RENATIONALISATION: THE COST

Context

Labour's renationalisation agenda is expected to have a significant impact on the wider economy and on society. Not only will acquiring the assets come at huge financial cost to the public purse but maintaining and upgrading the assets would require future investment from the government. This will add to the UK's debt levels and paying for this debt will increase borrowing. In addition, depending on the final price paid, renationalisation could come at a cost to pensioners and savers.

A number of commentators have sought to estimate the up-front cost of Labour's renationalisation plans.[1] These studies range from estimating the cost of the entire agenda to focusing on the renationalisation of one industry. This new CBI analysis provides updated figures on the up-front cost of renationalisation based on Labour's most recent proposals. This analysis also seeks to understand some of the wider economic impacts of these plans, including the impact on the UK's public finances and the potential cost to pensioners and savers.[2]

The scope of this analysis only focuses on the cost side of renationalisation and does not seek to estimate the potential benefits. It does however recognise that the UK government would be buying assets which could positively impact its balance sheet depending on the purchase price and therefore the level of debt issued. In addition, depending on the prices charged to consumers and the government's ability to keep costs down, it also recognises that these assets have the potential to make a profit and therefore boost the government's income. However, it is difficult to ascertain the exact scenario that would play out as there are a lot of unknowns such as how much would the government pay, what price would it charge to consumers, would the industry make a profit? For these reasons, this analysis has not tried to quantify the possible financial benefits of renationalisation.

Methodology

To estimate the cost and wider implications of renationalisation, a number of assumptions were necessary. These are explained in more detail below.

Estimating the up-front cost

Firstly, to estimate a reasonable takeover price for each industry requires a definition of which entities would be acquired in each industry. Based on the most recent proposals put forward by Labour, renationalisation in each industry is defined as the following for the purposes of this analysis:

- **Water:** Labour's manifesto pledge can be interpreted as bringing the 9 water and sewerage companies back into government ownership, reversing the privatisation of 1989, as well as bringing the 7 water only companies into government ownership.[3]
- **Energy:** Labour's latest proposal for energy networks is set out in "Bringing Energy Home"[4] which indicates that the transmission and distribution markets of the energy sector would be brought into government ownership, but the generation and retail markets would remain private. This would involve the acquisition of National Grid, the distribution network operators and gas distribution networks in England, Scotland and Wales.

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[1] Commentators include the Centre for Policy Studies, the Social Market Foundation, Clifford Chance and the University of Greenwich.
[2] Nera Economic Consulting conducted a study looking at the impact on pensioners and savers of renationalisation.
[3] The water industry in England and Wales was privatised in 1989. Since then, the water industry in Wales has been devolved to the Welsh Government by the 2017 Wales Act.
[4] Brining Energy Home, Labour's proposal for publicly owned energy networks.

- **Rail:** As the rail network is already owned by the government, nationalisation would involve bringing the train operating companies into government ownership. Labour's proposals indicate that the train franchises would be brought in gradually as they expire and would require the acquisition of the rolling stock which is currently owned by leasing companies.[5]
- **Royal Mail:** This would involve reversing the privatisation of Royal Mail and bringing it back into government ownership through the acquisition of Royal Mail plc.

To estimate the up-front cost of each of the entities within these definitions, market capitalisation has been used where available. Where this is unavailable, proxies have been used to understand the current market value. For energy and water, the regulated value of the assets, the regulated asset value (RAV) and regulated capital value (RCV) respectively, have been used as proxies.[6] For the rail rolling stock, this is based on the asset value of the largest rolling stock leasing companies and their respective market shares.

A mark-up of 30% is then applied to the asset values. This is based on evidence of historical takeovers which shows that utility companies have typically fetched a price above the asset value.[7] Comparing the market capitalisation of those publicly listed companies to their respective asset values also indicates a similar mark-up.

Estimating the impact on the public finances

Secondly, an understanding of how the up-front cost would be accounted for in the public finances was required. The impact of the up-front cost of renationalisation on the public finances is expected to be two-fold:

- **Debt impact:** It is expected that the up-front cost will be financed through the issuance of gilts, which will be transferred to shareholders as compensation. While this will not show up directly in the borrowing figures, due to accounting reasons, it will be reflected directly in the debt figure. That is, the stock of government debt in the UK economy will increase by the up-front cost.
- **Borrowing impact:** Servicing the debt will require the government to make debt interest payments. This will be reflected in the government's borrowing figure as a government expenditure. The size of these payments will depend on the impact the new higher level of debt has on the government's borrowing costs. To be able to get an indication of this, a scenario of the higher level of debt was run through a macroeconomic model.

