

The Privatisation of British Telecom (1984)

Starting point

Privatisation became one of the defining policies of the Conservative Party's eighteen years in power between 1979 and 1997. Yet it was barely mentioned in the 1979 Conservative general election manifesto and the new government's first budget speech contained only an oblique reference to shrinking the state. As Margaret Thatcher reflected in her memoir, since now "*almost universal lip service is paid to the case for privatization it is difficult to recall just how revolutionary – how all but unthinkable – it seemed at the end of the 1970s.*"¹ Such "*unthinkable*" policy solutions only found favour due to the growing perception that the persistent economic performance problems in the public sector required radical remedies. This case study looks at the ways in which bold and untested proposals were turned into successful policy.

Policy background

Although privatisation has a number of potential meanings, the sale of publicly owned assets (otherwise known as denationalisation) became almost synonymous with the use of the term as applied in the UK. Nigel Lawson recalled that "*most of us felt denationalization did not sound positive enough*" and therefore the process came to be officially described as privatisation.² This usage was an invention of David Howell (Secretary of State for Energy, 1979-81, and Secretary of State for Transport, 1981-3) and seems to have gained favour simply through the lack of a better alternative: "*It is an ugly word and Margaret disliked it so much that for some time she refused to use it. But none of us could come up with anything better.*"³ In its broader conception, privatisation also signalled a change in the relationship between the state and business, as well as the deregulation, liberalisation and the introduction of competition into formerly publicly owned industries.

One of the key aspects of the debate on the origins of privatisation is to what extent it was planned in advance by the Conservatives while in opposition. Many of those from the time saw little evidence of planning for privatisation. At our policy reunion, John Wakeham recalled that the economist Stephen Littlechild deleted a chapter on privatisation from a book, which he wrote on options for a future Conservative government in 1978, because he feared including it would mean

¹ Margaret Thatcher, *The Downing Street Years* (London: HarperCollins, 1993), p. 677.

² Nigel Lawson, *The View from No. 11: Memoirs of a Tory Radical* (London: Bantam, 1992), p. 198.

³ *Ibid.*

the book would not be taken seriously.⁴ The focus of the 1979 manifesto was on controlling money supply, reducing public expenditure and cutting tax. Yet, while it did not outline a programme of widespread privatisation, the manifesto did promise “to sell back to private ownership the recently nationalized aerospace and shipbuilding concerns, giving their employees the opportunity to purchase shares”, as well as selling off “shares in the National Freight Corporation to the general public”.⁵ Many commentators have concluded that denationalisation came about either largely by accident or as a policy emerging through trial and error. According to James Foreman-Peck, “in the late 1970s privatisation was scarcely even a gleam in the minister’s eye”.⁶ Andrew Gamble has described the eventual policy making process as “a series of ad hoc decisions and experiments” that were “given retrospective justification and coherence by government ministers”.⁷

However, one of the architects of the policy process, Nigel Lawson, has rejected these interpretations: “They could not be more mistaken.”⁸ Although admitting that little detailed work had been done in opposition, Lawson explained that the reluctance to go public with these plans was the result of “chiefly Margaret’s understandable fear of frightening the floating voter” and he remained adamant that “privatization was a central plank of our policy right from the start.”⁹ Other accounts suggest that a certain amount of work had been done even before the Heath government a decade earlier. A denationalisation group had worked through the Conservative Research Department and a study was prepared on the potential for such a policy.¹⁰ However, these proposals did not make it into Heath’s already very full programme. Whatever its exact origins, the ultimate form of privatisation adopted under Thatcher evolved as initial successes spurred on grander initiatives.

After winning the 1979 election, the Thatcher government was determined to introduce a raft of reforms that would restructure the economy, roll back the state, and redefine the relationship between the public and private sectors. This radical agenda had been generated in direct response to the failure of previous regimes, but it also responded to a growing disenchantment with the mixed economy of the post-war settlement. Andrew Gamble has suggested that the new direction of the Thatcher government was possible “because by the time it took office so many of the policies and ideas associated with the 1940s had been discredited”.¹¹ As the government pushed through measures to boost economic performance, reduce dependency on the welfare state and limit the power of public sector unions, post-war political consensus gave way to an increasingly adversarial

⁴ Institute for Government, Policy Reunion on Privatisation (24 November 2010); details available at: <http://www.instituteforgovernment.org.uk/our-events/64/policy-reunion-privatisation>

⁵ Conservative Party General Election Manifesto (1979), available at: <http://www.conservative-party.net/manifestos/1979/1979-conservative-manifesto.shtml>

⁶ James Foreman-Peck, ‘How Privatisation Has Changed Britain’, *BBC* (3 December 2004), available at: <http://news.bbc.co.uk/1/hi/business/4061613.stm>

⁷ Andrew Gamble, ‘Privatization, Thatcherism, and the British State’, *Journal of Law and Society*, vol. 16:1 (Spring, 1988), p. 7.

