Global Counsel

The “cost” of Labour’s nationalisation agenda

Blog post by Head of UK Leo Ringer, 12 February 2018

The nationalisation of several utilities and rail franchises is a key plank of the UK Labour Party’s policy platform. To the dismay of implicated business leaders, it is also relatively popular, according both to the 2017 general election result and to separate polling. But how much would it cost - is Shadow Chancellor John McDonnell right to claim, as he did in a speech this weekend, that it would be “cost free”? Answering this means teasing out a number of related but distinct issues.

The first is the straightforward price tag – the number in pounds sterling that a Labour administration might be required to pay. For example, the water regulator Ofwat has suggested that the commitments to bring water back into public ownership could cost £69bn, while more recent analysis from the Social Market Foundation put the figure at £90bn. These raw numbers help us to draw broad comparisons with other spending priorities such as, say, the annual UK health budget (c£155bn) or the official cost of HS2, the UK’s forthcoming high-speed rail network (£56bn). But they are relatively uninteresting in their own right as they tell us nothing about what is being acquired, or what it is worth.

A second question is therefore a more interesting one – for any given price tag, would Labour be getting value for money? This is where things begin to get complicated, because the notion of “value” is both slippery and subjective. Here are three rabbit holes down which a future Labour administration would have to jump.

- First, the value of assets such as regulated utilities like water is substantially determined by the policy framework in which they operate – which in turn, would be in control of the administration seeking to buy them. Not only does this generate narrow concerns about manipulation of the framework to justify preferred valuations, but more broadly the long-term value of these assets depends upon a policy framework that is susceptible to a five-yearly political cycle, and therefore inherently uncertain. Valuing against this policy uncertainty is difficult.

- Second, there are established mechanisms for valuing assets that Labour would be expected to adopt – or explain why it will not. The implicated companies themselves will have a clear idea of their total value, and McDonnell’s implication that he is minded to look beyond these numbers introduces legal risk for a Labour administration. The civil service has its own value-for-money methodology, captured in the Treasury-authored “Green Book”, which exists to “best promote the public interest”. Administrations seeking to depart from this may find themselves issuing “ministerial directions” – where a minister formally overrides the financial advice of his or her department – thereby exposing themselves to pressure from oversight bodies including the National Audit Office and parliament.

- Third, if part of the rationale for in-housing these assets is that there is a social value to doing so, alongside a pure economic value, what does this mean for their valuation? In terms of the up-front transaction, does it imply that Labour would be willing to pay a "social purpose premium", above the assets' economic value, to bring them into public ownership? And on an ongoing basis, how would the assets' valuations be affected by the trade-off Labour would be seeking to make between broader social policy objectives, such as keeping bills down, and the assets' financial sustainability?

A third question is whether the government could square the nationalisation programme with its own fiscal rules. Is the cost consistent with what Labour has said it will do to manage down the country's deficit and debt – in essence, is nationalisation politically affordable? The 2017 Labour Party manifesto committed to balancing day to day spending with revenues (closing the deficit) and ensuring the national debt falls relative to trend growth within a five-year period. When McDonnell claims the programme would be "cost free", he is talking about the deficit – that the return from the assets would cover the cost of servicing the associated debt. It is plausible that this equation balances, and McDonnell's deficit rule would not come under substantial pressure. But he is not talking about the national debt. Any form of spending to nationalise private assets would require fresh borrowing, and therefore put pressure on McDonnell's debt rule.

These rules are primarily a political constraint, but they can become difficult and costly to drop quickly, particularly if the government follows the existing approach of asking parliament to vote on them. Obeying rules has proven to be a substantial concern for chancellors past – the question now is the degree to which John McDonnell would be similarly motivated. One option open to him is to change the way nationalisation would be accounted for in the UK's public finances – there are several ways to keep these measures "off balance sheet" for the purposes of not scoring against the measured debt metric. But while these may be presentational fixes – important politically, and to some degree in the eyes of the electorate – they would not fool the discerning sovereign debt analyst.

Instead, the analyst is concerned about a different, fourth question: the affordability of nationalisation in an economic sense, which is primarily a function of what the public finances can bear. This is (arguably - see below) the ultimate fiscal constraint within which Corbyn and McDonnell will have to operate, irrespective of the rules they have set themselves. What the public finances can bear is, in turn, a function of the price at which sovereign debt investors will lend to the UK, which, in turn, is a function of their view of the merits of each purchase in underlying economic terms – irrespective of how creatively they are accounted for.

Importantly, the nationalisation programme will not be happening in a fiscal vacuum – Labour's headroom within the public finances will be determined in large part by factors beyond its control. For example, a Brexit-related shock could deprive a Labour administration of the necessary borrowing space, irrespective of the price tag of an asset purchase, or whether that price represents value for money. This illustrates where questions of value for money and affordability are linked, but distinct: Labour may be able to afford to make investments that appear to represent poor value for money; equally, it may be unable to afford investments that would seem good value for money.

But a final question, which has not applied to administrations in the UK for several decades, is whether a Labour administration would recognise the idea that sovereign debt markets present a constraint at all. The idea that the UK is approaching unsustainable levels of borrowing and debt has been at the core of the Conservative approach to fiscal policy since 2010, but in view of Corbyn, McDonnell, and a broader set of economic commentators, it is a straw man that has not been tested, only acted in fear of. Labour's inclination to stare down sovereign debt markets in order to meet nationalisation commitments may be among the biggest economic judgments that its senior team would have to make.

So, when we have worked out the price tag (difficult), value for money (even harder), consistency with fiscal rules (fudgeable) and economic affordability (disputed economic territory), we will have a better sense of how deliverable Corbyn's agenda is. But while these questions will occupy analysts and onlookers for some time, they are unlikely to dull Labour's enthusiasm for a policy approach which already has the support of 40% of the British electorate.