (as the Biblical stories about the bad advice given by the court prophets show[20]), and believe rather that the truth emerges through the testing of spirits. The constitutional equivalent seems to be the balance of powers. Independent regulation is part of this balance, but a major concern remains whether the regulators are in fact strong enough to check abuses of power by the utilities. The initial spate of take-overs in the electricity industry, which showed that the RECs had managed to conceal their true profitability from OFFER, showed that this concern is well-founded and that light regulation was simply inadequate for the job the Regulators were expected to do. Changes have been made since then, but it is too early to decide whether enough has been done.

Competition and public accountability are two ways of ensuring that those with political or economic power use it in the public interest however that interest is defined. Privatization removed public accountability, but initially it did not put effective competition in its place. One of the consistent criticisms of all three privatization schemes was that there is no effective competition at the point of consumption. The gas scheme left British Gas as a huge monopoly buyer and provider; the duopoly in electricity generation was scarcely better, the regional electricity companies until recently were local monopoly buyers and suppliers, and the regional water companies remain so. Competition is too recent a development to know whether it will have as much effect in ensuring that the privatized utilities use their powers for the common good, *e.g.* in improving energy efficiency, as it has had on price and levels of service. There is though a case to be made that the utilities should be subject to greater public accountability than is normal for a public limited company. Although privatized, they control vital national resources; they have important public powers in matters of health and safety, and in the case of the water companies, environmental protection; aspects of their businesses are natural monopolies;

[19] The benefits are illustrated by the fact that the nationalised Water Authorities, which combined regulatory and utility functions, did not apply their powers to control water pollution to themselves, nor indeed to other polluters either. The work of the National Audit Office has already begun this process.

[20] *E.g.* The story of Micaiah in *I Kings 22.*

and they do not face the same commercial risks as other enterprises simply because of the essential nature of their products - as Lord Russell pointed out, they could not be allowed to go into liquidation. As has been argued in chapter VI, it is impossible to treat the utilities on the same basis as other public limited companies, and a greater element of public accountability seems an appropriate price for their privileged position. Competition is not a panacea.

Monopoly power heightens the problem of control, and this underlay the argument whether a public monopoly is to be preferred to a private one. This question was in the background of the Parliamentary debates, but it was never argued out. The closest Parliament got to doing so was in the water debate. The Opposition called Joseph Chamberlain as a witness in support of the preference for public monopolies. His criteria for control remaining with 'the representatives of the people' were two: (1) that the monopoly was sustained by the state, and (2) that it was in the interests of the inhabitants generally. The introduction of competition has meant that the first condition is no longer satisfied for most of the gas and electricity industries, though it remains true for water and for the gas and electricity networks. The second condition applies to all three utilities, but the history of nationalisation undermines Chamberlain's argument: the representatives of the people have not been particularly effective in ensuring that the utilities serve the common good. As noted in chapter IV, the only speaker to pose criteria of his own was Earl Russell (perhaps no one else did so because, as he acknowledged, the task was 'difficult'). He proposed three criteria: (1) Is the industry a natural monopoly? If it is, the presumption must be that it is not entirely suitable for private ownership. (2) What are the objectives to be set for the industry? Are they essentially commercial, or essentially a service? If the latter, again the presumption must be against privatization. (3) Could the industry be left to go bankrupt? If not, again the presumption must be against privatization. Judged by these tests all three privatizations are found wanting, and Lord Russell's criteria provide a clear basis for distinguishing the supply of gas (and electricity and water) from the supply of petrol.[21] For the Government Lord Harris referred to the opinion of Milton Friedman that on balance a private monopoly was preferable to a public one, but he did not give Friedman's criteria, though this opinion is no surprise given his strong preference for a limited state. Apart from this the Government supporters generally relied on the argument that the anticipated gains in managerial efficiency and in attracting private capital outweighed the disadvantages of creating a private monopoly (not that any disadvantages were admitted), and that the disciplines of the capital market would be a better check on management than bureaucratic control. This claim

[21] Supplying petrol involves no natural monopoly, and is much more clearly a commercial activity than a service. However, there are other reasons why an element of public control might be necessary over the oil industry. In the order of need oil should be equated with electricity: both are essential to the modern economy, though neither is essential to life; and in terms of scarcity oil is a finite resource like gas: there is public interest in controlling the rate of depletion.

is difficult to substantiate. While it is clear that the threat of take-over is a powerful incentive to improved performance, the way those threats have been repelled has resulted in far better gains for shareholders than for customers. Bureaucratic control might have ensured a better deal for customers without the loss of capital through the distribution of special dividends. But more importantly, it is evident that the capital market, like any other market, works in the interests of the strong. (A notorious contemporary example is the computer software market where Microsoft, the dominant company, has created a virtual monopoly.) The acquisitions policy of the largest utilities, creating multi-utilities, is a step down the same road, and has more to do with concentrating power than with economic efficiency. Not only does it violate the principle of subsidiarity, it weakens the mechanism of control because of the scope it gives for concealing information from the regulator. As Pius XI insisted, 'the proper ordering of economic life cannot be left to free competition';[22] the market must be regulated. Responding to these concerns the Government introduced in the Competition Act 1998 fines for abuse of dominant position.

Economically the key issue in controlling abuse of power is openness. Political control over the nationalised industries had been both more extensive than originally intended and conducted largely through informal channels with no system of public accountability. Privatization has ended that system and opened up the control process; the question it raised, though, was whether that openness would be bought at the price of a loss of public accountability. Economic analysis illuminates both points. A competitive market works to improve the flow of information, thereby improving openness and reducing the opportunities for the abuse of power. However, only recently has this had any effect on the utilities. In practice the problem of the control of political power has simply been replaced by the problem of controlling market power. Privatization may have removed the abuse of power which concerned the New Right, namely the discretionary powers of ministers, but it has made possible a different abuse to which they are blind, that of market power.[23] The crucial element here is the regulatory regime, and the present proposals to strengthen the regulatory regimes are to be welcomed.

One of the marks of the Church's re-engagement with the ethics of economics was a move away from its tendency to ally itself with the establishment,

[22] *Quadragesimo Anno*, section 88.
[23] Even beyond the New Right public debate has shown a reluctance to embrace standard Keynesian analysis which demonstrated that achieving social goals necessitates a substantial extension of the functions of Government. See R. Lekachman in R. Skidelski (ed), *The End of the Keynesian Era*, p.65: 'The curious irrelevance to public debate of standard Keynesian analysis is the result of stubborn resistance on the part of conventional economists to the structural features of economies in which the free markets of their models are less and less important and the allocation of resources is dominated by the interplay between private market power and Government authorities, who sometimes resist that power but more often serve the will of those who yield it.'

whatever form it took, and to be more critical of those in authority, even to the point of working against an economic system which no longer serves the common good. An early concern was with the concentration of economic power, which Pius XI described as 'despotic economic domination',[24] and in time other concerns were added, *e.g.* the priority of labour over capital, the responsibility of the state to defend the 'collective goods' without which society cannot function, and, more recently, the need to safeguard the environment. These all feature in the criticism of liberal economics which is a strong theme running through the social teaching of both the Popes and the WCC, and reflect a deeper concern that liberalism is simply not adequate to control the power of the dominant economic interests and ensure that the requirements of social justice are met. The paradox is that liberalism, which itself was conceived as a check on the exercise of power, is equally capable of becoming a source of oppression and a denial of justice, and the essential point of the Christian position is that all power, whatever the system through which it is exercised, must be exercised within a moral framework. This is precisely the point made by John Paul II in *Centesimus Annus* when he insists that if capitalism aspires to be the universal economic system, its aspiration can only be blessed if it is 'circumscribed within a strong juridical framework which places it at the service of human freedom in its totality, and which sees [itself] as a particular aspect of that freedom, the core of which is ethical and religious.'[25] As Clifford Longley has said, the Pope thus deprives economic liberals of their 'favourite doctrine', namely the 'independence of political and economic action from moral and religious scrutiny.'[26] In the same vein the Catholic Bishops in the autumn of 1996 rejected as contrary to Catholic Social Teaching the belief in the automatic beneficence of market forces. On the contrary, they say, 'It insists that the end result of market forces must be scrutinised and if necessary corrected in the name of natural law, social justice, human rights and the common good. Left to themselves, market forces are just as likely to lead to evil results as to good ones.'[27] Controlling the abuse of power is not just a matter for constitutional checks and balances; it is also about creating the proper moral dimension, as Adam Smith accepted. This seems to be recognised in the way the regulators have used their powers to bring an element of social justice to bear on the way the utilities actually operate, especially in those areas where they have monopoly powers. A good example is the way Ofwat has reminded the water companies that as monopoly suppliers of an essential commodity they occupy a privileged position which places them under an obligation to take reasonable steps to assist customers in difficulties. The introduction of competition does not remove the need for a moral framework, nor the role of the regulators in building it.

[24] *Quadragesimo Anno*, section 105.
[25] *Centesimus Annus*, section 42.
[26] 'Structures of Sin and the Free Market' in *The New Politics*, p.108.
[27] The Catholic Bishops' Conference of England and Wales, *The Common Good*, paras 76-77.