⁸ Lawson, *View from No. 11*, p. 199.

⁹ *Ibid.*

¹⁰ Brendon Sewill, ‘Policy-Making for Heath’, in Alistair Cooke (ed.), *Tory Policy-Making: The Conservative Research Department 1929-2009* (Conservative Research Department, 2009), p. 61.

¹¹ Gamble, ‘Privatization, Thatcherism, and the British State’, pp. 2-3.

relationship between reformers and defenders of the status quo. In particular, the key tenet of the New Right strand of Conservatism, which developed during these years, held that the market was the best way to organise economic activities since it provides financial constraints and incentives that reduce waste and inefficiencies. In the words of Lawson, there is *"no equivalent in the state sector to the discipline of the share price and the ever-present threat of bankruptcy."*¹² It should be noted, nonetheless, that the policies adopted in practice were not always as radical as the rhetoric.

There were a number of reasons why addressing the performance of these industries was of concern to the incoming Conservative government. During the 1960s and 1970s, Britain suffered from high inflation, low growth and difficult industrial relations. As Kenneth Baker, who was to oversee the privatisation of BT, later recalled: *"Inflation in the '70s got totally out of hand. We were running at 18 to 20 per cent inflation, and if you run that for very long it's a disaster."*¹³ Damned by commentators as the 'sick man of Europe', the ideas of economists Friedrich Hayek and Milton Friedman gained supporters on the right who advocated tackling inflation, increasing the role of markets and limiting the size of government in order to transform the country's fortunes.

The state had been gradually accruing public corporations since the nineteenth century, but particularly so under the 1945 Labour government. By 1979, nationalised industries represented 10% of the economy and 14% of capital investment.¹⁴ However, the productivity performance of nationalised industries lagged behind the private sector and the rate of return on capital was only 0-2%. John Wakeham pointed out that, unlike the private sector, the nationalised industries had been unable to deliver on their commitments under Harold Wilson's planning agreements.¹⁵ Furthermore, government was struggling to contain the collective bargaining power of the trade union movement. A civil servant in the Treasury, Gerry Grimstone, recalled a John Moore speech on privatisation that used a quotation from Herbert Morrison's address upon launching the post-war nationalised industry programme: "Morrison had made much of how employees in the public sector would accept lower wages and work in the public interest, but this belief was hard to square with the reality of poor industrial relations in the nationalised industries. Furthermore, there was a backlog of under-investment as ministers sacrificed higher external financing limits to protect more politically important programmes. One way in which this was manifested were the huge waiting lists for new telephone lines as British Telecom could not cope with exploding demand from the City. In the words of Baker, the producer-dominated operation meant *"there were hundreds of thousands of people waiting for an ordinary telephone connection because only one company could do it. They would send out their employees when it suited them, rather when it suited you."*¹⁷

Facing severe economic challenges, strong political momentum therefore developed in favour of denationalisation and accompanying policies of liberalisation with a number of ambitious ministers,

¹² Lawson, *View from No. 11*, p. 203.

¹³ Interview with Kenneth Baker, 'Commanding Heights', PBS (19 September 2000), available at: http://www.pbs.org/wgbh/commandingheights/shared/minitext/int_kennethbaker.html

¹⁴ Statistics cited by Sir Nicholas Monck at IfG Policy Reunion.

¹⁵ IfG Policy Reunion.

¹⁶ John Moore was Economic Secretary to the Treasury during 1983 and then Financial Secretary to the Treasury until 1986.

¹⁷ Interview with Kenneth Baker, op cit.

most notably Nigel Lawson, Keith Joseph, Geoffrey Howe, John Nott and David Howell, lined up behind the strategy. Within the civil service there was a general feeling that current policies were failing so badly that anything was worth trying, though there was little experience or knowledge of how to go about privatisation. Nevertheless, civil servants initially did not quite appreciate ministers' agenda. Nick Monck suggested to Nigel Lawson, who was Financial Secretary to the Treasury, that the department should prepare an estimate of the value of the industries remaining in the public sector versus their value outside. Lawson refused to commission such a study, arguing that the market would value them, and that this was beside the point anyway since their value was not the driver behind the change which was being undertaken for much more fundamental philosophical reasons. Monck has conceded that, in any case, officials would have underestimated the scope for efficiency gains in the nationalised industries.¹⁸

Since the policy was not highlighted in the manifesto, officials had done no pre-election preparation for an extensive privatisation programme nor indeed had the Tories while in opposition. As Lawson acknowledged, this created some initial difficulties since, *"to all intents and purposes, it had never been done before. This is remarkably rare in Whitehall. Whenever a Minister has what he thinks is a new idea, the chances are that it is nothing of the sort."*¹⁹ However, it turned out this was an area officials wanted to work on – it was seen as exciting – and John Wakeham acknowledged that the success of the privatisation programme came from ministers and civil servants working highly effectively together to make the changes happen – he was struck by how *"helpful"* civil servants were.²⁰ In the view of Lawson, officials *"found that while pioneering was hard work, it was actually much more enjoyable than re-treading a well trodden path."*²¹ Although empirical evidence for the efficiency benefits of private versus public ownership were inconclusive, not least because the public sector often carried out some non-commercial activities, the government remained steadfast in its determination that privatisation would improve economic performance.²²

Initiation

Understanding the success of privatisation as a policy lies in large part in appreciating how it grew from a piecemeal approach into something more comprehensive. It was the initial successes of relatively small scale sell-offs and modest liberalisations that emboldened the government to go further.

