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Privatization and Public Enterprises

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Abstract

This paper considers whether privatization is an appropriate response to the problems associated with large public enterprise sectors in industrial and developing countries. It is argued that privatization is likely to be the source of some gains in efficiency, as privatized enterprises are less susceptible to political interference, management incentives are improved, and government financial backing is withdrawn. However, more significant gains can be expected from measures that result in public or privatized enterprises being subjected to competitive pressures, and attempts to improve upon incentive and control mechanisms currently used to influence public enterprise performance. From the fiscal point of view, only if there are associated improvements in efficiency can privatization be of benefit to the budget.

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Summary

Privatization--and in particular denationalization--has been attracting growing interest in both industrial and developing countries. Among the advantages attributed to privatization, two are most often emphasized. First, by limiting the scope for political interference, improving managerial incentives, and imposing the discipline of the private capital market, privatization will lead to increased economic efficiency. Second, the sale proceeds (or the removal of the need to subsidize loss-making enterprises) will benefit public finances. The principal aim of this paper is to examine these two propositions. The paper also explores some of the practical problems associated with privatization, drawing mainly from the privatization program in the United Kingdom. An appendix summarizes the broader experience with privatization in industrial and developing countries.

While the shift from public to private ownership can increase productive efficiency (i.e., to lower production costs), the paper points out that such increases may be only modest. Significant gains in efficiency are most likely if certain major public monopolies are privatized, but only if they are thereby exposed to competition and their monopoly power reduced. When accompanied by liberalization, to foster competition, and by regulation, to prevent anti-competitive practices, privatization will increase both productive efficiency and allocative efficiency (i.e., it will lead to a structure of output more highly valued by consumers, given social costs of production).

In economic terms, the scope for effective privatization of public enterprises depends upon a number of considerations: whether private sector managers have a greater incentive than public sector managers to improve efficiency; the number of public enterprises facing national or international competition; the extent to which public enterprises are "natural monopolies"; and the importance of social and other noncommercial (e.g., macroeconomic) objectives. Such considerations suggest that successful privatization is unlikely to be extensive, relative to the size of public enterprise sectors, in either industrial or developing countries. Improving the efficiency of public enterprises as well as seeking alternatives to privatization will need to be given a high priority. The paper also argues that changes in ownership alone will provide few lasting budgetary benefits unless privatization is associated with increased efficiency.

Notwithstanding these qualifications, the paper argues that authorities should, on the whole, support privatization. While it cannot be regarded as a panacea, privatization may often promote economic efficiency, not so much by transferring activities from the public to the private sector, but more by facilitating active competitive policy and by improving existing incentive and control mechanisms.

I. Introduction

The word "privatization" entered popular usage only recently, and certainly the activity with which privatization has become most closely associated--the sale of public sector assets--is a distinct phenomenon of the 1980s. However, like the word itself, the various activities that have been described as privatization can claim a longer history. 1/ Policies designed to stimulate the substitution of private for public provision are not a recent innovation. But the wide range of public sector activities that are now being considered for privatization, the various methods being suggested to achieve this objective, and the enthusiasm with which privatization policy is in some cases being pursued distinguishes current privatization efforts from previous ones.

The growing appeal of privatization, especially in industrial countries, can in part be traced back to economic developments of the mid-1970s. Rapid public sector expansion in the 1960s and early 1970s was, at the time, seen as a major contributor not only to economic growth but also to social and political stability. The expanding role of the public sector in the economy was rarely challenged. However, the situation changed drastically in the mid-1970s, when the inability of economies to adjust to external price shocks--in particular, the first round of OPEC price increases--led to a marked deterioration in macroeconomic performance. Subsequent recovery was slow, and part of the blame was leveled at large public sectors, which, it was argued, robbed the economy of the flexibility it needed to achieve the necessary adjustment. 2/ At the same time, both the efficiency and effectiveness of public sector activities began to be seriously questioned. In a number of countries--most notably, the United Kingdom and the United States--the backlash against the public sector was given additional impetus by the election of governments pledged to reducing the size and scope of government. Privatization in all its forms was to play a major part in achieving such a reduction.

1/ The words "privatize" and "privatization" appeared for the first time in the 1983 edition of the Webster's Ninth New Collegiate Dictionary, where their earliest recorded use is given as being in 1948. However, S.H. Hanke claims responsibility for popularizing these words while serving on the U.S. President's Council of Economic Advisers in 1981 and 1982 (Washington Post, January 13, 1986).