4, Incentives

A major element in the case for privatizing the utilities was that it would open them to private sector management practices resulting in improved efficiency.[28] It surfaced in a number of ways in the Parliamentary debates, including subjecting the utilities to the disciplines of the capital market, giving management and employees a personal stake in the business, and basing the regulatory regimes on prices. It rests on the belief that personal enrichment is the most effective incentive, and rejects the idea that there is an objective public interest which can be enunciated by a public body. In New Right terms the belief is that as each person pursues his or her own interests, the 'invisible hand' will ensure that everyone benefits. Against this it was argued that the utilities were not so much businesses as services, and while they should make a reasonable return on their assets, the dominant motivation should be public service and not profit. This view rests on the belief that pursuing profit will not ensure that everyone benefits - at all, let alone equally - and that the invisible hand needs to be replaced by one that is both visible and powerful. Not only is there an objective public interest which can be defined, it is important to establish that serving it is a higher motivation than profit.

The clash of values here is clear. If 'service' epitomises the second view, 'efficiency' epitomises the first, and so, making the utilities more efficient meant viewing them as businesses in which marketing water is no different from marketing petrol. In discussing this clash of values it needs to be said at the outset that service and efficiency are not necessarily opposed. Christians cannot be heard to be against efficiency because it is good stewardship, but they may rightly ask what criteria are used to judge it. For the advocates of privatization efficiency meant greater profitability, better value for money, better use of resources and better responsiveness to the needs of customers.[29] But the privatized utilities remain 'public' companies providing a 'public' service, and managerial incentives need to recognise that the managerial function in public service is different to that in private enterprise. As R.A.W. Rhodes has argued,

> Public service management is about more than setting clear objectives, and exercising hierarchical control and co-ordination. A defining characteristic of the public sector is the determination of collective values out of a mosaic of conflicting interests, a process

[28] It was believed that their commercial performance would improve once they were opened up to the greater flexibility and energy of private enterprise. For Michael Portillo, speaking in the gas debate, this was almost a sufficient justification for privatization. The fact that there is a natural monopoly, he argued, was not a reason for not privatizing because ministers and civil servants were not necessarily any good at running a business; freedom from Government control would be a great fillip for management.

[29] Or the three E's: economy, efficiency and effectiveness. (R. A. W. Rhodes, "The Hollowing Out of the State', *Political Quarterly*, vol. 65 (1994), p.144.) It is notable that by the time of the third debate - the electricity debate - the Government had taken on board the importance of service to the public, and argued that public service was not helped by insufficient pressure on costs and prices.

> which extends beyond such values as managerial efficiency to encompass equity and justice.[30]

A particular temptation for 'private' management is, as Earl Russell pointed out, that efficiency is confused with cheapness. In the provision of a service the two are not the same: 'There may be an incentive to make [water] cheap. There is no incentive to supply remote rural areas.... There is no incentive to provide spare capacity. If there were an incentive to be more efficient in providing clean water, the whole apparatus of the National Rivers Authority would have been unnecessary.' Where the emphasis is placed on profit, cheapness is liable to drive out wider considerations of efficiency. This point was taken up by Lewis Moonie in the electricity debate. The motivation of private companies, he said, was to maximise profit for shareholders, and this in turn leads to pressure to maximise sales. There is no incentive to save energy. And in the water debate Andrew F. Bennett wondered how the short-term goals of private companies were consistent with the long-term perspective necessary in the water industry. While there is some substance in these points, they are really overstated. In a capital intensive industry like the utilities it is important for survival for the companies to take a long-term view, and to make appropriate provision for research and development.[31] Nevertheless, the way the utilities are viewed - as businesses or as services - will affect the way their efficiency is defined, and this in turn determines the motivation of those who run them.[32] The Opposition arguments about the plight of the poor and those in rural areas, the effect of privatization on employment in other industries (e.g. the coal industry), protection of the natural environment, and so on, are best understood as pleas for a wider definition of efficiency. Christians would generally agree, and would add that an overriding concern for cheapness and profitability would inevitably lead not only to inefficiency in achieving the basic objective of the utility, but also to corruption in the way it is managed.

Christians have had difficulty with the profit motive because it seems to encourage greed and selfishness, and to place the individual at the centre of concern. Against this Christian social teaching insists that profit is not the basic purpose of a business enterprise, but the creation of a 'community of persons'. The drive to maximise profit carries the risk that options will be appraised according to purely financial criteria, and this concern surfaced often in the debates. Profit is often referred to as 'the bottom line', and there is a sense in which this is true - without profits a business would collapse, but the

[30] *Loc. cit.*

[31] It is also said that other companies considering making take-over bids for the utilities see them as attractive because they provide a steady source of income. If this is so there must be a considerable incentive to ensure that this remains the case, and that in turn must require a longer term view.

[32] Vickers & Yarrow make a similar point: while share price may be an indication of good performance, and can have a useful effect on management of incentives, the factors which improve it may well mean that the public service ethos is lost. (*Privatization and the Natural Monopolies*, pp.13 & 14.)

question remains should the drive to maximise profits drive out all other concerns? The answer must be No, and many industrialists would agree. Beyond the bottom line of profits there are other bottom lines, for example the function of businesses in providing work - one of the essentials of being human - a matter central to John Paul II's conception of the firm as a 'community of persons'. Christians might wish to place two further 'bottom lines' under profit; the first being 'people', and the second being 'the planet' - discussed later in this chapter. Christians have traditionally taken the ethic of service as their own following the example of Jesus who came not to be served but to serve,[33] and would be ranged more on the side of the idealists than the realists. Joseph Chamberlain's argument in favour of the public ownership of the utilities has a strong Christian appeal, but it does depend on a strong public service ethic, one strong enough to motivate managers to high standards of efficiency and service. That ethic may have existed in the times when Chamberlain spoke, but does it exist today? It certainly seems less marked in our public life, and maybe Christians have to accept that the source of motivation has changed. This seems to be the argument of John Atherton,[34] who urges Christians to take more seriously the values of self-interest and efficiency. The dominance of these and other market values seem to be part of a change in the moral fabric of society; Christians need to ask: Did this change just happen, like the movement of the tectonic plates - part of the evolution of the world and its peoples, or is it the result of malign influences - more judgement than blessing? Are we witnessing an incident in the eternal war between good and evil, or a revelation of the nature of the divine economy?

Economic efficiency is equated with better profitability, or better value for money, and because economics is precisely about how this is to be achieved, the economic case provides essential support for the political pursuit of efficiency - but only to a limited extent. The limitation, and it is a substantial one, is that the efficiency gains from privatization might not be as large as hoped for because some of the market disciplines which promote efficiency, *e.g.* take-overs, would not have much relevance to the utilities. Moreover, economic efficiency is formulated in Paretian terms which Christians would question.[35] Thus allocative efficiency means allocating goods between consumers so that it would not be possible by any re-allocation to make some people better off without making anybody else worse off. Defined in this way, efficiency comes into conflict with wider notions of fairness. Thus it might be economically

[33] *Mark* 10.45; *cf. Luke* 22.24-27.

[34] Atherton, *op. cit.*, chapter 7. In the same vein Wogaman asks: 'Is it ultimately possible to fuel an economy on creative devotion to the common good or is it necessary to appeal to the self-interest of people to get them to exert themselves? Perhaps we might all agree that it would be a good thing to have a society in which people really did work together generously and co-operatively. The question is whether such a society is possible. (Wogaman, *Great Debate*, p.161.)

[35] And not only Christians - there is a major debate among economists: see Amartya Sen, *On Ethics and Economics* (Oxford: Blackwell, 1988), p.31 who describes Pareto optimality as 'a very limited kind of success.'

efficient to vary prices for gas or electricity in different areas of the country according to the cost of supplying those areas, as indeed Vickers and Yarrow argue, but such a system manifests a social unfairness which infringes the Biblical duty of the rich (in this case those in low-cost areas) to help the poor, and might have the adverse effect of causing further rural depopulation and urban concentration. The concern for value for money begs the question of what value is being prioritised, and as has been noted, the common mistake is to identify efficiency with cheapness. The Biblical criterion of solidarity suggests that what is really needed is not so much a cheap gas or electricity distribution system as one which ensures that desirable social as well as economic goals are achieved. These might include supplying all areas of the country reliably and at a uniform price. It is unfortunate that privatization has caused the utilities to be viewed exclusively as businesses, with the element of service being overlooked. While economists accept that there are incentives other than financial gain, including the quiet life, their primary focus is upon profit maximisation and personal enrichment, and in a captive market standards of service are likely to be the casualty of the pursuit of narrow goals of efficiency. If, as suggested above, harder, market values are now more widely accepted, the reason is not so much the inevitable evolution of the divine economy as the outcome of a political philosophy which extols the economic above the social and political.

Incentives depend for their effect on the way we view ourselves and the end for which we are destined. It hardly needs saying that an incentive system based on maximising self-interest and competitive behaviour is founded on a very limited view of both, and some economists recognise this. Thus Amartya Sen, commenting on the view that economics has tended to view human motivation as pure, simple and hard-headed, and not messed up by such things as good will or moral sentiments, says: 'there is something quite extraordinary in the fact that economics has in fact evolved in this way, characterising human motivation in such spectacularly narrow terms. One reason why this is extraordinary is that economics is concerned with real people.'[36] The force of this is effectively admitted by economic liberals who seek to redefine self-interest in broader terms to include activities more properly described as philanthropic or altruistic. An oft-quoted example is that of Milton and Rose Friedman:

> Narrow preoccupation with the economic market has led to a narrow definition of self-interest as myopic selfishness, as exclusive concern with material rewards.... Self-interest is not myopic selfishness. It is whatever it is that interests the participants, whatever they value, whatever goals they pursue. The scientist seeking to advance the frontiers of his discipline, the missionary seeking to convert infidels to

[36] Sen, *op. cit.*, p.1.

the true faith, the philanthropist seeking to bring comfort to the needy....'[37]

The point is, though, that the incentive argument for privatization did show an 'exclusive concern with material rewards', and the effects are apparent in the balance of benefits. Even so, Veljanowski has a point when he admits that self-interest is not attractive in itself but argues that it is the most natural and powerful motive of man?[38] After all, Jesus was not afraid to use the reward motive, and as Alfred Marshall said, 'progress chiefly depends on the the extent to which the *strongest* and not just the *highest* forces of human nature can be utilised for the increase of social good.'[39] On this view the moral validity of incentives comes down to the end to which they are directed.

