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From the Editor

This issue of the ACE Journal focusses on two applied issues of major contemporary significance. The first is share ownership. Ken Heather- from Portsmouth Polytechnic - Alan Storkey (Oak Hill Theological College) address two related questions here, in papers read at the ACE Conference last autumn. Secondly, the highly charged (so to speak) poll tax receives a rigorous critique from Paul Mills and Michael Schluter.

It was good to meet th leader of the Sydney Christian Economics Group, Kim Hawtrey, in London last autumn, and to learn of its fellowship and vigorous work. A challenge to us! We are including their conference programme on the back inside cover for your information and interest.

An important weekend conference on Economic Alternatives may be of interest to some of our members. Forthcoming in Bath on Sept. 9-11, it asks: 'Is getting and spending all we are here for? In recent years both Christian and secular economists have been searching for viable alternatives to current economic orthodoxies. Western capitalism brings wealth but also seems to bring conflict. This study weekend will examine a number of alternatives and attempt to see whether they are viable in the world of today.' The speakers are Paul Elkins, Fr. Andrew Lascaris and Tony Walter - from whom further details and application forms are available (15 Southcot Place, Lyncombe Hill, Bath, BA2 4PE Tel. 0225 314833).

Finally, comments and contributions are always welcome. To write is a stimulus to both author and readers.

Andy Hartropp.

PRIVATISATION AND THE DISTRIBUTION OF ECONOMIC POWER

INTRODUCTION

At last there is a pause for breath in the government's privatisation programme. After the 1987 summer sale of BAA and the early autumn sale of the government's stake in BP there will probably be a substantial break before the next round. With the exception of Austin Rover in 1988, it may be towards the end of the life of the present parliament before anything else is sold. Then there may well come the sale of steel, water, electricity and perhaps parts of the Post Office.

But the end of a round of privatisations would seem a good time to review the success of the policy thus far. One thing seems beyond dispute. It has revolutionised the thinking of many, both in this country and now in many others, with regard to what can be produced within the private sector. For example, it would surely have been inconceivable a few years ago for Lord King of British Airways seriously to suggest health and education as possible candidates for privatisation during the nineties. The political atmosphere has altered so much that the Adam Smith Institute published on 23rd June 1987 'The future of Privatisation' in which its authors, Madsen Pirie and Peter

Young call for privatisation of BR, London Underground, the prison service and the fire and ambulance services. However, to say that more privatisations are feasible is not to say that they are desirable. It is to the likely major effects of the policy generally rather than the effects upon any one industry in particular that we now turn.

The major claimed benefits of the programme are first, that the private firm is a superior producer in terms of efficiency; second, that privatisation raises revenue which can be directed to more useful purposes, and third, the "democratisation of wealth" has wider benefits in giving more people a vested interest in the success of the market system by encouraging them to identify positively with wealth creation. We shall look at each of these in turn. First, what of the view that private ownership increases efficiency?

IMPROVED EFFICIENCY.

Efficiency is a term which has given endless confusion. To some economic efficiency is a state in which more of one good cannot be produced without producing less of something else. But to others this is a definition of technical or perhaps cost efficiency. Some prefer to reserve the term economic effficiency as indicating that society is not only technically efficient but is also producing goods in the right proportions, that is, the mix of outputs is what society prefers.

Now few christians would dispute that efficiency, however defined, is in itself a good thing. The so-called cultural mandate surely includes the concept that God's gifts have been provided partly for the benefit of man and that he should use them as wisely as possible. Inefficiency seems inconsistent with this. Insofar, therefore, that greater efficiency does not detract from other goals which christians value, say a reasonable distribution of income for example, most would regard it as desirable.

However, to a large extent, the government's confidence in the superior efficiency of private as opposed to state ownership is a matter of faith. There are two reasons of importance why this must be so. First there is the question of the possible divergence of accounting costs and social costs. This problem can best be illustrated with reference to coal. What will happen if and when the coal industry is privatised? Presumably this will accelerate the closure of the pits with higher accounting costs. But these tend to be in areas of relatively high unemployment .This will impose additional costs on the rest of society in the form of increased unemployment benefit and reduced income tax payments. Is it then more efficient if these pits are closed? The answer must be yes if one believes that resources, particularly labour, are mobile enough to find alternative sources of employment. However, this is rather hard to demonstrate. Indeed, the proportion of redundant miners finding alternative sources of employment has been depressingly low. Hence the element of faith required. It was precisely this