2/ For example, see Bacon and Eltis (1978).

Privatization has also been frequently mentioned in the context of developing countries, where the industrial sector and, occasionally, key elements in the commercial sector are heavily dominated by public enterprises. Loss-making enterprises have, for many years, been a drain on government resources in these countries. They have required direct budgetary transfers or have relied on government-guaranteed borrowing to finance their cash operating losses. However, the wider macroeconomic problems that have afflicted developing countries have forced them to reconsider their strategies for dealing with public enterprises. In particular, many of the countries that have adopted Fund-supported adjustment programs have been trying to address the problems that give rise to the need for financial support for public enterprises, and privatization is, to varying degrees, being considered as a means of relieving governments of their heavy involvement in industry and commerce.

This paper will examine the role that privatization can play within a wider strategy designed to overcome the problems associated with public enterprises. It will for the most part skirt the detail of privatization initiatives in various countries--many of which have been reviewed elsewhere (Berg, 1983, 1985)--and try to address some general issues that arise in evaluating the potential role of privatization. Section II briefly reviews the arguments used in support of public production and nationalization, and discusses the performance of public enterprises, while identifying problems to which privatization can be seen as a direct response. These problems, include the tendency for politicians to interfere in public enterprise operations; the inability of politicians and civil servants to effectively monitor enterprise managers; inappropriate managerial incentives; and the availability of financial support from the government with only limited constraints. As a consequence, public enterprises are inefficient and often incur losses. Advocates of privatization claim that it will lead to increased efficiency and reduce the associated budgetary cost. Section III outlines these and other arguments used in support of privatization, while focusing on techniques of privatization and problems of implementing it, in particular, asset valuation, marketing, and financing. These problems are illustrated with country experiences, especially the ambitious program of asset sales under way in the United Kingdom.

Sections IV and V examine, in analytical terms, the likely impact of privatization. In Section IV, it is argued that to secure significant improvements in efficiency, changes in ownership need to be accompanied by measures to expose enterprises to competitive pressures. Section V analyzes the fiscal and financial impact of asset sales. It is argued that a change in the budget deficit resulting from the sale of a public sector asset to the private sector can give a misleading impression of the fiscal consequences of such a sale. The government will benefit financially over the medium term as a result of privatization only if it is able to appropriate some of the gains arising from improvements in efficiency associated with privatization and increased competition.

Section VI discusses the implications for adjustment policies arising from the principal conclusions of this paper. Privatization should be encouraged to the extent that it fosters more active competition and improves existing incentive and control mechanisms for public enterprises. It should be noted, however, that if privatization involves no more than a transfer of activities from the public to the private sector, it may yield only limited gains.

II. Public Enterprises: Their Role, Performance, and Problems

1. Role

The size and structure of the public enterprise sector vary significantly within groups of otherwise comparable industrial and developing countries. For example, in the non-socialist industrial countries, the share of gross domestic product (GDP) deriving from public enterprises in the mid-1970s varied from 4 percent in the Netherlands and Spain to 15 percent in Austria. Similarly, among non-socialist developing countries, the shares varied from 1 percent (Nepal) to 14 percent (Taiwan, Province of China) in Asia; 7 percent (Liberia) to 38 percent (Zambia) in Africa; 1 percent (Guatemala) to 38 percent (Guyana) in Latin America; and 4 percent (Malta) to 14 percent (Portugal) in Europe (Short, 1984). This heterogeneity reflects the range of considerations that has been brought to bear upon the decision whether to undertake a particular activity in the private or the public sector of the economy.

From the standpoint of economic analysis, public ownership has most commonly been viewed as a response to the failure of private markets to achieve allocative efficiency. Market failure can occur for a number of reasons, and public production in various areas--welfare services and public goods--can be justified by reference to particular sources of market failure. In the case of the traditional public enterprises, in particular those involving the use of networks (power generation and distribution, water supply, telecommunications, and transportation), the possible emergence of a natural monopolist--that is, a situation where a single producer can exploit available economies of scale--is the principal concern. However, in these areas and others, market failure has often tended to serve as an expost justification for nationalization. Moreover, while market failure can provide a strong rationale for government intervention, it does not follow that intervention must take the form of public ownership. For example, economic objectives of nationalization have been achieved through the use of regulatory controls, legal sanctions, taxes, transfers, and subsidies. To explain why the preferred mode of intervention has so often been nationalization, and why the public sector now encompasses activities that are well outside the traditional domain, especially in developing countries, we must look to a wider concept of market failure.