Though not discussed in the manifesto, the first few announcements of privatisation plans came in 1980 and a Ministerial Sub-Committee on the Disposal of Public Sector Assets E(DL) began meeting

¹⁸ IfG Policy Reunion.

¹⁹ Lawson, *View from No. 11*, p. 198.

²⁰ IfG Policy Reunion.

²¹ Lawson, *View from No. 11*, p. 198.

²² For a discussion of the contemporary academic evidence on public and private sector ownership, see J. A. Kay and D. J. Thompson, 'Privatisation: A Policy in Search of a Rationale', *The Economic Journal*, vol. 96 (March 1986), pp. 18-32.

at the end of May 1931.²³ The new government's first disposal of assets included shares in British Petroleum (BP), but this came on the back of a sale by the previous government in 1977. This was followed by the denationalisation of bodies such as British Aerospace in February 1981 (which had only been in the public sector since 1977) and Cable & Wireless in November 1981. These were treated as discrete sales whose aim was to raise revenue for the Exchequer. Yet, they proved to be an important learning experience for ministers and officials involved. In particular, Lawson regarded the sale of Amersham International in February 1982, which was 30 times oversubscribed and opened with a more than 30% premium, as a fairly disastrous experience.²⁴ Having significantly undervalued the sale, the media and opposition accused the government of squandering taxpayers' assets and rewarding the party's supporters in the City.

Gerry Grimstone saw one of the major turning points as the privatisation of Britoil, overseen by Lawson as Energy Secretary, which nearly failed because it was priced at the upper limit of what was saleable.²⁵ It was at this point that ministers stopped regarding privatisations as a series of discrete sales, to be judged each on their own merits, and began to look on them instead as part of a programme that also embraced the sale of council houses and measures to increase share ownership. This was made easier by the fact that the Treasury was already seen as having an overall lead on government policy on nationalised industries, setting the framework within which sponsor departments managed the relationships with their industries. The programme, as it developed into one, also had ministerial coordination from the beginning, through the Cabinet Sub-Committee on the Disposal of Public Sector Assets, which monitored the progress of the policy.

However, in understanding how these early moves developed into the policy success as we perceive it today, the most important privatisation was British Telecom (BT). In this case, ministers were particularly keen to look at ways of liberalising the market and introducing competition into the sector. Due to the sheer infrastructure costs associated with the industry, telecoms had long been considered a so-called 'natural monopoly'.²⁶ However, new technologies were beginning to reduce the capital investment required for entry into the market and the prospect of greater competition became feasible. In July 1977, the Carter Committee report had recommended the separation of telecommunications from the Post Office, but this measure was not implemented until the change of administration.²⁷

The British Telecommunications Act 1981 finally provided for the removal of BT from the control of the Post Office. It also enabled the Secretary of State for Trade and Industry to licence other operators to run telecommunication systems. This ended the monopoly that had existed since the nationalisation of the industry in 1912. The next stage was to develop the market. The Thatcher

²³ The National Archives, CAB 134/4339, 'Ministerial Committee on Economic Strategy: Sub-Committee on Disposal of Public Sector Assets: Meetings 1-8', Papers 1-18 (31 May 1979 – 19 December 1979).

²⁴ Lawson, *View from No. 11*, pp. 208-10.

²⁵ IfG Policy Reunion.

²⁶ See Yair Aharoni, *The Evolution and Management of State-Owned Enterprises* (Cambridge, MA: Ballinger Publishing, 1986), p. 264.

²⁷ For Keith Joseph's role in overseeing the separation of the postal service from telecommunications, see Morrison Halcrow, *Keith Joseph: A Single Mind* (London: Macmillan, 1989), pp. 142-3.

government set up an expert committee to look at ways of introducing competition into BT's value added services. In February 1982, a consortium of Barclays, BP and Cable & Wireless set up Mercury Communications in competition with British Telecom to meet some of the unmet demand for phone lines. However, Mercury only operated in this small niche market and did not act as a significant threat to BT's core business.