Much the same is true about competition. Nature seems to point to competition as a basic principle of life: it is the fittest and the most adaptable who survive. Novak points to the Christian and biblical images of life as 'a journey, a race, a combat, a struggle against the world and the devil', in which all are not equal.[40] 'Human dignity', he says. 'depends upon the power of such inequalities. Otherwise, human responsibility is empty.' To compete (*com* + *petere*: to seek together although against each other) is not a vice but a virtue, 'an indispensable element in natural and spiritual growth. Competition is the natural play of the free person. All striving is based upon measurement of oneself by some ideal and under some judgement.' Competition is vital to the advance of civilisation; it underlies advances in knowledge and social progress: 'A non-competitive world is a world reconciled to the *status quo*.'[41] Novak's advocacy is attractive, and brings together the material and the spiritual as basic to any adequate theology of competition. Raw competition, 'red in tooth and claw', striving to outdo others, must be led by moral excellence, the striving to outdo oneself in the pursuit of higher goals. Grace perfects nature. The problem with unleashing the competitive spirit in the free market is that grace becomes the victim of nature, and the concern for social justice is sacrificed on the altar of personal enrichment.[42] Competition must somehow be separated from individualism.

The root problem for incentives, as with other aspects of the privatization

[37] Milton & Rose Friedman, *Free to Choose*, p.27, quoted in Michael Novak, *The Spirit of Democratic Capitalism*, p.94. There are clear parallels with Novak's equally implausible redefinition of social justice: see pp.70-71 above.
[38] *Selling the State*, p.36.
[39] A. C. Pigou (ed), *Memorials of Alfred Marshall* (London: Macmillan, 1925), p.310, quoted in Veljanowski *ibid.* Veljanowski points out that Adam Smith did not like self-interest as a personal trait but supported the market because when harnessed it gave the best results.
[40] A good example is St Paul in *Philippians* 3.12-14: 'I have not yet reached perfection, but I press on, hoping to take hold of that for which Christ once took hold of me.... forgetting what lies behind and straining towards what lies ahead, I press towards the finishing line, to win the heavenly prize.'
[41] Novak, *op. cit.* pp.345-8.
[42] A point made by CYTUN in its report *Wales: A Moral Society?* (Swansea: CYTUN, 1996).

debate, is the separation of economics from ethics. Economics cannot operate in a vacuum; it presupposes not just an accepted legal framework, but also an accepted moral and social framework. Markets may operate on the basis of the rational calculation of self-interest, but they depend on more than this. They depend on honesty, fair dealing and truthfulness; they depend upon solidarity in striving together as well as against each other; and ultimately they depend upon restraint in personal appetites. These values are not encouraged by the single-minded pursuit of utility and the maximisation of rewards, and the thoughtless preaching of competitive individualism actually undermines them.[43]

5. Stewardship

All three utilities involve the exploitation of natural resources, and in the case of water the ownership of large areas of land which form part of the national heritage, and over which the public have enjoyed rights of access. The transfer to private ownership raised acute concerns over whether these resources would simply be exploited for gain, and whether the environment would be properly protected. Privatization heightened the general concern over conservation of the natural environment, arguably *the* major concern of our times, and, not surprisingly, it was raised in the Parliamentary debates. It surfaced in various forms and focussed around three issues: efficiency, conservation, and heritage.

Efficiency has been discussed in the previous section. The argument about conservation raised two main concerns: the depletion of natural resources and pollution control. Conservation must be of concern to Christians because the natural order is seen as part of God's creation; it is, therefore, precious in itself, to be cherished rather than exploited, and it was argued in chapter II that this view requires a responsible stewardship related to man's needs rather than his wants. This runs counter to the commercial spirit; energy conservation is not attractive to an industry whose aim is to sell energy and to maximise its profits. While Christians might agree with Alan Beith who criticised the failure of the Electricity Bill to make energy conservation a priority, this was by no means the dominant view. Consistent with New Right thinking, the Government appeared unwilling to impose any such constraints on the freedom of the market,[44] and John Hannam criticised leaving British Gas as a single entity precisely because it would have too much power over how, when and where gas and oil fields were developed. This, he said, could have a negative effect on the development of UK gas reserves. *Per contra* it was argued that leaving such decisions to private companies amounted to an

[43] See Ronald Preston, *Church and Society in the Late Twentieth Century: The Economic and Political Task* (London: SCM Press, 1983), p.45. In much the same way Hayek does not seem to appreciate that the politics of self-interest and pressure groups which he abhors are the product of the economic order he defends. The same motives which drive people to seek their self-interest in the market drive them to seek the same end by political means. See also King, *op. cit.*, p.87.)

[44] See, e.g. Lord Sanderson's statement about leaving energy efficiency decisions to consumers, p.87 above.

irresponsible abdication of control over a vital national asset, and left future generations hostage to the greedy spirit of the age. The clash of values here is more about means than ends. No one said that energy conservation was a bad thing; all were agreed that it was desirable, but the Opposition were more inclined to make it an absolute, and, therefore, were less willing than the Government to put it in the balance with other commercial factors. The issue seems to come down to whether the market or law is more likely to achieve the necessary degree of protection. Bearing in mind the criticism already expressed about the ability of the market to achieve socially determined goals, the Christian preference would be to rely on law. This is because the Christian concern for the environment places value on using finite resources in the interests of all based on principles of justice,[45] and this seems best expressed in economic terms by the Government setting the appropriate framework within which the market should operate rather than by removing the framework altogether. This conclusion is borne out by the review of energy efficiency and environmental protection in chapter VI. Energy efficiency has not been a success of privatization, and environmental protection has shown an indifferent record. The improvements there have been have come from regulatory pressure rather than market forces, and Ofgas still does not have a duty to promote protection of the environment.

Pollution control fares no better than energy saving under classical market economics because pollution is external to the market system, and others are left to bear the cost. One possible advantage of privatization, certainly in the electricity industry, was that stringent environmental standards could be applied - something to which Governments had not subjected either themselves or the nationalised industries. It was odd, to say the least, that with the Water and Electricity Bills proceeding in tandem, the Government took the opportunity to strengthen considerably the controls over pollution in rivers, but did nothing to 'clean up the electricity industry, one of Britain's greatest polluters.'[46] The absence of such measures from the Electricity Bill was, therefore, regrettable, despite Lady Hooper's argument about the environmentally beneficial effects of new power station technology.[47] All the more astonishing was the simultaneous announcement that the budget for energy conservation was being cut, a decision apparently defended by the Secretary of State on the grounds that the Government were not in the business of bribing industry to save its own money - a remark castigated by Lord Lovell-Davis as 'breathtaking in its lack of perception of the essential need, which is to preserve the nation's energy resources.' The argument about pollution is essentially about taking seriously

[45] This concern comes through consistently in the social encyclicals and the WCC statements; perhaps its best expression is the doctrine of the universal destination of created goods. Griffiths takes the doctrine of creation as the starting point of the Christian critique of economic life (*Morality and the Market Place*, p.78), and Hay uses stewardship as the organising concept for his principles of economic life (*Economics Today*, p.71).

[46] The Earl of Swinton in the electricity debate.

[47] See p.84 above.

the duty to care for the earth, and about who is to pay for it. While the Government clearly has a major responsibility, and it would be wrong to suggest on the evidence of the debates that they did not accept it, it is also true that every citizen has the same responsibility. The moral question seems to be about leadership: How is that general responsibility to become a reality? That it is unlikely to do so without a clear framework of rules is the lesson of the pre-privatization arrangements; and businesses run on a commercial basis are unlikely to 'clean up their act' unless it becomes clear that the polluter pays. Again it seems that the Christian concern for the planet is to be equated with establishing a more responsible framework for the market.

The third stewardship concern was about the national heritage. Despite assurances to the contrary, it was widely felt that the privatized utilities, particularly the new water companies, would not show the same concern for areas of natural beauty, access to the countryside, and similar matters as had the former nationalised industries. Their tendency would be to regard the land and other assets in their ownership simply as assets available for exploitation or sale.[48] What purpose has a commercial company in managing its assets for the general public good when its duty is primarily to its shareholders? The Government response, that the concern of the privatized utilities for their public image would ensure a responsible attitude towards the national heritage, seemed sanguine to say the least, especially given the encouragement to dispose of surplus land,[49] but in fact this aspect of the debate has shown little cause for concern. However, this outcome is more fortuitous than inevitable. Privatization is inimical to the very idea of things being held in common, and to the extent that this was part of the rationale of the nationalised industries, it marks an important change in the ethical base of our society.[50] More particularly, the very fact that 'public' land has been privatized fails to recognise Joan Ruddock's point that the land holdings of the water companies have a social significance greater than their commercial value; if this is the case then it would seem to follow that rights of access should be taken out of the market.