An important group of arguments--some clearly of a macroeconomic character, others more of a political/ideological nature--relates to economic development and planning. In many developing countries, public production was viewed as essential given the underdeveloped nature of resources and markets. In general, private returns to investment were not sufficiently attractive to private investors, and few native entrepreneurs, with investable funds, were either willing to bear the risk or able to run modern enterprises. Other countries felt that the private sector was or would be dominated by certain ethnic, social or economic groups, and that therefore these groups should either be divested of economic power or prevented from obtaining such power. In some cases, the scale of investment required exceeded the capital-raising capacity of the indigenous private sector, and foreign ownership was felt to be undesirable.

It has also been argued that public ownership and control, particularly of the "commanding heights" of the economy, facilitates the development and planning process. This argument has been used to justify nationalization programs in both industrial and developing countries. Many developing countries also felt the need for a different economic orientation from the capitalism of former colonial powers, and viewed the experience of the U.S.S.R. with central planning and state enterprises as an attractive alternative for achieving successful rapid industrialization.

In addition, substantial social benefits were expected to derive from the creation of public enterprises. In many cases, public ownership was thought to be conducive to the attainment of a number of social policy objectives. The inability of the market to achieve distributional objectives--in particular, widespread access to essential goods and services at reasonable prices--is a source of market failure in the standard sense. But public ownership has been ascribed wider social objectives. For example, it has been used to create employment or to prevent rising unemployment. Of particular concern have been the social costs imposed when a locality or region is dominated by a firm or industry that is experiencing financial problems. The extension of public ownership to many areas of manufacturing industry--both declining industries (i.e., those with poor demand prospects) and those suffering temporary difficulties--is often related to the adverse employment consequences of continued private ownership and the possibility of bankruptcy. The social goals of public ownership take on particular significance in developing countries, where unemployment and inequality are more readily associated with political instability.

Public ownership has also been advocated as a political strategy. However, while there are clear examples of nationalization and denationalization that reflect prevailing political ideology, there are many instances of inconsistency, and political intent is frequently masked by reference to economic and social considerations. As a result, there is little correlation, both across countries and over time, between political stance and the size of the public enterprise sector. Nationalization can also serve strategic interests. A country that retains an interest in major world industries, even where it is inefficient to do so, will not depend on potentially unreliable external sources of supply.

While all of the above considerations help to account for the central role currently assigned to public enterprises in both industrial and developing countries, they do not fully explain why the boundary between the private and public sectors differs so much across countries. Because so many extraneous and arbitrary factors come into play, it is impossible to predict the size and structure of the public sector of a given country, even taking into account its economic, social, political, and other seemingly relevant characteristics. Indeed, in many instances, an enterprise ends up in the public rather than the private sector largely through an accident of history.

2. Performance

A growing body of evidence claims to show that when the public and private sectors can be compared in terms of productive efficiency, the private sector outperforms the public sector. For example, Borcherding, Pommerehne, and Schneider (1982) summarize the results of a number of studies covering a wide range of activities (including air, bus and rail transport, electric and water utilities, and insurance) in the United States, Germany, Australia, Canada, and Switzerland--countries with allegedly similar social and political institutions--that support this view. However, such results should be treated with caution. There are few examples of truly comparable public and private sector activities and enterprises, and attention therefore focuses on specific aspects of comparability. But as the focus of attention changes, the results of the comparison also tend to change. 1/

The results of such comparisons may also change over time, both in the long term and the short term. For example, impetus was given to creating municipal enterprises in Italy at the end of the nineteenth century by studies comparing similar private and public enterprises which clearly showed inefficiency in the private sector (Marchese, 1985). However, once a model of successful nationalization, the public enterprise sector in Italy is now said to be riddled with inefficiency and corruption (Martinelli, 1980). The relative inefficiency of the private sector in the United Kingdom was discussed by Pryke (1971) whose later work (1982), on the other hand, showed the private sector to be

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1/ Thus Millward (1982) and Yarrow (1986) reach different conclusions as to the relative efficiency of public and private enterprises from surveys of a similar body of literature.

more efficient than the public sector. But perhaps the major limitation of such comparisons arises from the fact that public enterprises are assigned multiple objectives--including social obligations to deliver essential services, sell at below cost (which may involve cross-subsidization), and provide employment--and to the extent that these objectives must be traded off against commercial objectives, public enterprises are bound to appear less efficient in terms of the criteria by which private enterprises are judged.