difference of understanding which gave rise to the miners' strike of 1984-5, where the Cortonwood colliery at the centre of the dispute was unprofitable or socially highly viable depending on the assumptions made about the time taken for the redundant labour force to be redeployed. Fortunately for the government it is only the coal industry which gives rise to this problem in its severest form since most other industries which are candidates for privatisation are expanding industries. Hence the question of the mobility of shed resources is much less severe in other sectors, although there are certainly some potential difficulties with steel. With respect to coal, however, the problems here will come sooner rather than later, for it is difficult to see how the coal sector can be successfully floated until the industry's accounting profit performance is improved. That must mean more and more rationalisation in the relatively short term. In the case of steel the industry's results as it has been prepared to be sold off are remarkable as can be seen from Table C. This is an industry facing fierce competition from a European Community with considerable excess capacity yet its results are very impressive. But the reduction in the size of workforce necessary to bring this about is indeed dramatic.

Second, there is the problem of profits as a measure of efficiency. Should greater profits arise from privatised sectors, this might simply reflect consumer exploitation. For example does the increase in the last financial year (1986-87) in British Telecom's profits to £2,067m, an 11.7 per cent increase on the previous year, reflect a better use of resources or too high prices to consumers as a result of being able to exploit its considerable degree of monopoly power?

It is because of just such a difficulty that the order of priority in the privatisation programme over the next five years seems somewhat strange. The dangers of such exploitation are clearly great in the case of electricity and water, two prime targets for the end of the eighties, yet the government seems to be dragging its feet over the privatisation of the coal industry where the danger of an abuse of monopoly power need not arise. The coal industry could be sold in such a way as to eliminate the Coal Board entirely. Each pit could be sold so it was separately and independently managed so that all pits were in competition with each other. The scrapping of import restrictions would make the industry even more competitive.

Of course, consumer exploitation can be greatly limited by appropriate price controls, should the industry be a natural monopoly, as in the case of electricity or water. It certainly seems unlikely that the reluctance to privatise coal quickly is the government's perception of the problem of social cost mentioned above, except insofar as this constitutes a political embarrassment. In that case one would have thought that the government would regard coal as an outstanding case for selling. But it seems to have been moved down the list of priorities. One explanation is that coal privatisation will bring little revenue compared with electricity and electricity is more attractive to potential investors if coal is made less attractive through opening up the British coal industry to

foreign competition, reducing the CEGB's costs and increasing profits.

How might a christian view the question of monopoly power? Clearly the existence of power is part of the structure of the universe as God has created it. But in a sinful world a system whereby the abuse of power can be held in check is to be encouraged. One of the benefits of Old Testament property laws was that it checked a possible increase in power over crucial resources. Whilst the transferance of property favouring the elder offspring and the complete absence of land and property taxes prevented units from becoming uneconomically small over time (see Deuteronomy 21 v 15-17), the jubilee principle was designed partly to prevent an excessive degree of power over crucial resources. Surely the need for such laws can be discovered in that which Christ referred to in the particular context of divorce laws as the "hardness of heart" of people. (Mark 10 v 5).

Now since governments are comprised of individuals who themselves are not above the temptation to exploit their positions, the dissipation of some economic power out of state hands holds many attractions. But competition and private ownership of resources are by no means the same thing. To transfer economic power from the public to the private sector whilst leaving the degree of concentration of power unaffected seems to hold few benefits. Thus one regards the privatisation of, say, Rolls Royce with greater enthusiasm than that of, say,

water or electricity unless stringent safeguards are imposed on the new owners and managers of those resources.

However, this raises questions as to whether the power in a privatised concern is transferred to the new owners, the shareholders or to the day to day decision takers, the management. We shall return to this later.

BETTER USE OF REVENUE

Clearly, one enormous benefit of state asset sales, predicted to be more than £5 billion per annum until at least the early nineties, is the additional exchequer revenue which enables the financing of alternative projects. Although it can be used to reduce taxation, this is to set a once and for all income against a continuous net outflow of funds. To the extent that the government uses privatisation proceeds in this way, christians should surely be concerned at the deception which this entails. It would thus seem better to treat this additional revenue as an opportunity for increased capital spending of whatever form seems appropriate. But one obvious problem with wishing to maximise revenue through state asset sales is that there is a basic incompatibility with the first objective, namely increased cost efficiency. It would not be possible to quantify it, but the loss of state income must be billions of pounds as a result of the announcement of price controls in some industries which has meant a substantially lower share price to compensate for lower profit expectations.

