The political economy of nationalisation in Britain 1920–1950

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Contents

List of tables

1 Industrial organisation and economic factors in nationalisation

Robert Millward

The changes in the ownership of British industry in the 1940s were quite remarkable. Only fifty years before, at the end of the old century, the British government's disinclination to intervene in industrial matters was renowned. By the end of the 1940s government regulation and ownership of industry matched any country in the Western World. Nationalisation of transport and fuel by the 1945–51 Labour government was a major element in these changes: coal, railways, docks, inland waterways, road transport, gas, electricity, airlines, telecommunications, the Bank of England, iron and steel were all taken into public ownership. Only Supple (1986), Hannah (1979) and Edgerton (1984) have really tried to explain the reasons for this. The mainstream textbook explanations have involved two arguments (Aldcroft 1968, 1986, Alford 1988, Cairncross 1985). The first is that nationalisation was an inevitable outcome of long-standing problems especially in the ailing coal and railway industries. This however raises questions about why non-ailing industries like electricity, telecommunications and airlines were nationalised and why some ailing industries like cotton and shipbuilding were not. Why moreover was nationalisation the chosen form of public intervention for long-standing problems – what was inevitable about that? The second argument has been that the Labour government's nationalisations of the 1940s were the centrepiece of the socialist vision; they crystallised all that had been discussed and promised in the rise of socialism in the twentieth century. This raises the question of why socialism should have very restricted industrial boundaries with most of manufacturing left in private ownership.

These questions are addressed in this book and take on added significance from subsequent industrial developments in the UK including the 1980s privatisations. It will become clear from the rest of this book that the importance of sound finance and the promotion of efficiency were central elements in the push to nationalisation and in the minds of those who drafted the 1940s industrial legislation. The assets of the old private companies were vested in new bodies like the Iron and Steel Corporation, the British Transport Commission, the National Coal Board, all of which had a corporate status free from Treasury supervision of personnel and from day to day supervision by the Minister or Parliament. This was expected to promote initiative, enterprise and a basically commercial ambience. By the late 1970s and early 1980s questions of finance and efficiency were precisely, if not necessarily justifiably, at the front of the dissatisfaction with the nationalised industries. By the 1980s the absence of defenders of nationalisation was quite marked across much of the academic and political spectrum. A recent volume on the long-term features of the post-war British economy concludes that nationalisation, as a model, had had its day (Dunkerley and Hare 1991, p. 416). This critique has been buttressed by a new wave of literature on incentives and property rights. The seminal work was by Alchian and Demsetz (see for example Alchian 1965 and Demsetz 1983). Private ownership allows individual owners unilaterally to sell or exchange their shares in a firm. In public ownership individuals can exchange their set of rights only by migrating or by political action. Hence, so the argument goes, the pressure on management is so much less in public firms. These arguments raise very clear puzzles about the motives for nationalisation; how could anyone, one might ask, have thought it an appropriate instrument of industrial policy.

Let us start here by recalling the main elements of government industrial policy in the inter-war period and the main phases of public ownership of industry. For the latter, table 1.1 provides a chronological list of the major highlights. In the nineteenth century, British government intervention in manufacturing and mining was concerned mainly with questions of safety and was often triggered off by mine explosions and factory accidents. This was also important in railways, tramways, electricity, gas and water supply where in addition problems of granting rights of way, compulsory land purchases and monopolistic tendencies had drawn in both central and local government. Then there were the collective actions increasingly characterising the wage bargaining of both workers and employers with contingent threats to law and order. Finally the widening of the franchise from the 1860s meant that Members of Parliament were subject to a wider set of pressures many of which stemmed from economic, including industrial, issues. From the late nineteenth century, workers with complaints about wage and employment levels came increasingly to expect their MPs to press their case.