It is notable that the economic analysis had nothing to offer on the question of stewardship, a clear example of the way conservation, pollution and preserving the national heritage are perceived as external to economic concerns. From an economic perspective natural resources are there to be exploited, and so this silence is not surprising, but it is none-the-less regrettable. Not only is it a serious negation of the Biblical view of the land as gift, it shows a society in

[48] Roy Hughes described water privatization as selling a property portfolio.
[49] Wyn Roberts, the Minister of State at the Welsh Office, opening the second day of the water debate in the Commons said it was Government policy that surplus land should be disposed of (the Water Authorities already had power to do so and were being encouraged to use it), and on charging for access he said it was right that those who use the facilities should pay for them and not the general mass of consumers.
[50] This point found expression in another form, *viz* that things bought with taxes are in some way held in trust, are almost inalienable.

which the economic model is out of step with the underlying social model, a point argued persuasively by Owen Nankivell.[51] Privatization, especially against the weight of the arguments, as with water, by exalting the economic over the social and political merely reinforces this dysfunction.

A basic moral issue underlying the issue of stewardship is about how we hold things in common, and indeed, about how we define those things which are to be held in common and enjoyed by all. A consistent theme in Christian social doctrine is that some things are to be received as gifts and therefore lie outside the category of tradeable commodities, and Brueggemann makes the further point that failing to recognise their giftedness leads to alienation, rootlessness and the destruction of community. John Paul II has condemned the excessive and disordered way in which man consumes the resources of the earth, pointing out that it is based on 'an anthropological error': man wrongly places himself at the centre of concern, in place of God, 'as though [the earth] did not have its own requisites and a prior God-given purpose.'[52] The land is also subject to the requirement of common use and the duty to care for the environment limits freedom in use. These concerns were echoed particularly in the water debate by speakers who stressed its uniqueness, asking *e.g.* Who owns the rain? and arguing that supplying water is essentially a non-commercial undertaking which should be kept out of the market. The subsequent argument about water disconnections showed that the privatized industry, and to some extent the Regulator, took a different view, treating water like any other commercial commodity. Because water raises most acutely the main questions about privatization - political control, economic justification, environmental protection and the balance of benefits - it is appropriate to consider it as a special case.

❑ WHY WATER IS DIFFERENT

Like air and light, water is a common good which we tend to take for granted (at least in places like the British Isles where supplies are plentiful), but unlike air and light water can be stored and appropriated, and thus a market in water is possible. However, until privatization the provision of water had been seen as a public service, and subjecting water resources to market disciplines seemed inappropriate if not brutal. When water was a state industry, free at the point of use, it seemed normal to be asked to economise in hot weather; there was no great concern about leakage and waste, nor about the environmental impact of providing enough water for our needs. Privatization has begun to introduce another set of attitudes, particularly in those with meters who pay for the water they use. If there is a market in water then we tend to expect to get enough not only for our needs but also for our wants, we become less tolerant about failure of supplies, leakage and waste, and the

[51] *Economics, Society and Values*, 1995.
[52] *Centesimus Annus*, section 37.

pressure on the environment increases as supply is expected to keep pace with demand.[53]

The problem is that the industry has no ultimate control over the level of supplies (as one company executive said during the 1997 drought, even the most efficient water company cannot supply water if it does not rain[54]) and the general level of water in the ground is an important part of the ecological balance. Increasing supplies used to be a 'simple' matter of building another dam, but this is no longer an appropriate solution. Dams are hugely expensive, not only in money but in their environmental costs, *e.g.* silting, damaging the old flood plain of the river, displacement of peoples, and loss of wildlife habitats. Increased water supplies have to come from the better use of existing resources: conservation and not exploitation is now the name of the game. In 1997 the twenty-seven smaller water companies pressed for the construction of several big new reservoirs, but they were opposed by Ofwat and the Environment Agency who argued that the first step must be to tackle waste and thereby reduce the demand for water, a view backed by the Government's Round Table on Sustainable Development. Demand management may also make better economic sense than expanding supplies; the market may have a role to play. In 1995 Dr Stephen Lintner of the World Bank was reported as saying: 'We need to treat water as a valuable resource that should be wisely used. Much of scarcity is not due to its unavailability; its because it is badly managed.'[55] Proper pricing of water would encourage more efficient use. If farmers and householders had to pay an economic price they would ensure that their water was not wasted. But the market cannot provide the whole answer. Charging an economic price would bear heavily on the poor who would, in most cases not be able to afford as much water as they need, and it would enable the rich to buy enough for what they want, in excess of their needs, like irrigating green gardens and golf courses in arid areas, thus selfishly reducing the general level of supplies. Some kind of public regulation of use is essential if there is to be proper stewardship of this essential resource. Water should not be treated simply as a marketable product.[56] Because it is so basic to life, there being literally 'no alternative', water can be equated with the administration of justice, defence and other 'basic' goods of which the state must guarantee supply. Given the weakness of the economic case, the impossibility of competition, and the other problems connected with its supply,

[53] In the UK daily water consumption is just under 50 million litres, divided as follows: Electricity supply 53.3%; Public water supply 33.6%; Fish Farming 7.6%; Industry 4.6%; Agriculture 0.6%; Other 0.2% Domestic water use is divided as follows: Car washing, dripping taps & Leakage 32.5%; WC flushing & waste disposal 32.0%; Washing, baths, showers 17.0%; Washing machines 12.0%; Gardening 3.0%; Drinking 2.5%. (*The Independent* 22.8.95.)

[54] Chris Mellor, finance director of Anglian Water reported in *The Independent*, 31.10.97.

[55] Quoted by Hamish McRae in 'Our costly thirst for free water', *The Independent*, 10.8.95.

[56] *Cf.* Fred Pearce, 'Putting a Price on Adam's Ale', *Times Higher Educational Supplement*, 24.10.1997, reviewing Stephen Merrett, *Introduction to the Economics of Water Resources* (London: UCL Press, 1977), cites with approval Merret's criticism of neoclassical economics as 'a methodology which sanctifies fictions and diverts attention from the difficult task of analysing real world phenomena,' particularly in relation to water whose supply is a 'natural monopoly'.

the privatization of water seems inappropriate.

6. Who Benefits?

Much of the uneasiness over privatizing the utilities is caused by the perception that in some way the poor will loose out. In private hands the utilities are bound to be operated with different commercial objectives; increasing profits would assume a greater importance, and concern for the more vulnerable members of society would decline. This perception was underlined in 1995 when it became possible for the utilities to be taken-over. The point was made that they were 'steady earners', and thus attractive to the big multi-national companies[57] because they provide a reliable flow of income. For this reason alone, in private hands they are bound to be operated with different commercial objectives, a point made by Keith Barron in the gas debate: 'the Government are handing over a profit-making public service and turning it into a machine that will make big money for big money.' Much the same point was made in the water debate by Harry Barnes who said the result of privatization would be that basic resources would be controlled by a few 'big players' because 'capital inevitably concentrates in the hands of the few.' Ann Taylor also took up this issue. She referred to an opinion given by the British Business School that three groups benefit from privatization: (1) short-term speculators,[58] (2) the City (from professional fees), and (3) top managers in the privatized industries. The economic analysis, particularly of the asset sales, confirms the accuracy of this opinion. Even if, without the pressure of competition, everyone is getting a better deal out of the privatized utilities, not everyone is getting a fair share of the extra wealth created.[59] The family silver has been sold off without the family benefiting properly.

This concern about the effect on the poor underlies the Biblical criterion of egality, and has been insisted upon strongly by both the Popes and the WCC, especially in the doctrine of the universal destination of earthly goods. The question is how, in practical terms, the poor are best to be cared for. The Government argument was that the introduction of more efficient management would lead to everyone getting a better deal, and it was widely felt on the Government benches that private companies were much more responsive to the needs of their customers than the nationalised industries had been. This may well be true, but the comparison is not of like with like. Private companies who are sensitive to the needs of their customers are those experiencing competition, and unless they provide good service their profits will decline. It was precisely the criticism of the original privatization schemes that the utilities would not face the normal competitive pressure to be aware of their customers'

[57] The actual example was Hanson Trust.

[58] The taxpayer looses because of the low flotatation price, and the speculators benefit.

[59] Per contra the argument that the ownership of shares by pension funds means that the benefits of privatization are passed on to everyone. This is, of course, not strictly accurate; the benefits go to the holders of private pensions.

needs. Allied to this was a belief that the nationalised industries were run more benevolently, and the interests of the poor were better protected. Feelings that this protection would end surfaced particularly in anxieties about disconnections and pricing in rural areas. A more commercially minded management, it was said, would pursue a tougher disconnections policy, and would seek ways of recouping the extra cost of supplying rural and remote areas, both of which would be more likely to bear hardly on the poor rather than the rich. The temptation facing a monopolist, reinforced by the RPI-X formula, is to reduce quality as a means of reducing costs and increasing profits, particularly where there is no alternative product to which dissatisfied customers can switch. This is certainly the case with water; for most purposes with electricity also, and to a considerable extent with gas.