While the original intention was simply to open up the telecoms market to competition, the need to finance the modernisation of BT encouraged talk of privatisation. Concerns had been raised that future expenditure would bust the government's budget ceiling and, according to economist Jon Stern, denationalisation was "*driven in large part by the need to get BT's investment programme off the PSBR (Public Sector Borrowing Requirement).*"²⁸ It was also felt that market constraints would inevitably cut waste and increase profits. Key figures, such as John Moore who became Economic Secretary to the Treasury in 1983, later claimed previous failures to introduce stricter guidelines and control mechanisms demonstrated that governments could not drive through efficiency savings in public companies to the same extent as private management teams which had a clear profit motive.²⁹

On 19 July 1982, the government formally announced plans to sell up to 51% of BT shares to private investors. Kenneth Baker, Minister for Industry and Information Technology, was keen to emphasise that the Bill offered corporate independence from the Treasury and ministerial control: "*It also gives freedom to BT to grow, to operate overseas, and to make acquisitions... the market is growing so quickly that BT can expand only by becoming a free, independent company*".³⁰ However, the announcement of the 1983 election caused the Bill to be withdrawn due to a lack of time to secure its passage through parliament. Privatisation was now a campaign issue and the Tory manifesto contained a list of the enterprises which it intended to return to private ownership including British Telecom.³¹ On 10 June, the Conservative Party was re-elected with an increased majority and, having secured a second term in office, the Thatcher government reintroduced the Bill. As a number of those at our policy reunion emphasised, it was the fact that the government was able to build on earlier small scale denationalisations which saw privatisation develop into the successful programme it became.

²⁸ Jon Stern, 'What the Littlechild Report Actually Said', in Ian Bartle (ed.), *The UK Model of Utility Regulation* (Bath: University of Bath, 2003), p. 12; available at:

http://www.bath.ac.uk/management/cri/pubpdf/Conference_seminar/31_Model_UTILITY_Regulation.pdf

²⁹ John Moore, 'Why Privatised?', in John Kay, et al. (eds.), *Privatisation and Regulation: The UK Experience* (Oxford: Clarendon Press, 1986), p. 85.

³⁰ Kenneth Baker, *House of Commons Debate*, vol. 33, cc.31-113 (29 November 1982); available at <http://hansard.millbanksystems.com/commons/1982/nov/29/telecommunications-bill>

³¹ Conservative Party General Election Manifesto (1983), available at: <http://www.conservative-party.net/manifestos/1983/1983-conservative-manifesto.shtml>

Options

The UK's privatisation programme was unprecedented anywhere in the world. As such, decisions had to be made on the basis of what was deemed possible at the time, something that all participants at our policy reunion stressed. This proved, in the end, to be another key feature of the policy success, but it was not apparent at the time. The sale of British Telecom was of a size and a scale never tried before, and many questions emerged. Government needed to decide whether to restructure the company before selling it off, which might either be used to maximise revenue for the Treasury or promote liberalisation of the sector, and what regulatory mechanisms should be put in place post-privatisation. Working out the details of this as they went along may have led to missed opportunities (such as in setting a high enough share price), but importantly, it led to a model of privatisation that could then be applied to other industries.³²

While the primary aim of denationalisation was to improve performance, it had a secondary benefit in the form of increasing public share ownership. This goal can be seen as an extension of the government's drive to promote home-ownership and a wider commitment to reduce the size of the state. Margaret Thatcher believed *"through privatization – particularly the kind of privatization which leads to the widest possible share ownership by members of the public – the state's power is reduced and the power of the people enhanced."*³³ More pragmatic motives also lay behind the move. Trade union leaders were opposed to denationalisation, but the government adopted a divide and rule tactic to overcome these concerns. BT employees were offered the right to pre-register for a tranche of free shares. Over 90% of the eligible work-force took advantage of the offer and this allowed the government to confront trade union leaders with the popularity of the sale among its own membership. In the general population, the proportion of share owners increased from 7 per cent in 1979 to 25 per cent ten years later. From a political perspective, Nigel Lawson also felt that the widest possible distribution of shares among the public would cement the transfer of these businesses to the private sector: *"For the more widely the shares were spread, the more people who had a personal stake in privatization, and were thus unlikely to support a Labour Party committed to renationalization. And if this forced Labour to abandon its commitment to renationalization, so much the better."*³⁴

There were some conflicting goals among the principal players around elements of the privatisation design. While the government wanted to put as high a value on the company as was consistent with a successful share sale, the management (with their own merchant banking advisers) had a personal interest in talking down the value to ensure maximum upside for their share options. Indeed, in the later electricity privatisations, John Wakeham had to fire two chairmen due to their obstructive tactics.³⁵ Moreover, as Andrew Gamble has highlighted, it was necessary to secure the willing co-operation of the management of the nationalised industry and inevitably the management opposed the breaking up of their industry:

³² IfG Policy Reunion.

³³ Thatcher, *Downing Street Years*, p. 676.

³⁴ Lawson, *View from No. 11*, p. 208.

³⁵ IfG Policy Reunion.