One example of such a reduction of state income below its potential maximum is to be found in the water industry. Present government plans are to set up a national river authority to oversee those functions remaining in the public sector. Mr Roy Watts, chairman of Thames, the largest of the ten water authorities in England and Wales, has suggested that this will reduce the value of Thames alone by as much as £200 million when the flotation of its shares takes place. Similarly the revenue raised in selling off coal would be greatly reduced if the suggestions made earlier to increase competition were adopted. Perhaps it is such considerations rather than union opposition that makes coal a relatively unattractive target. The exacerbation of regional unemployment in the depressed regions where the least profitable pits are located would, however, be difficult, but the total success of the government in defeating the miners two years ago over this very issue makes it unlikely that union opposition is seen as a serious obstacle to privatisation of the industry.

Not only is there a problem with the trade off between revenue maximisation and efficiency, but there is also the question as to who benefits from the increased revenue. Christian economists, indeed all economists, have struggled with the question of an what constitutes an optimal distribution of income. However, it does seem difficult to justify that those who make the capital gains in state sell offs are higher income groups and it is those same people who benefit from the

secondary gains if the revenue is used to reduce taxation rather than to increase expenditure on social capital.

DEMOCRATISATION OF WEALTH

Finally, what of the democratisation of wealth? This is arguably the government's most important aim in its privatisation programme in that it has the long term objective of changing attitudes to wealth creation through greater individual ownership of capital. One of the great criticisms which has been levelled at the government over its policy of privatisations has been that it has consistently under-priced the assets involved. (see Table A) The appearance of significant profits on the first day of share trading in virtually every case (until the B.P. fiasco, caught up in the stockmarket crash of October 1988) has produced strong criticism from the government's political opponents. It is one thing to sell the family silver. It is another thing to fail to get anything like the best price for it. The clearest indication of government sensitivity to criticism at this point is its attempt over the BAA sale, and later its BP shares, to move towards a system of tendering for a proportion of the shares, although this is only designed to maximize revenue from those shares aimed at the institutions. But it is certainly possible for the government to argue that the under-pricing of assets to members of the general public and the consequent loss of exchequer revenue is a small price to pay

when set against the benefits of a spread of share ownership greatly in excess of anything previously thought possible.