There are two basic questions: Is a private monopoly more likely to be responsive to its customers' needs than a public one? and, Is its perception of those needs likely to go beyond commercial needs (e.g. new products and faster response times) to include favourable credit and payment arrangements for those on low incomes? Somewhat against the expectations the answers in both cases have turned out to be affirmative. With all three utilities there has been a change of culture with service to the customer becoming more important than established corporate attitudes - illustrated well by the battle between British Gas and the first DGGS. Favourable payment schemes for the poor and the 'new poor' have been introduced, together with other social benefits. The most notable example is, of course, the virtual elimination of disconnection for debt. On the other hand, differential pricing has been introduced, ending the element of social solidarity which uniform pricing represented. It is doubtful if the advances would have come about apart from regulatory pressure, which in this respect has shown itself to be an adequate substitute for competition. It is also significant that the Government could not be excluded from the argument about disconnections. This was right. Disconnections have a social cost because cutting people off from water and energy is cutting them off from two of the essentials of life, and this really ought not to be a matter for commercial judgement. It is also right for the further reason that the supply of water and electricity, and to a lesser extent gas, involves an element of social policy, therefore determining policies for supply cannot be conducted in isolation from the way the tax and social security systems operate to help those in need.[60]

The increasing division between the rich and the poor is one of the scandals of the age of affluence, and a consistent theme in modern Christian teaching is the call for this inequality to be reduced. All discussion about the poor concerns at root the question Who owns the surplus?[61] As life has become richer and more

[60] A related point was made by Alan Beith in the electricity debate. He criticised the policy of allowing the industry to pass out of public ownership with some households still not connected to the mains.

[61] *Cf* Nankivell, *op. cit.*, pp.136-7.

complex so the Popes have called for a more just and equal sharing, with a 'preferential option for the poor'. Has utility privatization reflected this option? In part, and then only after a struggle. The general impression is to the contrary. Differential pricing and preferential deals for credit customers widen the gap between rich and poor, as does the priority given to the regulators' duty in fixing prices to ensure a reasonable return on capital employed over duties to the consumer and the environment, though this is to change with the introduction of the new primary duty towards the consumer and the improvement of the social and environmental obligations of the companies. Similarly, the inequitable distribution of financial benefits (described in chapter VI) has contributed to widening the gap. This outcome is consistent with the New Right philosophy underlying the privatization programme, which argues that social costs are better dealt with by appropriate arrangements for compensation, thus turning them into an aspect of property, than for social subsidy.[62] As Paul Vallely has said, 'Poverty today is not seen as a moral problem for society but an economic one to be considered in terms of its social consequences: to secure the peaceful functioning of capitalism the casualties of the economy should be taken care of. Welfare programmes have become a mechanism for attaining social, rather than individual, good. Thinking about welfare has largely lost the sense of the intrinsic worth of the individuals who find themselves dependent on social assistance.'[63] In much the same way, requiring the private sector to make good the lack of public investment in the water infrastructure, shows that we have lost sight of the essential nature of society as a community of persons in solidarity. There was something quite immoral about the Government pocketing the proceeds of the sale (even if they were used to reduce taxes) and then forcing up prices to clean up the industry. Access to clean water is a basic human right; profits from its supply should be used either to improve the environment or to reduce the price.

7. Economics and Ethics

This study has argued that privatization is not just a political or economic matter, it is also an ethical matter precisely because it raises basic questions about fundamental issues: What is the source of value? To whom are we accountable? How shall we live together? These are religious questions *par excellence*, and within the privatization debate they are part of the wider debate about the relation of economics to ethics. Chapter I identified three ethical tensions which focus the themes of this study, and which form a convenient basis for reflecting on the underlying issues and drawing together its conclusions.

[62] See *e.g.* Jack Wiseman, 'Growing Without Nationalisation' in Veljanowski (ed) *Privatization and Competition*.

[63] 'Towards a New Politics', in Paul Vallely (ed) *The New Politics*, p.164.

❑ VALUE & TRUTH

Perhaps the basic tension in ethical reasoning is the source of ethical values: are they in some sense 'given', or are they to be deduced by rational intelligence from 'the way things are'.[64] This tension goes to the heart of economic reasoning. According to Jane Collier, one of the driving forces behind the evolution of modern economics was the desire of economists to have their discipline accepted as an objective science, and this led them to seek to base it on empirical data as in the natural sciences.[65] The problem is that economic data largely result from human choices which in turn reflect human motivations, and it is clear that these motivations are determined by 'given' values as much as by rational calculation. The way out of this dilemma was seen to be through the formulation of certain axioms, *i.e.* propositions about the world and human motivation which were taken as universally true; these formed the foundation of the new science. High claims were made for axiomatic economics; thus Ludwig von Mises argued that 'social and economic theory is not derived from experience - it is prior to experience...no kind of experience can ever force us to discard or modify *a priori* theorems.'[66] Von Mises is one of the gurus of the New Right, but the axiomatic approach characterises all shades of economic theory, and some axioms are held in common, *e.g.* that people behave rationally in the sense that they know what they want and how to choose it from the possible alternatives.[67] But for all its claims to universal acceptance, an axiom remains an interpretation, and thus economic theory rests upon the way in which economists interpret the world, rather than on empirical data disclosing the way it actually is. Another way of putting this is that economic theory rests on the *beliefs* of economists about the way things are; it has, in fact, much in common with religion, and the claims of neither are ultimately provable.

As has been pointed out, lying behind the different economic theories are different visions of what human society should be like. Maybe this is what von Mises had in mind in his claim that economic theory is prior to experience. Certainly the change in economic thinking which came in after 1979, and which undergirded the case for privatization, was not just about tackling inflation. As Edmund Phelps points out, the monetarist belief that monetary policy should follow a fixed rule, leaving to the market the task of adjusting to shocks rested upon no formal analysis, rather 'The impetus for this policy position seems to have been a philosophical distrust of Government.'[68] Similarly, the later phases of the privatisation programme rested more on social and political objectives

[64] These two positions are not necessarily opposed. Christian ethics, which accepts certain values as given, would also argue that these are deducible from 'the way things are' which includes the existence of God, and that his is the design which undergirds the universe. The 'rational' position tends to be atheistic and utilitarian in its premises.

[65] Jane Collier , 'Contemporary Culture and the Role of Economics' in H. Montefiore (ed.). *The Gospel and Contemporary Culture*, (London: Mowbray, 1992).

[66] *Human Action* (London: Hodge,1949), p.190, quoted by Collier, *op. cit.*, p.106.

[67] The basic economic approach is conveniently described by Hay, *Economics Today*, ch.3.

[68] Edmund S. Phelps, *Seven Schools of Macroeconomic Thought*, p.29.

than on economic analysis, and in the case of water actually went against the weight of the economic argument. Given this, the Christian argument that the shape of human society is too important to be left to the invisible hand cannot be ruled out as wishful thinking. The insistence of the Popes and the WCC that there is a radical limitation to economics which renders it inappropriate to determine social structures,[69] and that an economic system must serve wider needs than the material is essentially a plea for a better economic model. Peter Sedgwick, for example, argues that the creation of wealth must be seen more widely than producing material goods to include social assets like education and the environment.[70] Economists too have argued for an alternative to the assumptions of classical theory, in particular that ethical and ecological concerns should have equal weight with purely 'economic' considerations.[71] Among those arguing for a change of approach is the Nobel Prize winner Amartya Sen. He points to the twin origins of economics: an ethics-related approach concerned with the question How should we live? and an 'engineering' approach concerned with logistical issues rather than with ultimate ends. Sen observes:

> It is arguable that the importance of the ethical approach has rather substantially weakened as modern economics has evolved. The methodology of so-called 'positive economics' has not only shunned normative analysis in economics, it also has had the effect of ignoring a variety of complex ethical considerations which affect actual human behaviour and which, from the point of view of the economists studying such behaviour, are primarily matters of fact than of normative judgement.'[72]

He questions the basic assumption of rational behaviour because 'we all make mistakes, experiment and get confused. The coolly rational types may fill our text-books, but the world is richer.'[73] It cannot be, as he says, *uniquely* rational to pursue one's self-interest to the exclusion of everything else. It may be fair to argue that maximisation of self-interest is not irrational, 'but to argue that anything other than maximising self-interest must be irrational seems altogether extraordinary.... To try to use the demands of rationality in going to battle on behalf of the standard behavioural assumption of economic theory (to wit, *actual* self-interest maximisation) is like leading a cavalry charge on a lame donkey.'[74] Sen is also critical of welfare economics which defines welfare narrowly and individualistically: 'Welfarism is the view that the only things of intrinsic value for ethical calculation and evaluation of states of affairs are

[69] Pope Paul VI, *Octagesima Adveniens*, section 45.
[70] Peter Sedgwick, *The Enterprise Culture* (London: SPCK, 1992), p.175.
[71] *E.g.* Elkins & Max-Neef, *Real Life Economics* (London: Routledge, 1992).
[72] Amartya Sen, *On Ethics and Economics*, pp.3-7.
[73] *Ibid*, p.11.
[74] *Ibid*, pp.12 & 16.

individual utilities.'[75] Welfarism is open to criticism on two counts: (i) although it can be argued that a person's utility is, at best, a reflection of person's well-being, they may value the promotion of certain causes even though the importance attached to them may not be reflected in the advancement of their well-being; and (ii) other terms are more apt to describe personal well-being than 'utility'. Discussing this last point Sen points out that the poor and unfortunate may be more easily reconciled to deprivations than the more fortunate and affluent, and because of the sheer necessity of survival may take pleasure in small mercies and may manage to suppress the pain of intense suffering, 'but it would be ethically deeply mistaken to attach a correspondingly small value to the loss of their well-being because of this survival strategy.'[76]

Sen's argument amounts to a strong plea for a more ethics-based approach to economics, in particular one that takes positive rights seriously and thus incorporates the demands of justice. The moral acceptance of rights, as he says, may call for systematic departures from self-interested behaviour; indeed 'even a partial move in that direction can shake the behavioural foundations of standard economic theory.'[77] The short history of the utility privatization bears out Sen's criticisms. Light regulation was soon seen to be insufficient; not only did it fail to set proper prices, it left the poor and vulnerable without adequate provision. The demands of social justice simply could not be left unheard, and the regulators negotiated an extension of their powers to remedy the situation. The feeling that an 'error correction mechanism' should be incorporated into the price formula makes the same point. If these changes are to be incorporated into the economic model then incentives will have to be widened beyond the purely financial. There is a partial recognition of this in the incorporation of an energy efficiency factor in the electricity price formula, but nothing less than a moral change in how we view ourselves is really required.