In order to placate public sector managers, therefore, the Government gave less priority to the achievement of liberalization, and concentrated on the goals of raising money for the Exchequer and widening share ownership.³⁶

These concessions had to be made in order to gain management support and smooth transition from public to private ownership. In November 1983, Kenneth Baker, as Minister for Industry and Information Technology, set out a duopoly policy that limited the number of long-distance fixed-link operators to two (British Telecom and Mercury) for seven years.³⁷ This arrangement was agreed to allow Mercury's alternative network "a chance to get established."³⁸ Although the government announced further proposals to liberalise equipment supply and maintenance, commentators including Stephen Littlechild have argued that the duopoly approach stifled the development of competition.³⁹

In the case of BT, the company's accounting system was such that it could not be broken up into individual profit centres so it had to be sold as a whole.⁴⁰ David Clementi, a director at Kleinwort Benson which advised the government on a number of privatisations, pointed out that the largest sale ever seen before was the \$500m sale of AT&T in the United States – British Telecom was valued at around £8bn – so a 51% sale, the amount necessary to sell if BT was to be moved outside the public sector, meant raising £4bn. The American banks were sceptical about the ability of the City to manage a sale of that size. Nick Monck said many people warned that it was "too big to sell", but the government knew BT simply could not be split up due to the poor state of its financial records.⁴¹ Thatcher acknowledged that separating the company would have been preferable for the sake of competition, but "accounting and management systems were, by modern standards, almost nonexistent" and there was "no way in which the sort of figures which investors would want to see could have been speedily or reliably produced."⁴² Rather than delay the sale by years, the privatisation process pushed ahead on the basis of maintaining the company intact. Having decided to ignore these concerns, one of the remaining issues with the British Telecom denationalisation was finding a way of moving an unprecedented amount of shares into the market. Here the government relied heavily on its City advisers. They needed to make the privatisation attractive to institutions and overseas investors, as well as mobilising individual shareholders on a massive scale in a country where only a small number owned shares. The government and its advisers spent two years working out how to manage such a large sale and conducting a marketing campaign.

Another of the key issues was the design of the regulatory regime. Although some work had been done by academics, this was an area where there was no prior direct experience to draw on for

³⁶ Gamble, 'Privatization, Thatcherism, and the British State', p. 12.

³⁷ Oftel, 'A Brief History of Recent UK Telecoms and Oftel'; available at: <http://www.ofcom.org.uk/static/archive/oftel/about/history.htm>

³⁸ Interview with Kenneth Baker, op cit.

³⁹ See Stephen Littlechild, 'The Birth of the RPI-X and Other Observations', in Bartle (ed.), *UK Model of Utility Regulation*, p. 41-44.

⁴⁰ Ibid, p. 41.

⁴¹ IfG Policy Reunion.

⁴² Thatcher. *Downing Street Years*, p. 680.

ministers and officials. In particular, there was a clear tension between the toughness of the regulatory regime and the value of the company. The government commissioned economist Stephen Littlechild to investigate ways of regulating BT's profitability. His report, published in February 1983, proposed an RPI-X formula for price setting that would maintain price increases at a fixed level below the rate of inflation for a number of years. This model of price capping had initially been suggested in discussions about the Buzby Bond in the form RPI-2 and Littlechild realised it could be generalised into RPI-X and provide an alternative to US style rate of return regulation:

This idea [an RPI-X price cap] could be adapted to present circumstances, by incorporating a condition in BT's licence requiring it not to increase tariffs on monopoly services by more than RPI-X per cent, i.e. to reduce these tariffs by X per cent in real terms. There are several details to be settled: to which services should tariff reduction apply? Should the guarantee apply to each service separately or to a basket of services? At what level should X be set?⁴³

Since RPI-X meant prices would be set below the rate of inflation, increased profits could only be generated by reducing waste and inefficiencies. Although calculating the value of X over time would prove challenging, Littlechild's report only envisioned the need for temporary regulation as it argued that sufficient competition would emerge within a few years to remove the price cap mechanism:

Competition is indisputably the most effective – perhaps the only effective means – of protecting consumers against monopoly power. Regulation is essentially the means of preventing the worst excesses of monopoly; it is not a substitute for competition. It is a means of 'holding the fort until competition comes.'⁴⁴

In order to achieve this objective, Littlechild recommended a review by the Monopolies and Mergers Commission after five years. In the end, RPI-X was adopted by the government not only for BT, but also subsequent privatised utilities and became a standard mechanism. Thatcher acknowledged that this innovation turned out to be an influential departure: *"it has since been adopted overseas, for example in the United States."*⁴⁵ As with all major policy processes, the eventual form that privatisation took in each case was the result of discussions between key players on the inside and outside of government about how best to meet the multiple and at times contradictory objectives.

Decision

Participants at our policy reunion stressed that the key determinants of decisions were the practicality of the proposals and what would allow the momentum of the overall programme to be maintained. The Treasury had been given responsibility for co-ordinating privatisation, but departments played an important role in sustaining the required pace of change. In the case of

⁴³ Stephen Littlechild, *Regulation of British Telecommunications' Profitability* (London: Department of Industry, 1983), Para 15.5.

⁴⁴ *Ibid*, Para 4.11.

⁴⁵ Thatcher, *Downing Street Years*, p. 681.