Estimating the impact on savers and pensioners

Finally, if the government were to pay less than the market price, this would have an impact on pensioners and savers. Anything less than the true market value would translate into a loss to shareholders equal to the difference between the true market value and the final price paid, which would then translate into a loss to UK pensioners and savers who are linked to these investors. To try and quantify this impact, the following has been assumed:

- **Lower price paid:** An estimate of the lower price paid by the government is based on the value of the assets without the mark-up as it is believed that the government should at the very least pay the values of the assets being acquired.
- **Share of UK investors:** The shareholders are a mix of foreign and UK institutional investors. Based on the literature, it is assumed that 20% of the shares are held by UK investors.[8]

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[5] Waiting for the franchises to expire would, in theory, involve no up-front cost but in practice the current owners of the franchises may wish to terminate their franchises early, which would require compensation from the government.

[6] The latest values have been sourced from Ofwat and Ofgem.

[7] See for example *https://www.ft.com/content/4ff1842e-c882-11e2-acc6-00144feab7de* and *https://research-doc.credit-suisse.com/docView?sourceid=em&document_id=x495529&serialid=kX64DIexNP8DWJVYeGP9nsFKrOmXDNQXyDfaWRluCAk%3D*

[8] Nera, the impact of nationalisation of utilities on UK households' savings and pensions. based on data from Bloomberg for the publicly listed companies and a review of investors' websites for non-listed companies.

Results

Based on the assumptions above, the CBI's analysis provides the following results.

Renationalisation will initially cost £196bn

- Renationalising the energy networks (distribution and transmission) in Great Britain, the water and sewerage companies in England, the rail operating companies and Royal Mail Group is estimated to cost the government £196 billion, 9% of GDP.
- This could pay for HS2 more than twice over[9], and is almost the current Health and Social Care budget (£141bn) and education budget (£69bn) combined.[10]
- Renationalisation could also pay for almost half the value of the infrastructure pipeline across both the private and public sectors from 2016/17 onwards (£425bn).[11]

This will increase government debt levels by almost 11%, with debt reaching 94% of GDP

- It is assumed that the up-front cost of renationalisation will be financed through the issuance of government bonds.
- Adding this to current debt levels would result in debt of over £2 trillion (or 94% of GDP) - **levels of debt not observed since the 1960s**.
- The government will need to service this debt by making regular interest payments to bondholders. This is estimated to increase borrowing by over £2bn each year.[12]

If the government pay less than the market price, this could result in an average loss of £327 per household

- If a Labour government choose to pay a price based purely on the value of the acquired assets, it would be lower than the true market value, and therefore shareholders would not be fully compensated.
- This will have an indirect impact on shareholders and pensioners who are linked to shares invested by institutional investors (including pension funds and banks) and directly by individuals.
- Compensating shareholders with the estimated value of the assets rather than the true market value is estimated to have a direct loss to UK savers and pensioners of £9bn, which translates into an average loss of £327 per UK household.[13]
- Putting this into context:
    - There are 91 pension pots invested in the energy, rail and water sectors covering over 7 million members.[14]
    - There were almost 11 million ISA accounts worth £69 billion in the UK in 2017/18.[15]

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[9] Secretary of State for Transport, HS2 Update: Written statement – HCWS1809, "*Adjusting by construction cost inflation, the range set out in Allan Cook's report is equivalent to £81 to £88 billion in 2019 prices, against a budget equivalent to £62.4 billion*."
[10] This is based on resource and capital budgets for 2019/20 as set out in the 2019 Spending round.
[11] Infrastructure and Projects Authority, National Infrastructure Deliver Plan 2016 – 2021, page 24
[12] This estimate is based on running a scenario in the Oxford Economics Macroeconomic Model to understand the impact of an increase in debt levels on debt interest payments.
[13] This estimate assumes that the takeover value is the value of the assets without the mark-up, and an assumption on the proportion of shares in the prospective companies that are owned by UK investors.
[14] This is based on data from the Global Infrastructure Investor Association
[15] Individual Savings Accounts (ISA) statistics, HMRC, April 2019.