In the period 1914–40 three additional factors were at work. The First World War not only brought trade unions into national wage negotiations and introduced central planning in some sectors but it also revealed certain new techniques, technological gaps and weaknesses on

Table 1.1. *Establishment of major statutory public enterprises in British industry 1900–51*

1902	Metropolitan Water Board
1908	Port of London Authority
1926	Central Electricity Board
1926	British Broadcasting Corporation
1933	London Passenger Transport Board
1940	British Overseas Airways Corporation
1943	North of Scotland Hydro-Electric Board
1946	Bank of England
1946	British European Airways Corporation
1947	National Coal Board
1948	British Transport Commission
1948	British Electricity Authority and Area Electricity Boards
1949	Area Gas Boards and British Gas Council
1951	Iron and Steel Corporation of Great Britain

which government action was expected in peacetime – for example, airframes, dyestuffs and related chemical products leading to government involvement in the establishment of Imperial Chemical Industries (ICI) in 1926 and the development of the 'ring' of aircraft manufacturers (Fearon 1974, Reader 1977). Secondly the stagnant economic conditions of the inter-war period caused governments to be involved in industrial performance. The most dramatic output losses were in the export trades which had been central to the economy in the late nineteenth century and which were regionally concentrated. Given the widening electorate this carried political difficulties and in addition the output losses were seen, then and subsequently, as a manifestation of industrial decline. The third factor was that technological and administrative changes were making for larger sized industrial undertakings. Interest in this stemmed in part from the potential monopoly power of such large business units but also and (cf. Hannah 1976, p. 73), perhaps more important, British governments, conscious of the loss of export markets and apparent industrial decline, saw the move to large firms as typical of the USA and Germany, the pace-setters, and indeed of the 'new industries' (non-ferrous metals, telephone apparatus, tyres); hence the green light to push British industry along that path.

In the 1920s industrialists, politicians and civil servants clung to the pre-war world, which included an Empire bias, whilst the Treasury's classical view on crowding out and wage flexibility helped to erode some of the state intervention hanging over from the war (Lowe 1978). Unemployment persisted in certain regions where decline seemed to be reinforced. The establishment view that regional unemployment was essentially a symptom of the world depression and that the depressed areas were a social rather than an economic problem gave way by the 1930s to attempts, albeit half-hearted, to shift industry to the depressed areas (Parsons 1988, chapters 1 and 2). A product of this complex of forces was a government policy towards industry with two elements. First was a hesitant and often reluctant alleviation of key sectors from the full brunt of market forces. Short-term palliatives to cotton, iron, steel and other staples came from bank loans and overdrafts which by the end of the 1920s were drawing in the Bank of England, anxious to avoid financial disasters and to avoid embroiling the government (Kirby 1974, Heim 1983, 1986). The longer-term policy was to support the introduction of price-fixing schemes whose effectiveness has been much disputed except where foreign competition was excluded by protection as in the 33 per cent steel tariff of the 1930s.

In any case such price fixing came increasingly, as in the coal industry, to be seen as undermining the second element of policy, the elimination of excess capacity and promotion of amalgamation. For much of the period such promotional activity by the government was hesitant. Contraction and rationalisation occurred towards the end of the 1930s for the cotton industry but largely because demand never recovered; rationalisation through the 1930 Coal Mines Act was undermined by the lack of compulsory powers which again did not materialise until the end of the 1930s (Kirby 1973a, b). In the utilities field the major success was the Central Electricity Board which from 1926 centralised the high-tension transmission of electricity in a national grid and saw the gap with US technical efficiency eliminated by the end of the 1930s (Foreman-Peck 1991). Finally the generally protective and anti-competitive attitudes which inter-war governments displayed, especially towards large business units, carried over to transport. In a broad sense the main characteristic of the inter-war years was the emergence of the four railway companies under such tight regulation that they had difficulty in adapting to the new small highly competitive mode of transport. As a result government policy restricted road transport in such a way as to favour both the large railway companies and the larger business units emerging in both road freight and road passenger activities – Pickfords, Carter Paterson, Tilling, Scottish Electric Traction (Savage 1966, chapters 7 and 8).