British Telecom, decisions on the sale were determined by the need to create enough demand for the offer. This encouraged a gradual process that would ensure the stock market could absorb an unprecedented share issue and allow the government to maintain the support of BT's management. The sale was therefore structured with three part payments and a full dividend which made it a must buy for institutional shareholders. Ministers had to be comfortable with a valuation that they could defend to the House of Commons. Again, it was the need to develop workable solutions that saw the programme develop mechanisms and ways of working that could be replicated.

Having a credible regulatory regime was seen by the investment banks and others involved in the flotation as crucial in securing investor confidence in the sale.⁴⁶ On 12 April 1984, the Telecommunications Act removed BT's monopoly in running telecommunications and established the Office of Telecommunications (OfTel) as a non-ministerial government department to promote competition in the telecoms industry and protect the rights of consumers. Under the terms of Act, BT had to provide universal provision across the UK and retain unprofitable activities such as the 999 emergency service number. In July, Bryan Carsberg was appointed Director General of OfTel and one month later the communications regulator was officially established. The original intention had been to hand the responsibility for telecoms to the Office of Fair Trading (OFT), but the organisation's Director General, Gordon Borrie, felt this was too large an additional undertaking for the OFT. Instead, the government established OfTel and decided it should be under the control of a single Director General in the same fashion as the OFT. This model was chosen because it was thought to give greater clarity than having a board and became the standard for regulatory authorities.⁴⁷ Having decided to adopt Littlechild's RPI-X recommendation for price controls, the Department of Trade and Industry (DTI) set up a working party to try to agree what 'X' in the formula should be. The working party consisted of three civil servants, three people from British Telecom, an independent chair from Coopers and Lybrand, and Bryan Carsberg. The latter recalled that BT obfuscated to such an extent that the committee could not reach agreement and, in the end, the Secretary of State simply had to impose a formula of RPI-3% for the first five years of privatisation. Carsberg as DG of OfTel realised the degree of fat that could be cut out in the newly privatised company and the rate was increased to RPI-4.5% in 1989 and eventually ratcheted up to RPI-7.5% in 1993.⁴⁸

In November 1984, more than half (50.2 per cent) of British Telecom shares were sold to the public. The government authorised a huge marketing campaign before the issue of the shares in order to inform the public and to create interest in the shares. Although the share offer was significantly oversubscribed, the flotation was regarded as a great success. More than three million ordinary shares were offered for sale and by the 28 November, when the offer closed, the shares had been 3.2 times oversubscribed. Dealing in the shares began on 3 December at a purchase price of 130p (50p on application and the rest to be paid in instalments). The total amount raised was £3,916

⁴⁶ Stern, 'What the Littlechild Report Actually Said', p. 12.

⁴⁷ IfG Policy Reunion.

⁴⁸ OfTel, 'A Brief History of Recent UK Telecoms and OfTel'; available at: <http://www.ofcom.org.uk/static/archive/oftel/about/history.htm>

million and nearly 96 per cent of eligible BT employees became shareholders in the company.⁴⁹ There was some criticism in the media that shares had been priced lower than market rate, but the government responded that this had been done in order to promote widespread share ownership. Indeed, according to Nigel Lawson, “*the maximization of proceeds, despite what many commentators said, was never the main objective.*”⁵⁰ Furthermore, since BT was the first major utility to be sold off, the government had implemented a cautious approach that transferred the company to the private sector in several stages. A second issue of shares in December 1991 reduced the government’s stake in BT to around 25 per cent and, in July 1993, the state sold almost all of its remaining stock. Each of these subsequent share issues boosted the Treasury’s accounts by around £5 billion.⁵¹

Consensus

The story of the BT privatisation, and the subsequent impact on British Gas privatisation, also highlights one other factor in the policy success – that of building an external consensus and perception of what would be acceptable, if not highly desired, policy in this area. As Peter Riddell has commented, privatisation was the “*most striking policy innovation*” of Thatcherism and came to represent “*the Jewel in the Crown of the Government’s legislative programme, around which all shades of Tories can unite.*”⁵² However, at the time, denationalisation was far from universally popular. The Labour Party was instinctively opposed and strongly resisted every single privatisation. The Liberals, as well as the Social Democratic Party (SDP), were against both privatisation and any further nationalisation since it was their belief that industries risked being destabilized by repeated switching between the public and private sectors.⁵³ The media and the public were also hostile to the idea of privatisation and continued to be unreceptive in the run-up to each individual sale. Antagonistic trade union leaders and reluctant management boards also had to be dealt with. In the case of British Telecom, there were concerns about the impact of liberalisation of the market on some of the suppliers who depended on their contracts with BT and this meant slowing down the pace of change to give them time to adapt.