And that brings us back to the idea of some values being given. The problem is that our post-modern culture has an inherent tendency to deplete the common moral culture. As Paul Vallely has said, 'The unintended consequence of neo-liberal deregulation of markets - and what Pope John II has called the "powerful cultural, economic and political currents which encourage an idea of society excessively concerned with efficiency" - was to accelerate all these.'[78] Even John Gray, once an apologist for the New Right, now concedes that 'there is no such thing as the free market, but rather a variety of cultural institutions and legal devices through which economic life is mediated,'[79] an admission that neo-

[75] *Ibid*, p.40.
[76] *Ibid*, pp.45 & 46.
[77] *Ibid*, p.57. Michael Stewart makes the same point. People have not behaved, he believes, as economic theory predicted: consumers have not always chosen to spend and industry has preferred to grow through take-overs and mergers rather than by investing in new plant and machinery. Not only is the economic model at odds with the social model, it is also at odds with actual economic behaviour. See pp.108-109 above and the sources there cited.
[78] 'Towards a New Politics' in Paul Vallely (ed), *The New Politics*, p.151.
[79] John Gray, *After Social Democracy* (London: Demos, 1997), p.19.

liberals have neglected the common moral framework upon which the market depends for its operation. Gray even goes so far as to argue that some goods like health care and education should be supplied according to ethical rather than economic criteria, that is on the basis of need rather than ability to pay. 'The over-riding task we face today,' he concludes, 'is that of preserving, and extending, forms of common life which highly individualist market institutions threaten to undermine or corrode.... Individual autonomy presupposes a strong public culture in which choice and responsibility go together as part of the common good.'[80] Gray is right; and the argument that water ought not to have been privatized is based on essentially the same premis. If some values are given, then some things are to be received as gifts and placed outside the category of tradeable commodities. The consequences of not doing have been well described by Richard Titmus:

> I fear that unless some lines can be drawn to eliminate some things from the category of consumption goods, all policy will become economic policy, and the only values that would count are those that can be measured in terms of money and pursued in the dialectic of hedonism.[81]

❑ CONSERVATION & EXPLOITATION

Arguably the greatest problem facing mankind today is the ecological question, the excessive and disordered way in which man consumes the resources of the earth.[82] This century, it is said, is the one in which the limits of natural resources like minerals, oil gas, and water will be reached, and even if the world population stabilises as predicted, the demand for raw materials will continue to grow because of the rising expectations of the world's poor, not to mention those of the rich. Consumerism has simply made the problem worse. Writing at a time of drought, *The Independent* said:

> The sense of civic duty has gone. No longer do we think of ourselves as citizens with a stake in this natural resource. We're consumers. We want value for money but we feel short-changed. When we are asked to save water, many of us think: 'Stuff 'em. I'm paying for it, so I'm going to use it. Saving water is not my problem.'[83]

Considerable energy today is expended on trying to reconcile the drive to exploit natural resources (which characterises the modern world with its emphasis on economic growth) with the need to conserve those resources if future generations are to have a future. The utilities are all concerned with the use of natural resources; has privatization anything to offer in resolving this basic

[80] *Ibid*, p.35.
[81] Richard Titmus, *The Gift Relationship*, (London: Allen & Unwin, 1970), p.12.
[82] Pope John Paul II, *Centesimus Annus*, section 37.
[83] *The Independent*, 2.9.1995.

conflict? The immediate impression is that it does not; rather that handing over gas, water and electricity to the free market will simply reinforce the present economic preoccupation with growth. It is notable that as the privatization programme developed the idea of energy conservation was abandoned in favour of energy efficiency, a move which showed that exploitation was more important than conservation, and the indifferent record on energy efficiency gives no encouragement for thinking that this was a misreading of the signs. Indeed privatization was seen as an appropriate opportunity to cut the budget for energy conservation, and this coupled with the astonishing omission of a duty on the DGGS to promote energy saving, and the even more astonishing remark that the Government was not in the business of bribing industry to save its own money,[84] showed a robust faith in the ability of the free market to achieve essential ecological aims. However, there may now be signs that privatization could be a means for administering a more effective environmental policy. Governments clearly find it easier both to impose duties on bodies which they do not own and to monitor their performance. Given the political will, a more ecologically sound policy can better be achieved at arms-length than through state ownership, and the recent initiatives on improving leakage targets and bathing water quality show what can be done. In the same way much tougher targets for using renewable energy resources in electricity generation and for reducing pollution levels in both generation and sewerage services could also be set. The real issue though is the emphasis of all shades of economic theory on growth.

Economic growth has for so long been accepted as the basis of the world order that it has if anything progressed beyond the status of an axiom to one of fundamental truth. Economic salvation (the word is aptly chosen) depends on continual growth. But the feasibility of this is now widely questioned. The questioning began with the effect of pursuing of policies designed to increase economic growth in developing countries. The result was not an increase in general welfare but an increase in so-called marginal persons: the ill-fed, inhumanly housed, illiterate, and the politically and socially excluded. At the same time the demand for energy and other resources by the rich nations was causing an alarming increase in pollution in the seas and the atmosphere alike. These results of the policy of growth were condemned in *Justice in the World*, a statement of a Synod of Bishops in Rome in 1971, and, according to one commentator, 'completely demolished the myth of simple economic development on which rich and poor had lived for a generation.'[85] *Justice in the World* paved the way for the concept of sustainable development, which is now widely accepted.[86]

[84] See p.86 above.
[85] Julian Filochowski, 'Looking out to the World's Poor', in *The New Politics*, p.74.
[86] But not by everyone. For a radically different approach see Stephen Clark, *How to Think About the Earth* (London: Mowbray, 1993). Clark also rejects the concept of stewardship, which he believes perpetuates inappropriate man-centered ideas of domination.

Economists too are critical of the concept of growth. Hay concludes that the critics of growth 'have made a convincing case for treating with scepticism the claim that a higher level of Gross National Product...can be directly equated with an increase in welfare.'[87] He gives four areas of concern:

> (1) The hedonistic model of utilitarian welfare is not an adequate framework for expressing all the elements which go to make up human satisfaction. Better welfare simply cannot be equated with an increase in material possessions.
> (2) Insufficient attention is given to the pattern of income distribution. Growth may make some people considerably better off, but there is no evidence to show that all share in equitably in the increased prosperity.
> (3) The market cannot be trusted to produce acceptable outcomes. Inequitable income distribution is one example of this; others are externalities like pollution and the destruction, or at least the spoiling, of the natural environment.
> (4) The erosion by market forces of the traditional values like trust, honesty and mutual obligation.

However as Hay points out, the critics of growth generally remain firmly within the utilitarian framework of conventional economic analysis. A Christian critique needs to go further stressing not only that the highest human satisfaction is to be found in a relationship with God and not in material goods at all, but also that possessions and possessiveness are actually dangers, idols even, taking us away from God and leading to increasing dissatisfaction. Hay concludes: 'Economic growth leading to ever-increasing consumption is not therefore an objective for the economy which a Christian can espouse.... Economic activity is to provide the basis for life in community; it is not supposed to be its *raison d'etre*.'[88] Noting that policies designed to increase economic growth have considerably increased the rate of use of natural resources, especially non-renewable resources - an outcome contrary to the Biblical requirement to be good stewards of creation - Hay argues against leaving the exploitation of a natural resource to market forces; it means, he says, that such markets must be regulated. While regulation could involve the assignment of stewardship responsibilities in a biological resource to some person or to a group of people, and this could be done by assigning them *private* property rights, Hay is not convinced that such a solution would work. This weakens the case for utility privatization. Similar conclusions were reached by an expert Working Group of the European Ecumenical Commission

[87] Hay, *op. cit.*, p.292. For a non-Christian view reaching similar conclusions see: Victor Anderson, *Alternative Economic Indicators* (London: Routledge, 1991). Anderson argues for a more sophisticated approach to economic analysis, moving the argument about growth away from the purely financial, GDP criteria to one that includes human and environmental realities.
[88] *Ibid* pp.292-3.

for Church and Society who examined from a Christian perspective the economic model used by the European Union. Affirming the createdness of nature and the intrinsic value of all things, and acknowledging a responsibility of stewardship and companionship with the created order,[89] the Group challenged the assumption of unlimited growth, and the general level of consumption in European countries, and called for responsible long-term planning to conserve resources, and for economic theory to 'internalise environmental and other costs', thus rejecting the present approach which views such things as externalities. Among the barriers to sustainability within the accepted economic model they identified 'narrow beliefs in material and technical "progress"..., in utilitarian ethics, and in the notion that the free market automatically resolves social problems.'[90] In particular they called for a new approach to energy policy: 'Above all, there is an urgent priority to reduce energy consumption, promote energy efficiency and switch to renewable alternatives.' The current EU goal of 'a free and competitive internal energy market' was seen to be 'in conflict with the goal of minimising the negative impact of energy.'