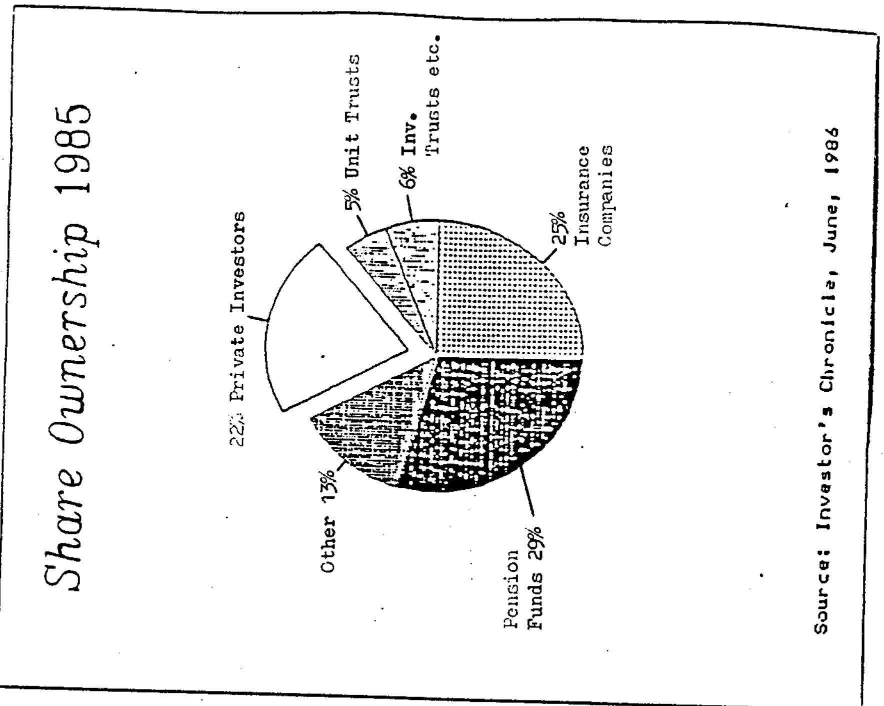
CHANGES IN SHARE OWNERSHIP

Certainly, the government is proud of its record at this point, since by the beginning of 1987 it was able to say that one fifth of the adult population owns shares. This means that the proportion of the population of which this is true has trebled since 1979, whereas it has gone up by only fifty per cent over the same period in the USA. In France, where privatisation is only in its infancy, the percentage of adults owning shares is thought to have increased from five per cent only to about ten per cent over the same time period. There can surely be no doubt that the predominant explanation for this phenomenal and unique rise is government policy towards asset sales. This can be seen from the fact that fifteen per cent of all adults, six and a half million, representing over three quarters of share holders, hold shares in at least one privatised company, or in TSB, and just over half of those hold shares exclusively in privatised companies or TSB. Clearly, the trends described above have also been reinforced by employee share schemes, three and a half per cent of adults now holding shares in the company for which they work. The extent to which the market system is consistent with the Bible is outside the scope of this article, but at least the above figures would appear at first sight to

indicate a move towards a wider spread of economic power which we earlier argued was in and of itself a good thing. It can also take some encouragement from the numbers in Table E showing a wider spread of shareholding in lower socio-economic groups.

But what the government does not say is that whatever the effects of the above, in one very important area the significance of its privatisation programme has so far been minimal. There has been no discernible effect in slowing down the trend towards an increasing proportion of shares being in the hands of the institutions. (See charts 1 and 2.) This steady upward trend over the last ten years has been entirely unaffected by privatisation, albeit some individuals who have been encouraged through state asset sales to invest in shares have taken their share ownership through the unit trusts etc. rather than involve themselves directly in the purchase of shares. It is, of course, possible, that the effect of the privatisation policy is cumulative and that it is too early for such effects to take place. Looking at Chart 3, the dramatic increase in the individual ownership of shares appears only to have begun in 1984-5. But it does seem as though the process has a long way to go before it slows down the movement of shares towards the institutions. It certainly looks as if it will take more than further privatisations to affect the trend. A significant change of attitude towards risk bearing is also required. However, it is just such a shift which the government seeks. Table D suggests that at the moment most people are still interested only in privatised shares.

Chart 1 CHANGES IN SHARE OWNERSHIP 1963 - 1985.