Moreover, elements within the government needed to be persuaded it was a necessary course of action and could be practically implemented. In the words of one Treasury official, “*it was not that privatisation was not desirable, but that we were not sure that it was possible.*”⁵⁴ In 1982, the government had considered a less radical option, known as the Buzby Bond, which would have allowed BT to raise finance capital on the bond market. However, those behind the scheme could not convince the Treasury that purchasers of these bonds would bear a genuine element of risk and transfer any financial burden from the state. In the assessment of economic commentator Samuel

⁴⁹ BT Archives Information, ‘Privatisation’; available at: <http://www.btplc.com/Thegroup/BTHistory/Privatisationinfosheetissue2.pdf>

⁵⁰ Lawson, *View from No. 11*, p. 237.

⁵¹ BT Archives Information, ‘Privatisation’; available at: <http://www.btplc.com/Thegroup/BTHistory/Privatisationinfosheetissue2.pdf>

⁵² Peter Riddell, *The Thatcher Decade: How Britain Has Changed During the 1980s* (Oxford: Basil Blackwell, 1989), p. 88.

⁵³ John Kay and David Thompson (eds.), *Privatisation and Regulation: The UK Experience* (Oxford: Clarendon Press, 1986), p. 76.

⁵⁴ Richard Heffernan, ‘UK Privatisation Revisited: Ideas and Policy Change, 1979-92’, *Political Quarterly*, vol. 76:2 (2005), p. 265.

Brittan, *"the failure of the Buzby project gave privatisation a shot in the arm."*⁵⁵ Indeed, Lawson recalled that he *"was originally in quite a small minority"* in arguing for denationalisation, but the *"failure of these attempts to square the circle helped to swing Whitehall opinion behind privatization."*⁵⁶ Externally these plans were controversial, but government pushed ahead and gradually public opinion altered as privatised utilities became an accepted feature of economic policy.

The privatisation programme was paradigm changing, not just affecting specific industries, but altering accepted wisdom about the relationship between state and market. The sale of BT was an important spur for driving forward the government's reform agenda, particularly as it spanned the government's first and second term, and 'popular capitalism' provided a narrative which has proved to have continuing resonance. In particular, the successful denationalisation of a huge corporation such as BT cleared the way for a number of other high profile privatisations and Thatcher set a challenge to implement a sale with more than 5 million private shareholders before the next general election. With this target in mind, the only option was to privatise British Gas. This sale was conducted as a refined version of the BT model. Again it was decided to privatise the company as a single entity, not least because breaking up British Gas would have added three years to the timetable. However, the privatisation programme was given its biggest test with the 1987 sale of BP shares. The stock exchange collapsed immediately after the sale was given the go-ahead and it was only the then Chancellor Nigel Lawson's decision to create a floor price that allowed the sale of shares to proceed. By the time of the 1992 election, around two-thirds of public industries, employing some 900,000 people, had been transferred to the private sector.⁵⁷

Reflections

Privatisation was a programme that developed over a long period and gained impetus after starting small. Building the process step-by-step turned out to be advantageous, as Kenneth Baker has remarked: *"If we had had great ideological confrontation at the beginning of the Thatcher years, [if we said] we want to privatise all these industries, none of them would have been privatized."*⁵⁸ The government had initially been very cautious and it was only once denationalisation had been shown to be practicable and the Conservative Party won re-election that momentum built for the scheme. In Thatcher's later appraisal, the *"depth of the recession meant that there was not much prospect of successful privatization in the early years, due to low market confidence and large nationalized industry losses"*.⁵⁹ Nevertheless, the government was committed to reforming industrial relations and, having piloted the sale of a few small publicly-owned industries, *"ministers began to realize that the principle could be extended."*⁶⁰ In this respect, the denationalisation of BT became the breakthrough

⁵⁵ Samuel Brittan, 'Public Private Partnerships – A Temporary Landmark for the Third Way', speech delivered on 13 November 2001; available at: http://www.samuelbrittan.co.uk/spee21_p.html

⁵⁶ Lawson, *View from No. 11*, p. 205.

⁵⁷ *Ibid.*, p. 197.

⁵⁸ Interview with Kenneth Baker, *op cit.*

⁵⁹ Thatcher, *Downing Street Years*, p. 678.

⁶⁰ Gamble, 'Privatization, Thatcherism, and the British State', p. 4.

high profile sale that gave momentum to the privatisation programme and *“showed to the rest of Britain it could be done.”*⁶¹

Participants at the policy reunion agreed that, given the uncertainty about the scale of the endeavour beforehand, the actual process still looked pretty good in hindsight. The only significant criticism levelled against privatisation was the initial failure to introduce effective competition. In the case of telecoms, the government maintained statutory restrictions on market entry and BT remained a virtual monopoly since Mercury was a comparatively small provider. Indeed, economists John Kay and David Thompson have questioned the rationale for privatising firms with such monopolies and concluded: *“Privatisation will tend to improve performance in a company only if supported by liberalisation; and if the two conflict, liberalisation is decidedly to be preferred.”*⁶² Bryan Carsberg suggested the omission of customer service in a regulatory regime that focussed on price meant that quality of service suffered, especially as consumers could not easily transfer to an alternative provider.⁶³ However, it must be remembered that this type of sale had never been done before and the government was concerned that trying too much too soon might stall the process. Nigel Lawson was adamant that *“it was important to privatize as much as possible as quickly as possible; and this would itself set up pressures for more competition and other structural changes.”*⁶⁴ John Wakeham has also suggested that momentum and tight timescales were vital, as this put an onus on ministers to be decisive and drive the process as hard as it could go.⁶⁵ As such, privatisation benefitted from an iterative model of learning after each new sale, continual reassessment and then pushing further, which helped avoid mistakes in order to keep moving the policy in the right direction.