> The market framework fails to address adequately how the potential for renewables and energy efficiency can be fully developed within a market dominated by cheap fossil fuels. It also encourages consumption and is based on prices which do not adequately account for environmental costs.[91]

There is much here to challenge the theoretical basis of the privatization programme, both the economic model upon which it was based and the New Right notions of the limited state and the beneficence of the free market. In the light of these criticisms utility privatization, without a strong role for the state, is more likely to be part of the problem than part of the answer to the ecological crisis. If defence and the administration of justice are accepted as part of the duty of Government by economic liberals because civilised life depends on them, how much more should it be the duty of Government to preserve the environment? More particularly, the tension between exploitation and conservation also shows up the inadequacy of the ethical basis of economic theory, namely utilitarianism.

Utility is a convenient concept because, as Joan Robinson has remarked, it is endowed with 'impregnable circularity.' 'Utility is the quality in commodities that makes individuals want to buy them, and the fact that individuals want to

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[89] The use of the term 'companionship' reflects Stephen Clark's argument that friendship and not stewardship is the appropriate basis for man's relationship with the earth. *Op. cit.* p.111.
[90] The European Ecumenical Commission for Church and Society, *The Dominant Economic Model and Sustainable Development: Are they Compatible?*, Executive Summary 1996.
[91] *Ibid.*

buy them shows they have utility.'[92] Therefore the only way the values of commodities, including labour and ideas, are revealed is through a process of exchange. Commodity values and moral values are both equally subjective: no line can be drawn between freedom in morals and freedom in economics. Utility also demands that all wants are accepted as given. From Bentham onwards, liberals have made it an act of faith that the individual is the best judge of his own interests. No distinction is admitted between what might be termed innate wants (*e.g.* for food, shelter and clothing) and created wants (*e.g.* cosmetics, narcotics, trash and luxuries). Needless to say, no moral criteria are to be used in judging wants: consumer demand is the only criterion. Utilitarianism is driven by an economic imperative: because someone wants it we must produce it. Conversely people should be left as free as possible to spend their money on what they want. Utilitarian ethics tends to absolutize choice rather than the features which make the choice good or bad. Choice makes us all consumers obliterating the fact that we are citizens first. 'Market forces are simply the measure of consumers making choices. In a consumer society there is incredulity that there may exist some things to which no one has a right.'[93]

Utilitarianism runs the risk of separating freedom from responsibility, although they are the obverse and reverse of the same coin.[94] Freedom degenerates into licence and anarchy without a framework to contain its expression, and that framework must include restraints upon individual desires and choices. Liberalism faces acute dilemmas in its rejection of such a framework. For example, at a personal level a purely 'want-regarding' view would permit trade in harmful substances like hard drugs and pornography; at a public level it permits the destructive exploitation of the environment. Utility alone cannot serve as an adequate moral criterion, and it must be very doubtful whether in fact it does so. Reinhold Niebuhr, for example, supported his argument that love was the basis of all moral systems by referring to the fact that no society rested content with negative prohibitions. Every elaboration of minimal social standards into higher standards, he said, makes the underlying, implicit value of love more explicit. While legal codes might not go beyond negative prohibitions, 'the moral codes and ideals of every advanced society demand more than than mere prohibition of theft and murder. Higher conceptions of justice are developed. It is recognised that the right to life implies the right to

[92] Joan Robinson, ***Economic Philosophy*** (London: Penguin, Harmondsworth, 1964), p.10, quoted by Collier, ***op. cit.***, p.114. It has to be said that this is a very ***economic*** view of utilitarianism. Historically, utilitarianism has insisted that moral principles be justified by reference to the promotion of human happiness, and the diminution of human suffering. This latter emphasis particularly has been used by some utilitarians to advocate a managed approach to the economy. Nevertheless, the individualist ethic has always been central; utilitarians have placed the moral emphasis on man and his needs and have been hostile to the prescriptions of traditional authority.
[93] Julie Clague, 'The Gospel of Life', in ***The New Politics***, p.125.
[94] A more reflective defence of utilitarianism is given by Samuel Brittan, *Capitalism With A Human Face* (Aldershot: Edward Elgar, 1995), chapter 3.

secure the goods which sustain life. This right immediately involves more than mere prohibition of theft. Some obligation is felt, however dimly, to organise the common life so that the neighbour will have fair opportunities to maintain his life. The various schemes of justice and equity which grow out of this obligation, consciously or unconsciously imply an ideal of equality beyond themselves. Equality is always the regulative principle of justice; and in the ideal of equality there is an echo of the law of love, "Thou shalt love thy neighbour as thyself.'[95] The practical result of this, when applied to conservation issues, is that demand for scarce resources needs to be managed. There is already a growing consensus about this in relation to water resources,[96] and it is foreseeable that it will come to include gas also. The theoretical basis for utility privatisation faces its severest challenge from the environment.

❑ INDIVIDUAL & COMMUNITY

One of the more notorious remarks of Lady Thatcher when Prime Minister was that there is no such thing as society, only individuals and families.[97] The basic biblical unit of the individual-in-community recognises the reality of both, and accepts that there is a tension between them. A persistent criticism of market economics is that it fails to address the common good, and operates as though the tension has been resolved in favour of the individual - more precisely in favour of those individuals able to operate effectively in the market. Privatizing the utilities simply confirmed this impression. The primary criterion in the provision of basic services was to be profitability, and the primary duty of the companies was to be towards their shareholders. This, together with the fact that initially these companies were monopolies (and in important respects remain natural monopolies), raised some basic moral questions: Should a 'public' monopoly be a means of private enrichment? and, Should the administration of the utilities be directed towards correcting social inequality? New Right theorists are clear that the answer to the first question is Yes, and to the second No, and the assessment of the balance of benefits in chapter VI broadly confirms these answers. Although customers are receiving better value for money, the main beneficiaries of privatization have been the managers and shareholders, and the common good, represented by the environment, has not received much benefit at all. It is perhaps too early to give a clear verdict on

[95] Reinhold Niebuhr, *An Interpretation of Christian Ethics* (New York & London: Harper & Brothers, 1935) in George W. Forell *Christian Social Teachings* (Minneapolis: Augsburg Publishing House, 1971), pp.383-4. Niebuhr powerfully reinforces his argument with an analysis of the history of corrective justice: society begins by regulating vengeance, then it advances to substituting public justice for private vengeance. Public justice is more objective and thus the criminal is recognised to have rights as a human being, and this leads to an emphasis on reformatory justice rather than retributive - a development which culminates in the command 'Love your enemies'. *Ibid* pp.385-6.

[96] See *e.g.*, Nicholas Schoon, 'Why we are too wet about water', *The Independent*, 28.2.1997.

[97] Interview in *Woman's Own* 26.10.1987. The Prime Minister was echoing the economic assumption that personal desires and choices are formulated independently of others. Sociology, which examines the social nexus shows that his is not the case, and the effect of fashion advertising and peer pressure on individual choice is an everyday reality. As Nankivell says, the economist 'needs to replace the concept of the consumer as an individual, rational agent with one that treats the consumer as a social animal.' Nankivell, *op cit.* p.55.

the question of social justice because the history of regulation shows an increasing concern for social issues. What can be said is that while social justice has not been ignored by the privatized utilities, they certainly do not see themselves as existing to correct social inequality.

Privatization has added to the individualist drift of modern times, but this is not a situation with which Christians can remain content, nor it seems can many secular theorists, and new approaches have been developed like communitarianism and stakeholding. The question is how can the interests of the community, *i.e.* the common good, be represented in a market system? New Right apologists for the market believe that it happens through the efficacy of the invisible hand, even though it seems perverse. Veljanowski, for example, accepts that the collectivist claim that order and good come from well-intentioned planning is much more attractive than 'the paradoxical assertion that a spontaneous order will arise as an incidental by-product of what on the face of it appears an antisocial motive (greed) and an anarchical system (competition) without conscious direction,'[98] but, nevertheless he believes that it works, and with the added merit that good intentions are not necessary for beneficial outcomes. Others are not so sure, including Christians who reject the belief in the automatic beneficence of market forces; and the evidence from both developed and developing countries alike that the gap between rich and poor is growing wider not narrower, supports the Christian view over that of the New Right. The common good requires more than market forces for its protection, and arguably it does require good intentions. One of those intentions must be to insist, as both Richard Titmus and Pope John II argued, that some issues cannot be determined by economics. Those things which are essentially public should be publicly owned, even if this does mean some loss of economic efficiency - but a loss of economic efficiency may turn out to be a gain in social efficiency, as Lord Russell pointed out. The New Right claim that privatization created real public ownership in place of the nominal public ownership of nationalisation is just a piece of verbal sleight of hand.[99] The test of ownership is Who bears the risk? Privatization was precisely a transfer of the risk to the private sector. The only real form of public ownership is through public institutions. David Owen was right when he argued that the National Grid, because it was a natural monopoly, should be publicly owned, and not simply because of its natural monopoly status but because it is exercising important public powers in relation to the supply of electricity. In this case the moral argument is supported by the economic argument; as Vickers and Yarrow point out, public ownership of the Grid would not necessarily be economically less efficient. But the point is that the moral argument is persuasive irrespective of the economics; and if it holds good for the Grid it also holds good for the electricity distribution system, the gas

[98] Veljanowski, *Selling the State*, p.32.
[99] See Peter Walker in the Gas debate, p.83 above.

pipelines and the water infrastructure, not to mention the public health powers of the water companies.