Transport, communication and fuel are what one might call network industries, carrying classical market failure problems of natural monopoly and externalities. In the distribution networks of electricity, gas, railways and telecommunications it was often cheaper for one firm to supply the same service as two or more firms: natural monopoly. In addition the social benefit of investment in roads, railways and telecommunications may be expected to exceed private benefits through reductions in road congestion and pollution and through the opening up of new territories. The movement to larger business units in transport, communications and fuel was a central feature of the inter-war period. Several of the chapters which follow describe this in detail. They show how the optimal size of business organisation was extended beyond the local to a regional, sectoral and generally sub-national dimension. But the whole process of voluntary amalgamation proved to be very slow, and professional, official and political opinions were converging in a call for a more rapid movement to larger units of business organisation in gas supply, electricity retail distribution, airlines and coal. Thus in electricity supply, whereas the national grid was being developed from 1926 by the Central Electricity Board, retail distribution was in the hands of a vast number of private and local authority undertakings who were resistant to amalgamation and not thereby able to capture, as the McGowan Committee (1936) pointed out, economies in marketing and finance. The same story applies to gas; there was no case here for a national grid but economies in distribution were possible from larger business units, as the Heyworth Report (1945) suggested. In domestic airlines up to twenty companies were operating in the 1930s in what was a small market and the private companies were disinclined to amalgamate and streamline operations; the Cadman Report (1938) was particularly critical of the Civil Aviation Authority in this respect. Finally official reports on the coal industry throughout the inter-war period pressed for larger business units to raise investment and productivity but by 1938 70 per cent of the industry's 1,034 companies still employed less than 6 per cent of the industry's labour force (Supple 1987, p. 303).

At the very minimum, government intervention to promote amalgamation would necessitate legislation but it would have to be much stronger than the arms-length variety typical of the inter-war years. Indeed more generally, the perceived failure of inter-war arms-length regulation seems to be enough to explain the move in the 1940s to changing the *ownership* structure of many of the industries and in particular to a shift to public boards of a regional or at least sub-national dimension. There is a further ingredient that was present. The concentration in the railway industry was already sufficient to exploit any regional economies of scale, and economies on a national scale were, as in coal, not so obvious. Yet both finished up not with sets of regional boards but with centrally owned and organized enterprises – the Railway Executive, the National Coal Board. Moroever, whilst regional boards did emerge in the other utility sectors they were supervised by overarching bodies like the

British Gas Council and the British Electricity Authority as well as the British Transport Commision which came to own all the assets in railways, docks, harbours and significant sectors of road transport. There is little doubt that this outcome was a product of the particular historical circumstances. Railways and coal were ailing industries, with a run-down capital stock and the second half of the 1940s after the war was in general a reconstruction period and one with a Labour government committed to administrative planning. The overarching national bodies were an intrinsic part of the legislation which established the nationalised industries and the Acts of Parliament placed on them the obligation to develop investment and training programmes (cf. Foreman-Peck and Millward 1994, chapter 8).

This analysis of the existing literature provides then certain pointers to the links between industrial organisation and nationalisation. These links are explored in the following chapters which also deal with the many unresolved questions. Thus the arguments we have advanced so far do not apply readily to cotton, aircraft, armaments production and shipbuilding. Larger business units were seen as desirable, yet none of these industries were nationalised. Nor was the water industry which displayed all the problems of local gas and electricity supplies. Further the coal industry had all the properties of a classic competitive industry and industrial arguments for nationalisation based on natural monopoly or externality issues look rather weak here, yet coal was the first major industry to be nationalised.

These puzzles are addressed in the detailed industry chapters which follow and we draw the threads together in the concluding chapter of the book. When nationalisation occurred in the 1940s it invariably took the form of the 'public corporation' which had many similarities to the earlier public boards listed in table 1.1 and we can usefully conclude this introduction by showing why this came to be the chosen legal instrument of public ownership in Britain.