Although the programme achieved a decisive shift in the boundary of the state, the continued pursuit of the policy depended critically on the defensibility of the last sale. There was also a need to balance the complex and often competing objectives of a smooth transition of assets to the private sector, popular capitalism and market competition. Privatisation created millions of new shareholders, including many utility employees, and in the view of Kenneth Baker this changed popular perceptions of the accessibility of share ownership: *“When we came into office, there were about three million people who owned shares in Britain. By the end of the Thatcher years, there were 12 to 15 million shareholders, and this had largely been achieved by the privatization of the great monopolies.”*⁶⁶ However, there was a failure to make wider share ownership stick since most subscribers sold relatively soon after the privatisations. A side effect of privatisation was the impact it had upon the City. According to Simon Linnett of Rothschilds, the boost of managing the massive

⁶¹ Interview with Kenneth Baker, op cit.

⁶² John Kay and David Thompson, 'Privatisation: A Policy in Search of a Rationale', *The Economic Journal*, vol. 96 (March 1986), p. 25.

⁶³ IfG Policy Reunion.

⁶⁴ Lawson, *View from No. 11*, p. 239.

⁶⁵ IfG Policy Reunion.

⁶⁶ Interview with Kenneth Baker, op cit.

share sales was the foundation for pushing London alongside New York and Frankfurt to become the world centre of financial services.⁶⁷

Since the government decided to legislate separately for each privatisation, rather than take a general enabling power, the process could be adapted and departments were able to adjust to changing circumstances. While the Treasury oversaw the process, there was a premium on rapid ministerial decision-making and mechanisms were developed to drive delivery including the establishment of the E(DL) Cabinet Sub-Committee. As the programme developed, there was a good degree of continuity among the ministers involved in different roles, among the civil servants (Gerry Grimstone worked on over 20 privatisations) and among the advisers (David Clementi worked on privatisations at Kleinwort Benson from 1979-1992). This helped foster a high level of effective collaboration between policy makers who had to develop solutions that worked within new constraints and pressing timescales. Although civil servants were outside their comfort zone, the perception that privatisation was an exciting policy area to work on, with regular ministerial exposure, attracted in high calibre people. Furthermore, in the words of Nigel Lawson, privatisation *“was an exercise in which Government found itself a financial innovator to an extent which is rare indeed.”*⁶⁸ In the case of denationalising BT, Stephen Littlechild’s pricing formula RPI-X proved a successful innovation and provided a useful tool for regulating future privatised utilities. As this example demonstrates, the policy did not simply develop within the boundaries of Whitehall. Drawing on external sources of expertise, academics such as Littlechild and City advisers like Clementi informed discussions and played an important role in making sure the terms of the offer were right; though, ultimately, ministers still had to make some vital judgement calls.

Privatisation succeeded by striking the balance between ideological commitments and a hard-headed appraisal of what is likely to work in practice. Objectives morphed and so did the techniques used as policy makers built upon what had gone before. As Margaret Thatcher later contended, the *“privatization programme was constantly breaking new ground”* and therefore each flotation raised separate issues: *“It is one of the disadvantages of being in the vanguard of reform – as the British who pioneered the industrial revolution know well – that the only experience you can learn from is your own.”*⁶⁹ Indeed, while government reforms are usually restrained by earlier initiatives and electoral interests, privatisations showed that politicians can push ahead of public opinion and redefine what is perceived to be politically possible.

List of Participants at Policy Reunion

Name	Role during this 'Policymaking Process'
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⁶⁷ IfG Policy Reunion.
⁶⁸ Lawson, *View from No. 11*, p. 237.
⁶⁹ Thatcher, *Downing Street Years*, pp. 678-9.

Lord Wakeham	Parliamentary Under-Secretary of State, Department of Industry (1981-82), Minister of State, HM Treasury (1982-83), Government Chief Whip (1983-87), Secretary of State for Energy (1989-1992, responsible for privatisation of electricity industry)
Sir Nicholas Monck	Under Secretary, HM Treasury nationalised industries' group
Sir David Clementi	Director, Kleinwort Benson (1981-94)
Sir Bryan Carsberg	First Head of Oftel (1984-1992)
Gerry Grimstone	Assistant Secretary Public Enterprises Division, HM Treasury,
Professor Andrew Gamble	Cambridge University – Academic Discussant