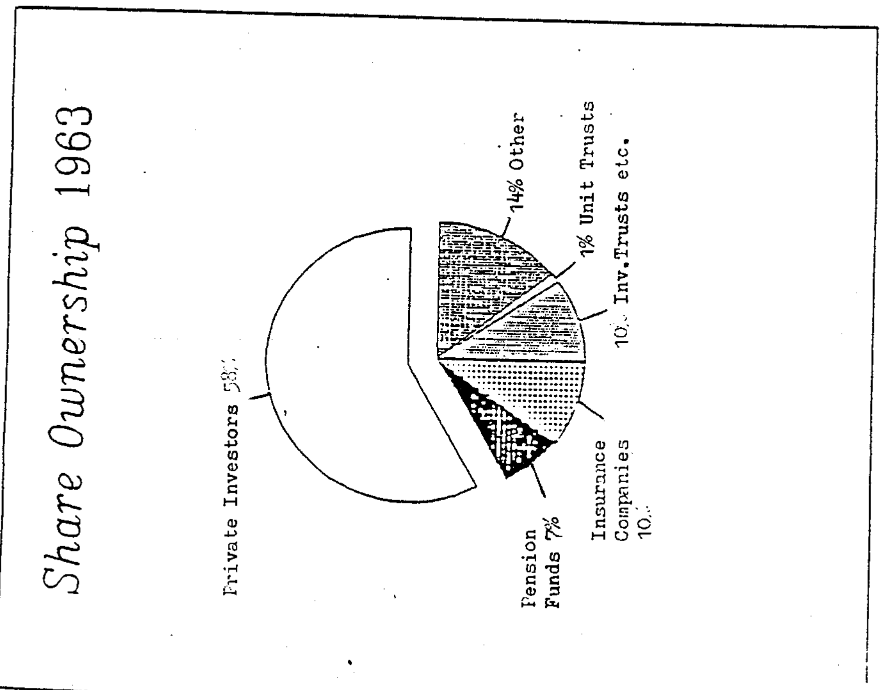
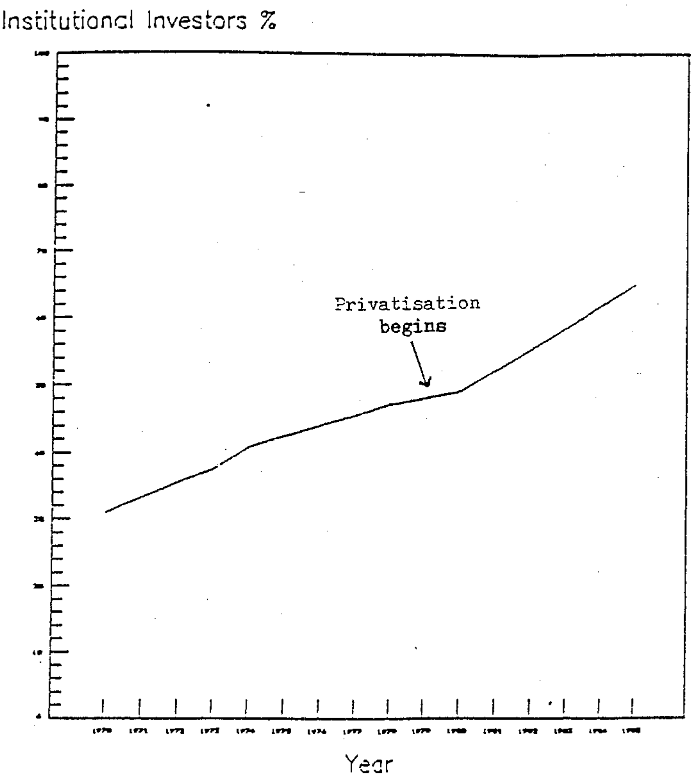


Chart 2 CHANGES IN INSTITUTIONAL SHARE OWNERSHIP 1970 - 1985.



Note:

The graph is based on the extrapolation of figures from a number of surveys over the period. They are:

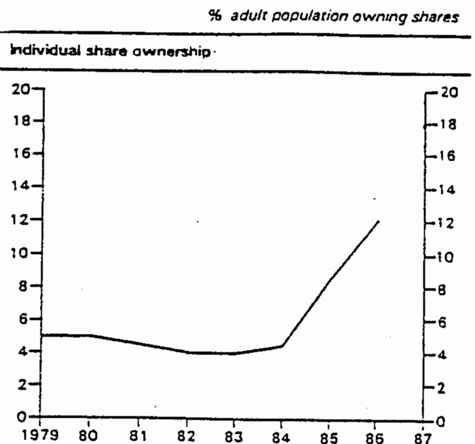
R Briston and R Dobbins: The growth and impact of Institutional Investors.

H Wilson: Committee to review the functioning of financial institutions.

Stock Exchange Factbook.

Investors' Chronicle.

Chart 3 CHANGES IN PRIVATE SHARE OWNERSHIP 1979 - 1987



Source: Financial Research Survey. Quoted in: Treasury. Economic Progress Report March-April 1987

SHARE OWNERSHIP AND MANAGEMENT BEHAVIOUR

All this raises two key issues. One is whether the spread of share ownership has any effects on management power generally. The other is how the spread of ownership will affect management power and its consequent behaviour in the growing number of privatised companies.

It seems unlikely that the sale of assets is going to change the structure of share ownership with respect to the build-up of institutional holdings. However, this is probably no bad thing in the eyes of a government committed to the market system and convinced of the vital role of profitability in bringing about maximum cost efficiency. In recent years some studies have raised doubts as to whether firm behaviour is consistent with management attempting to maximize profit, and thus shareholder income. Some evidence suggests some firms concern themselves more with the growth of the firm, subject, of course, to making a reasonable profit . It is not necessarily the case that a policy of aiming for growth will indirectly maximize profit in the long run. For example, firms may well be willing to pay more than a company is worth in a takeover bid just to increase size, provided that this is not going to reduce profit to an unacceptably low level. The result would be a larger firm but smaller dividends for the shareholders. Interesting support for this view is given in the 1987 May/June edition of the Harvard Business Review where a major survey of American firms' external diversification policies suggests an almost total

failure measured against any profit criterion. Since senior management salaries are frequently linked to size of organization rather than profitability this is not as surprising a conclusion as might at first be thought. It is unlikely that things are any different in this country. This also suggests that the process by which increasing institutional power can make itself felt in boardrooms has still some way to go.