Despite the inconclusive nature of the evidence, it is difficult to believe that existing public enterprises are not capable of achieving significant improvements in efficiency, be it in the public or the private sector. Moreover, increasing budgetary support for public enterprises suggests that their performance has been deteriorating, particularly in developing countries. 1/ To reverse this trend, the major sources of inefficiency need to be identified.

3. Problems

Many of the early proponents of government ownership argued that socialized industry could be self-supporting and economically successful only if it were freed from political interference. While public enterprises should be accountable to government, day-to-day decision making should be left to enterprise managers. This has been referred to as the "arm's length principle". In practice, public enterprises are subject to a wide range of statutory and administrative controls, as well as to less formal modes of intervention. Government influence extends well beyond that necessary to ensure that enterprises fulfill their economic, financial, and social objectives. Indeed, a significant part of the problem is that politicians can influence the objectives of public enterprises; in particular, less compelling noncommercial objectives are substituted for economic, financial and more immediate social objectives. Notwithstanding the claim that some countries have experienced a recent improvement in the relationship between politicians and public enterprises (e.g., Posner, 1984), in many countries it is unlikely that politicians can be persuaded to interfere much less than in the past.

It has also been suggested that in choosing to locate an activity in the public sector, market failure has given way to bureaucratic failure. For example, property rights (or agency) theory suggests that, because they do not have access to shared information, governments (the principals) face difficulties in providing appropriate incentives to

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1/ Although there are notable exceptions, Argentina and India for example, the World Development Report 1983 provides a number of examples of countries where budgetary support was much higher toward the end of the 1970s than in the late 1960s and early 1970s. However, part of this increased support will have been necessitated by worsening economic conditions rather than increasing inefficiency.

public sector managers (their agents) and in monitoring their performance. These managers are therefore given less managerial discretion than their private sector counterparts and so choose a relatively quiet life (Alchian, 1965). They will perform only to the level necessary to meet the performance standards set for them, and these may be modest compared to the potential of the firm or industry concerned. From a different perspective, public choice theory suggests that public managers can secure more pay, power, and prestige than their private sector counterparts by forming coalitions with civil servants in supervising ministries that result in increased budgets (Niskanen, 1971). Indeed, budget maximization becomes an end in itself, and other objectives--both commercial and noncommercial--have to be conceded to achieve it. While these two theories imply different behavior on the part of public sector managers--and so far the available evidence is *incapable of distinguishing between them--both theories predict that* public production will be relatively inefficient.

Political interference and bureaucratic failure are probably the principal sources of inefficiency associated with public ownership. However, there are other important sources of inefficiency. For example, with government backing, public enterprises cannot go bankrupt, nor do they face the risk of takeover; they are not, therefore, forced to observe the financial discipline imposed in the private sector. Specifically, public enterprises either do not have to borrow on the private capital market, or, if they do, government guarantees or the assumption of government backing results in their being favorably treated relative to private enterprises. This, of course, accommodates the inefficiency resulting from political interference and bureaucratic failure. It also allows public sector unions to exploit their power to interrupt the supply of essential goods and services to secure pay and conditions that are out of line with those in the private sector. In developing countries, it is also argued that limited human resources are spread too thinly over large public enterprise sectors. The above problems imply that public enterprises perform badly in terms of productive efficiency, because they are likely to have higher production costs at a given level of output than in the private sector.

It is also alleged that public enterprises fail to achieve allocative efficiency, because they face little incentive to respond to consumer demands; the quantity, quality, and other characteristics of goods and services provided by public enterprises are not those most valued by consumers. However, while public ownership per se leads to productive inefficiency, it can result in allocative inefficiency only when associated with considerable monopoly power--sometimes granted by statute--or when some other form of protection from competitive pressures is implied. 1/

III. Privatization

The poor performance of public enterprises can be tackled in a variety of ways, and privatization is not the first to be tried. As mentioned above, previous efforts have involved statutory and administrative attempts to control public enterprises. However, because these have for the most part been judged unsuccessful, attention is now turning to the possibility of increasing private sector involvement in public enterprises and, in the limit, completely disposing of some enterprises.