Safeguarding the common good must also mean acceptance of common values. This too underlies the secular concern, though no one under-estimates the difficulty of actually articulating them, let alone securing general acceptance. It simply goes against the spirit of this post-modern age with its distrust of meta-narratives. This is perhaps where the tension between the individual and community is most keenly felt. We experience simultaneously a widespread concern at the decline of community and an unwillingness to submit to the common values upon which community is based. 'So how,' asks Paul Vallely, 'are we to counter the tendencies inherent in late modern societies to deplete the common moral culture - a process which the neo-liberal deregulation of markets and of capital has only accelerated?'[100] Vallely's solution requires a rebalancing of our political programmes, that is, action by the Government. (Keynes might have applauded had he not been an immoralist.) This is not so absurd as it may sound. The aim of the incoming Conservative Government in 1979 was to change the soul of the nation; economics was the method, and it achieved a large measure of success. Every day in legislation Governments set ethical standards. So, for example to give effect to Pope John II's view of the business firm as a community of persons, the law could remove the powers of ownership of the shareholders, converting them into bondholders, and vest the company in the employees, or in some combination of the two.[101] This would be a powerful witness to the value, indeed the necessity, of solidarity in human life. Solidarity 'is not a feeling of vague compassion or shallow distress,' but 'a firm and persevering determination to commit oneself to the common good; that is to say, to the good of all and of each individual because we are all really responsible for all.'[102] Privatization has weakened this sense of solidarity. A practical example is improvements in the water environment. The measures necessary to clean up the Cornish beaches raise a substantial question about the way this kind of expenditure is funded. Is it right that the failure of investment, incurred under public ownership, to protect a national asset like the Cornish beaches should fall on that area alone, especially given its relative economic poverty when compared with the rest of the country? The environment in a real sense is a whole, and it seems appropriate that the costs of protecting it are shared by all.

None of this is to say that the individual takes second place or is unimportant. Keynes was right when he said that individualism was the best safeguard of personal liberty.[103] But it is to say that unless individualism is balanced by a strong sense of community it ends up destroying the very liberties it is intended

[100] *Op. cit.*, p.156.
[101] This suggestion is made by Hay, *op. cit.*, p.173.
[102] Pope John Paul II, *Solicitudo Rei Socialis* (1987), section 38.
[103] *General Theory*, p.380.

to protect because ultimately liberty rests upon shared values. Privatization has added not only to the sense but also to the reality of the erosion of those values. Calling a limit to the extent to which economics determines what is owned in common, also places limits upon the extent to which economics determines social policy. This is essential to holding the individual and the community in a creative tension.

8. Conclusion

Keynes said 'The political problem of mankind is to combine three things: economic efficiency, social justice and individual liberty.'[104] There will always be a tension between these things, and combining them inevitably involves a trade-off. Privatization of the utilities is the product of a post-modern age in which this trade-off is out of balance. Today the emphasis is on economic efficiency and liberty, and Christian concern focusses on the negative effects this has on social justice. Economic efficiency is depersonalising; it values people for what they have, do and produce rather than for what they are. 'This is the supremacy of the strong over the weak.'[105] When economic efficiency is placed first in the order of values technology becomes dominant and human needs take second place. This is one of the factors behind the search for community: 'Man is being reduced to *homo oeconomicus*. Market forces replace moral values as the impetus for technological innovation and progress is judged in terms of economic growth. The powerful gain while the weak lose out when efficiency is the god.'[106] Similarly, when liberty is over-emphasised community suffers, and a vicious circle is set up: 'as distorted notions of freedom lead to further fragmentations of society so, in turn, the divided society breeds more autonomous individuals.'[107] Social justice is the casualty; it mutates into the toleration of difference. This imbalance also leads to rootlessness, the basic problem which Brueggemann identified in societies which have lost the sense of creation as a gift, and have allowed economic criteria to determine social and ethical issues. At a deeper level we have lost the sense that salvation is communal: behind the concept of the Kingdom is the truth that we are saved together or not at all.

Keynes was right when he said that the use of Government power was necessary if efficiency, liberty and social justice are to be combined, but he was wrong in shifting the ethical perspective from the future to the present; arguably this is the root cause of the imbalance. It is exemplified, in different ways, not only in the economics of Keynes, but in the philosophy of Moore and the politics of the New Right. The effects of this shift are seen in the privatization programme with its corresponding emphasis on reducing the role

[104] J.M Keynes, *Liberalism and Labour* (1926), quoted in Preston, *Church & Society*. p.47.
[105] Pope John Paul II, *Evangelium Vitae*, section 23.
[106] Julie Clague, *op .cit.*, p.122. Paul Vallely argues, contradicting Pareto, that a system cannot be termed efficient if it merely improves the lot of one section of society. *Ibid* p.170.
[107] *Ibid*, p.123.

of the state, removing public accountability for the management of utility services, employing short-term, monetary incentives, downgrading the stewardship of natural resources, and rewarding the strong proportionately more than the weak. But this need not be the final judgement. If Dasgupta is right about the epochal nature of economics there can be no final economics; each age produces an economic system in tune with its spirit, driven by its wants and aspirations. On this basis we can imagine an economics driven by more ethical concerns. Atherton's analysis supports this; he suggests not only that economics is in a state of transition,[108] but also that the transition will allow the demands of ethics (or the 'challenges to the market', to use his term) to be brought to bear fruitfully on economic theory and practice. In a paradoxical way utility privatization points to the same conclusion. It has not, in fact, resulted in the triumph of liberal economics; rather it has shown its limitations. The demands of community, justice, stewardship and egality remain potent, and have resulted in important adjustments to free-market practice. But accommodating the challenges requires more than practical adjustments; it requires a change of view, a change of spirit. It really requires a religious perspective. Secular theorists who grapple with the problem seem essentially to be reaching out for a religious vision, and Paul Vallely observes a convergence between ideas like communitarianism and Catholic Social Teaching.[109] This too is a paradox: at the heart of secular society is a search for deeper values than those which sustain modern economic man. This is a reversal of the more usual situation described by Nankivell. He notes that periods of rapid economic change are marked by 'the search for a new ethical basis to justify the actions of those who run with, and take advantage of, change.'[110] Such a search resulted in the politics of the new right and its economically determined values, but this 'new ethical basis' has not proved adequate to the needs of the times,[111] and something akin to the Christian notion of the individual-in-community with its attendant requirements of justice and solidarity is required. The great advantage of the Christian vision over its secular counterparts is its eschatalogical dimension (the idea belief that man has an ultimate destiny) and its doctrine of sin. Sin is a breakdown in relationships, not only between people and between people and God, but also between people and the environment. There is now wide agreement among Christians that 'To view sin in exclusively personal terms is theologically shallow' and inevitably leads to an exclusively individualist view of salvation.[112] Sin infects the structures of society as well as the people who operate those structures, and it is notable that recent social doctrine has developed the concept of structural sin. To recognise this enables the root problem to be

[108] *Op. cit.* Introduction to Part Three.
[109] *The New Politics*, pp.159 ff.
[110] Nankivell, *op. cit.*, p.116.
[111] *Cf.* David Piachaud who argues that on most of its agenda the New Right has failed or is irrelevant: 'Revitalising Social Policy', *Political Quarterly* vol.62 (1991), pp.210-211.
[112] John Drane, 'Salvation and Cultural Change', in Donald English (ed), *Windows on Salvation* (London: DLT, 1994), p.178.

named and points to the resources necessary to deal with it. The debate about the future of the coal industry is instructive. It is the debate about privatization in microcosm, demonstrating the effects of structural sin - what happens when we are locked into a system in which economics is divorced from ethics. Reason takes precedence over revelation as the source of value, social justice and the common good take third place behind economic efficiency and individual freedom, and, most seriously, conservation of a major natural resource is sacrificed to shorter-term gains. While all three of these consequences are important, utility privatization brings the third into sharp focus. Whatever, the short-term benefits, in the long-term it is the stewardship argument and the effect on the environment, which the market treats as an externality, which counts. It is this argument which provides the essential criterion on which utility privatization needs to be judged.

APPENDIX 1

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APPENDIX 2

Papal Encyclicals & Apostolic Letters

The Papal Encyclicals and Apostolic Letters used in this study are published by the Catholic Truth Society, London.

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APPENDIX 3

Regulators' Reports

Each Regulator is required to prepare an Annual Report to the appropriate Secretary of State. The Reports are published as House of Commons Papers as shown in Table 3.

TABLE 3: **REGULATORS' ANNUAL REPORTS**

Year	*Ofgas*	*OFFER*	*Ofwat*
1986:	HC 202 (1986/87)		
1987:	HC 293 (1987/88)		
1988:	HC 197 (1988/89)		
1989:	HC 142 (1989/90)	HC 367 (1989/90)	HC 458 (1989/90)
1990:	HC 158 (1990/91)	HC 355 (1990/91)	HC 492 (1990/91)
1991:	HC 193 (1991/92)	HC 289 (1991/92)	HC 31 (1992/93)
1992:	HC 385 (1992/93)	HC 646 (1992/93)	HC 714 (1992/93)
1993:	HC 203 (1993/94)	HC 252 (1993/94)	HC 416 (1993/94)
1994:	HC 418 (1994/95)	HC 432 (1994/95)	HC 431 (1994/95)
1995:	HC 128 (1995/96)	HC 348 (1995/96)	HC 422 (1995/96)
1996:	HC 237 (1996/97)	HC 16 (1997/98)	HC 21 (1997/98)
1997:	HC 739 (1997/98)	HC 788 (1997/98)	HC 740 (1997/98)
1998:	HC 645 (1998/99)	HC 646 (1998/99)	HC 510 (1998/99)

NOTE:
Ofgas and OFFER publish reports for the calendar year, Ofwat for the financial year. Ofwat reports are listed under the year to which they mostly relate.