THE POWER OF INSTITUTIONAL INVESTORS

What gives management such power and makes such behaviour possible? The answer must surely lie in the nature of shareholder activity. Those who own the firm, the shareholders, lack an adequate level of knowledge to realise that profits could be higher and/or they lack sufficient power to oblige management to change its behaviour. Now what has surely lessened the effects of this divorce of ownership and control is the concentration of shareholder power into the hands of groups large enough to force changes in management behaviour. This is exactly what the rise of the institutional investors has been bringing about. For example, earlier this year when Fisons wanted to issue shares to overseas investors, thus diluting the hodings of the existing shareholders, the insurance companies were able to resist the move. This was no isolated case. It is part of a process by which institutional investors are increasingly using their power to oblige firms to conform to

behaviour in the interests of the shareholders. The Association of British Insurers produced guidelines during the spring of 1987 opposing proposals which give companies the right to issue more than two and a half per cent of issued capital until it has first been offered to existing holders. This move has been supported by the National Association of Pension Funds. The dissipation of shareholder power twenty years ago would have made such moves much less likely to have any effect.

Two other factors are encouraging the institutions to involve themselves in management decisions. One is that it has become more common for the institutions to hold larger blocks of shares in fewer companies, since it is now recognised that this can be done at very little additional risk. This further increases institutional power. The other is that management is increasingly aware of the decisiveness of the institutions' voting behaviour in takeover battles. This makes management far more receptive to institutional pressure. An outstanding illustration of this came in the middle of May, 1987 at the climax of Tesco's hostile and bitterly contested bid for Hillards, the Yorkshire - based supermarket group. Tesco's offer attracted 34.9 per cent of acceptances to go with its own 21.7 per cent stake - enough to secure victory, but with not much to spare. Family trusts and many small shareholders in Yorkshire voted against the offer. But virtually all the institutions voted to accept the offer. This included the biggest institution holding shares, the Prudential, which had a block of about 4 per cent. So the institutions were the critical factor in Hillard's

defeat. Although Prudential refused to comment beyond confirming how they had voted, their general policy is to support the encumbent management. But "at some price a bid can be too attractive for us properly to reject it."

We leave aside the great question as to the extent to which the pursuit of profit maximization is consistent with the welfare of a country's citizens, although one small aspect of that question is relevant here. Many managers feel that increased involvement by the institutions is harmful since it forces firms to think of short term profitability at the expense of the long term. Peter Hartley, Hillard's chairman criticised the acceptance of Tesco's bid as "another example of the selfish and irresponsible attitude adopted by city financiers." But the issues of 'short termism' are outside the scope of this article. However, if the operation of a market economy requires that firms follow a policy of profit maximization, then it is as well that the programme of privatisation has not led to a widespread dissipation of shareholder power.

Finally, what is likely to be the outcome of the spread of shareholder power on the industries which are privatised? Here there could well be a problem. The government fervently hopes that a high proportion of private investors will not take their short term profits and sell, but will become long term investors in those companies. In Table F I give my initial calculations. The extent of short term profit taking seems to vary considerably between shares. This data relates to a period immediately prior to the events of 'Black Monday'. The initial indications, however, suggest that small shareholders have sold relatively less than the institutions. Small shareholders mightbe expected to be more 'loyal'. They tend to have less knowledge of alternative sources for funds and far higher transactions costs if they choose to sell and subsequently wish to re-invest. To the extent that government hopes are fulfilled and it happens to a large degree that smaller shareholders do not sell, the dissipation of shareholder power will be greater here than in other industries. If this were to be so, management of privatised concerns might well be able to follow goals other than profit maximisation more easily than many non-privatised firms, and this in industries of crucial importance not only to the economy as a whole but also to lower income groups. This is obviously so because we are considering power in industries which are mainly basic utilities - the very reason that they were brought into public ownership in the first instance. As a result there may be less efficient use of resources in these key companies than the government had hoped. Christians must do some careful thinking here. Given the sinfulness of man, most of us would prefer to see power reasonably widely dissipated. The concentration of power almost certainly leads to serious abuse. Privatisation seems at first sight to dissipate power. In fact if shareholder power is too widely spread, it enables decision makers within firms to excercise greater power over the resources at their disposal. It is by no means clear that this is of social benefit.