1. Benefits

Privatization is seen primarily as a means of improving the efficiency of enterprises. Because it is believed to limit the scope for political interference in decisionmaking, to increase managerial incentives by making managers responsible to shareholders who can monitor their performance better than governments, and to impose the financial discipline of private capital markets (including the market for corporate control), there is likely to be an incentive to seek productive efficiency, and fewer barriers to attaining it.

Other benefits are also claimed. Through privatization, an enterprise can gain access to private sector financing, and private owners may bring access to new markets. If the sale of public sector assets can be made attractive to small investors, this will broaden share ownership, which may be thought desirable. Privatization may also spur the development of domestic capital markets, and, it has been argued, lead to a reduction in public sector deficits, especially if the government can dispose of loss-making enterprises. In addition, it may disarm public sector trade unions that are abusing a monopoly position. Advocates of privatization also tend to associate it with increased competition and hence improvements in allocative efficiency.

Privatization may also benefit enterprises that remain within the public sector. For these enterprises, increased efficiency will result principally from improvements to existing incentive and control

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1/ Allocative efficiency can also be defined in terms of resource allocation in the economy as a whole. Focusing on efficiency in consumption given production decisions implies that productive and allocative efficiency can be discussed independently. A partial equilibrium view of economic efficiency is therefore being taken. In a general equilibrium analysis, productive inefficiency would imply allocative inefficiency--because inputs are allocated inefficiently and there exists a Pareto superior structure of output and consumption--although the reverse would not be true.

mechanisms. However, there is a potential role for such privatization techniques as contracting out and franchising, which fall short of total or even partial denationalization. Moreover, if public sector activities can be transferred to the private sector in significant measure, the government should be better placed to focus on the objectives, conduct, and performance of those enterprises that remain in the public sector.

The main arguments made in support of privatization are discussed later in the paper. In particular, Section IV examines efficiency issues while Section V analyzes the impact of privatization on government finances. The remainder of this section focuses on techniques of privatization, national experiences and prospects, and practical problems of implementation.

2. Techniques

The term "privatization" has been used to refer to any shift in activity from the public to the private sector. This could involve us more than the introduction of private capital or management expertise into a public sector activity. However, for the moment, we will concentrate on the transfer of ownership of public enterprises to the private sector, that is total or partial denationalization. 1/ Ownership can be transferred in a variety of ways. An enterprise may be sold, in its entirety, to a specific buyer in private industry, probably engaged in a similar activity or seeking to diversify; to the management and employees; or to the public through a share issue. Alternatively, a part of the whole may be sold, normally to a specific buyer with a related interest. This may be appropriate where the enterprise as a whole is not attractive to a private buyer--e.g., because some of its activities are heavily regulated--but where other activities can be separated from the whole and run independently. Where salable parts cannot be identified, a proportion of the whole can be sold, the exact percentage depending upon how much control the government wishes to retain over the enterprise.

A change in ownership need not involve a sale. An enterprise can be privatized by handing over ownership by means of, say, a nominal sale to a private individual, to a private concern, or to a particular interest group, most likely the management or employees of an enterprise. Such a "giveaway" may be appropriate where heavy losses, massive debts, or a history of labor troubles make an enterprise unattractive to a specific buyer or to the wider public. As a final resort, an enterprise can simply be liquidated, and its plant and equipment sold off to the private sector. There are many other

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1/ A more general definition of privatization relates to the transfer of the rights to the net profit generated by an enterprise from the public to the private sector, which need not involve a change in ownership. Some of these types of privatization techniques are mentioned below and discussed in more detail in Section IV of the paper.

privatization techniques--Pirie (1985) identifies over twenty--but they do not involve changes in ownership. Some, however--specifically contracting out and franchising--may be appropriate in the context of public enterprises.

Once privatization is adopted as a policy, a number of practical problems, such as asset valuation, marketing, and financing, have to be addressed before it can be implemented. The following section reviews recent privatization developments and what is in immediate prospect. It cites specific examples of the problems associated with privatization, particularly in the United Kingdom, where it has been carried furthest. This review seems to illustrate some of the problems that are then discussed.