In the nineteenth century, public ownership and nationalisation had been invariably associated with an enterprise run by a government department. Where the municipal undertaking was the appropriate form for local government, the Post Office was a model for the nationalised industry. For many outside socialist circles this had generated a major fear, that of bureaucratic rigidities and political interference; the naval dockyards often being quoted as a classic example of poor performance (cf. W.S. Jevons 1867, 1874). This led several observers during the 1920s to favour the idea of a public board, taking the operations 'out of politics' (Ostergaard 1954, p. 206). For some, contemporary changes in the private sector appeared to point the way. The growing dominance of the joint stock company seemed to involve the divorce of ownership and control, with top management rewarded by salary rather profit. As one student of these views said: 'If it was not essential to good management for the directors to own some or all of the capital could there not be bodies without equity capital, that is without shareholders, but managed by a Board of Directors' (Chester 1979, p. 384). On the left there were also leanings towards public boards but for different reasons. Guild socialists and syndicalists envisaged them as Boards of Management with representatives from the work force and hence close to worker cooperatives. In the 1920s the Central Electricity Board and British Broadcasting Corporation were established without worker representatives, and some trade unionists – the Union of Postal Workers in particular – opposed the idea of a public corporation right through to the 1940s because it omitted representatives of what they conceived as the democratic elements, Parliament and the unions.

A crucial step in the development of the basis of ownership and control of the public corporation seems to have been a memo drawn up in 1928 in part as a response to the criticisms of the coal industry nationalisation proposals which the Labour Party had put to the 1925 Samuel Commission. The authors were Shinwell and Strachey who envisaged a 'public utility corporation' which would be vested with the assets of the industry and which would issue fixed interest stock held by the state in lieu of the compensation it, the state, had paid to former owners (Ostergaard 1954, pp. 209–10). There were to be no trade union representatives who would have conflicting interests and though many subsequently pressed for union representation it never emerged. In practice the Central Electricity Board stock and the London Passenger Transport Board stock were held by the former owners, a matter of concern to some who saw the industry as thereby reconstructed rather than brought under social ownership. These reservations disappeared once it had been made clear (by, amongst others, the Trade Union Congress in 1932; cf. Ostergaard 1954, p. 216) that the stockholders had no voting rights, did not own any equity and the government was the sole owner. In fact in one or two corporations, including the National Coal Board, the private owners were given compensation in the form of government stock and in the 1950s and 1960s this became the general pattern of finance, by stock issues. The final strand in the emergence of the public corporation as the legal instrument was the need to make it answerable to government. This had long been a bone of contention within the Labour Party which had opposed *ad hoc* boards like the Metropolitan Water Board and the Port of London Authority which were accountable to Parliament but not answerable to the relevant local government authorities. Indeed Morrison broke with Labour Party traditions in promoting the London Passenger Transport Board which was also *ad hoc* in this sense. All of which suggests a closer look at the role of both Labour and Conservative Parties is warranted and this forms the subject of the next chapter.

In summary, in the nineteenth century, government kept its distance from industry, preferring not to interfere with 'property'. The social and political forces which were already undermining that stance were enhanced in the inter-war years by the decline of the staple industries and the general loss of industrial leadership in both Germany and USA where large business organisations were coming to dominate the industrial scene. The reaction of British governments in the 1920s and 1930s was often hesitant and piecemeal. Price fixing and tariff protection were introduced to alleviate the worst affected sectors. The longer-term policy was to promote amalgamations of firms and rationalisation of industries to meet the new industrial competition. In transport, communications and fuel there were important scale economies to be realised but the government attempts to promote this by arm's length regulation came to be seen as ineffective and this explains some of the momentum towards public ownership in the 1940s. This line of argument is explored in several of the following chapters dealing with gas, railways, airlines and electricity. Other chapters address the puzzle of why some industries which appeared to have underlying structural weaknesses, like steel, cotton and motor vehicles were not nationalised. Water resource development moreover seemed to cry out for rationalisation but was untouched. Coal had all the properties of a classic competitive industry yet was the first major industry to be nationalised. Armaments and aircraft production remained in the private sector despite their strategic importance. There is, in other words, an overall mosaic to be explained and this is attempted in the last chapter.

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