CONCLUSION

The government regards the privatisation programme as having three major separate benefits; cost efficiency, releasing of revenue for other purposes, and the democratisation of wealth. In fact, they are not separable. The creation of the necessary conditions for a successful share float and the changes in the structure of share ownership that this may bring about have significant repercussions for government revenue and for cost efficiency. In other words these three goals are interdependent. What underpins all three is a matter of crucial interest to a christian study of economic relationships - the dispersal or concentration of economic power and its use or abuse.

Notes:

1. See, for example, D.D Shipley: "Primary Objectives in British Manufacturing Industry." Journal of Industrial Economics. Vol 29. No 4. June, 1981.

2. See, for example, G. Whittington: The profitability and size of U.K. companies." Journal of Industrial Economics. Vol. 28 No 4. June 1980.

Ken Heather

TABLE A. Premium on Shares in Selected Privatised Companies on First Day of Trade

	Part Paid Price	Opening Price
British Telecom	50p	95p
British Gas	50p	68p
British Airways	65p	119p
Rolls Royce	85p	128p
B.A.A.	100p	142p

Source: Various.

TABLE B. Performance of Selected Privatised Companies

	83-4	86-7
(1) Associated British Ports		
Pretax profits (£m)	14.5	26.0
Rate of return on capital employed	8.96	13.24
Number of employees	8,956	6,346
	84-5	**86-7**
(2) British Telecom		
Pretax profits (£m)	1,480	2,067
Rate of return on capital employed	17.69	21.16
Number of employees	238,304	236,241
	83-4	**86-7**
(3) Britoil		
Pretax profits (£m)	586.2	133.8
Rate of return on capital employed	71.17	16.76
Number of employees	2,651	2,371
	84-5	**86-7**
(4) Jaguar		
Pretax profits (£m)	91.5	120.8
Rate of return on capital employed	48.36	28.58
Number of employees	9,662	11,324

Source: Company Reports.

TABLE C. Performance of a Privatisation Candidate: British Steel

	1977-78	1981-2	1986-7
Liquid steel production (million tonnes)	17.4	14.1	11.7
Employees (000's)	196.9	103.7	52.0
Productivity (man hrs per tonne)	15.3	9.4	6.2
Net profit (£m)	-513	-504	178

Source: British Steel Corporation.

TABLE D. Shareholding at the Beginning of 1987 - Spread of Ownership Between Companies

Number of Companies Invested in	Number of Shareholders (millions)	% of all Shareholders
One	5.4	56
Two	2.1	22
Three	0.8	9
Four - nine	0.8	8
Over ten	0.3	3

Source: Based on tables from Dewe Rogerson, Marketing Consultants.

TABLE E. Socio-Economic Grouping: Percentage Shareholders in Each Group.

Class	1983	1987
AB	56	29
C1	26	34
C2	12	26
DE	6	11

Source: Dewe Rogerson, op.cit.

TABLE F. Reductions in Holdings of Some Privatised Companies

Company	Time of Privatisation	Original List of Stockholders	Most Recent Register	Subsequent Size of Register	Period Over Which Decline Measured	% Monthly Average Decline in Number of Shareholders
Amersham International	Feb. '82	65,000	Sept. '87	5,940	5 yrs 7 mths	3.508
Enterprise Oil	June '84	13,695	June '87	11,100	3 yrs	0.58
Jaguar	July '84	125,000	Sept. '87	34,918	3 yrs 2 mths	3.30
British Telecom	Nov. '84	2,300,000	Mar. '87	1,417,905	2 yrs 4 mths	1.71
T.S.B.	Sept. '86	3,000,000	Oct. '87	1,970,000	1 year	3.44
British Gas	Dec. '86	4,407,079	Sept. '87	3,000,000	9 mths	4.18
Rolls Royce	May '87	2,000,000	Oct. '87	1,250,000	5 mths	8.97
British Airways	Feb. '87	1,100,000	Oct. '87	404,000	8 mths	11.76
B.A.A.	July '87	2,187,500	Oct. '87	1,500,000	3 mths	11.817

Source: Various including Dewe Rogerson and Stock Exchange.