3. Experiences and prospects

a. The United Kingdom

As of April 1986, the United Kingdom had raised approximately £7.5 billion through the privatization of public enterprises. Of this, £6.7 billion came from the sale of seven enterprises, the sale of a majority stake in British Telecom yielding £3.6 billion. In addition recent sale of British Gas (the largest share issue ever made) will yield a further £5.4 billion. 1/ Details of these sales are shown in Table 1. 2/ In each of these six cases, sale was by one of two methods or a combination of both, namely, the sale of equity by tender and offers for sale at a fixed price. The latter were the more common. Both types of sale presented problems, with tenders failing to reach reserve prices and, most notably, offers being oversubscribed, with the market establishing large discounts (i.e., with the offer price significantly below the market price).

Determining the market price of a public enterprise in advance of a sale is difficult; there is very little information on which to base an estimate. Selling by tender would, therefore, seem to be logical, but it has been regarded as too complex a method of sale to secure the participation of small investors. However, offers for sale have, to date, met with some or all of the problems mentioned above. For example, in the case of Amersham International, a small radionics firm, an offer for sale of 100 percent of equity in 1982 was oversubscribed 25 times. The sale yielded £64 million. Subsequent trading established an immediate discount of over 30 percent on the sale as most of the original 65,000 shareholders sold out to the large institutions at a considerable profit.

1/ Between 1979 and 1983 a minority stake (12 percent) in British Petroleum was sold for £1 billion. This sale is not included in these figures. The sale of the Trustee Savings Bank in 1986 for £1.5 billion is also excluded, since the sale proceeds were returned to the bank.

2/ For details of the remaining sales, see Yarrow (1986), Table 1.

Table 1. United Kingdom: Privatization of Major Public Enterprises

Date	Enterprise	Share sold (percent)	Proceeds (£ millions)
1981	British Aerospace	51.6	43
1981	Cable & Wireless	49.4	182
1982	Britoil	51.0	627
1983	Cable & Wireless	27.9	263
1984	Enterprise Oil	100.0	380
1984	Jaguar Cars	100.0	297
1984	British Telecom	50.2	3,600
1985	British Aerospace	48.4	346
1985	Britoil	48.9	425
1985	Cable & Wireless	22.7	600
1986	British Gas	100.0	5,400 1/

Source: Yarrow (1986), Table 1 (updated by authors).

1/ £2,000 million was received in December 1986; £1,800 million will be received in June 1987, and £1,600 million in April 1988. The Government will also receive an additional £1,500 million in debt repayments over five years.

This is not an isolated example. Mayer and Meadowcroft (1985) report an average discount of 26 percent on a range of sales between 1979 and 1985. They also report that in most cases subsequent trading resulted in a large reduction in the number of people holding shares in the enterprises concerned. Only in the case of Britoil did the number of shareholders subsequently increase, but the sale by tender of the first tranche of Britoil shares was initially unattractive to small investors. In the case of British Telecom, the government took a number of measures to persuade shareholders to hold on to their initial allocation of shares. These efforts appear to have succeeded, despite an immediate discount of almost 100 percent, and a larger subsequent discount. The original 2.3 million shareholders have only fallen to about 1.7 million. More extensive measures accompanied the sale of British Gas, and these resulted in over 4 million successful applications for shares, and the early indications are that shareholders have been persuaded to hold on to their initial allocations, and that discounts are correspondingly smaller. 1/

The U.K. experience with other forms of asset transfer is limited. There have been a number of instances of complete parts of a whole enterprise being sold--for example, the sale of hotels and the cross-Channel ferry service run by British Rail, a communications subsidiary of British Airways, and a subsidiary of the British Steel Corporation. The National Freight Company and the Redheads ship repair yard were sold to their workforces. And, in one case, an operation--the cross-Channel hovercraft service run by British Rail--was given to its work force.

Notwithstanding the problems associated with offers for sale, recent figures (for the 1984/85 financial year) suggest that the companies involved have improved their profits, although to the extent that these enterprises retained some monopoly power, they have not necessarily become more efficient. Nevertheless, compared to their pretax profits immediately before privatization, Cable and Wireless has increased its profits four times, Jaguar two times, British Aerospace by 50 percent, and Britoil by 20 percent. The managers of these enterprises attribute the improvement mainly to the freedom to pursue commercial objectives unhampered by government interference in decision making. 2/ In the above cases, however, improved profitability occurred over a period when the economy was recovering from a major recession, and it is not clear what part privatization has played in this

1/ At the time of writing, dealings in 50 pence part-paid shares had just commenced. The immediate discount appeared to be about 20 percent.
2/ "UK Privatization: What the Management Think," Financial Times (July 20, 1985).

improvement nor whether it is permanent. 1/ The only failure in this respect has been Redheads, which was in severe financial trouble less than two years after privatization and was subsequently taken over by another ship repair yard. However, this failure should not be regarded as reflecting badly on the privatization strategy; on the contrary, it should be regarded as being to its credit. Privatization is intended to separate those commercial enterprises that can succeed in the private sector from those that cannot. The plans to privatize, amongst others, British Airways, the British Airports Authority, the National Bus Company, and Rolls Royce over the next five years, suggest that the program, at least in the U.K. Government's view, has on balance, been successful.

b. Other countries

Information about privatization in countries other than the United Kingdom is sketchy. However, a general view of what has been happening and what is planned is presented in Appendix I, which is an attempt to summarizing a mass of disparate information.

Interest in privatization appears to be a worldwide phenomenon, with nearly 50 countries having acted or announced an intention to act in this direction. However, of well over 1,000 proposals that have been identified, only 10-15 percent have been executed. 2/ Privatized enterprises are found mainly in the industrial and service sectors, and privatization has proceeded furthest in the areas of textiles, food processing, construction/engineering, banking, and hotels. The traditional public enterprises, especially utilities, have so far been largely unaffected. And despite the frequent mention of airlines and telecommunications in discussions of planned privatization--especially in Europe and Asia--it seems likely that the inroads made into the major enterprises, and therefore the public enterprise sector as a whole, will be small. Where major enterprises are concerned, most countries intend only a partial dilution of public ownership, with governments retaining a controlling interest (or a "golden share").

In many countries the primary motive for privatization is to rehabilitate enterprises and/or to facilitate the modernization of plant

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1/ The relationship between privatization and performance can only be determined by following a privatized enterprise through a complete business cycle. As Byatt (1985) has remarked about privatization in the United Kingdom "... we are at an early stage of a major shift in public policy. It will be important to look at this in say, five years' time, by when it should be possible to report on results" (p.20).

2/ These figures exclude those for the United Kingdom, Bangladesh--where privatization mainly involved returning mostly jute mills to their former owners between 1972 and 1982--and Chile in the immediate post-Allende years, when extensive denationalization of enterprises taken over by the previous government occurred.

and equipment as in Guinea, Mali, Niger, Togo, Zaïre, India, and Thailand. In some countries, for example Turkey, expanded revenue has been the object. In several countries--including Liberia, Senegal, and Sierra Leone--the World Bank Group has promoted privatization as part of its structural adjustment programs. Elsewhere--as in Kenya and Jamaica--some impetus has been provided by the United States Agency for International Development (USAID). In general, external support for privatization seems to have contributed more to the formulation of policy than to implementation. In Jamaica, for example, only 6 of 41 targeted enterprises have so far been privatized.

The Jamaican example illustrates perhaps the most striking feature that emerges from the information on privatization outside the United Kingdom, which is the marked divergence between stated intentions and follow-up action. No attempt will be made here to explain the divergence. It reflects a number of factors, for example, the inevitable gap between ideological rhetoric and a real intention to act. Moreover, it is probably too early to assess the true divergence, since the typical lead time has yet to be established. In this respect, the practical problems--including asset valuation, marketing, and financing referred to above--may be important. The paper will now examine these problems focusing on how they might be overcome, particularly in a developing country.

4. Problems of implementation

a. Asset valuation

The U.K. experience shows that even in a sophisticated financial environment, where shares are routinely traded in large volume and high quality advice can be readily obtained, it is difficult to establish the market value of an enterprise before its sale. A number of factors contribute to this difficulty: the size of the enterprise (or part thereof) being sold; the uncertainty regarding the structure of the market in which an enterprise will operate; the impact of any regulatory control that will accompany privatization; and the extent to which the private sector sees opportunities to improve the efficiency of privatized enterprises that the public sector ignores. Undervaluation of assets can be costly. For example, the British Telecom sale may have cost the U.K. Government as much as £3-4 billion in forgone sale proceeds. 1/ However, with the smaller underpriced issues, the loss has been correspondingly smaller, suggesting that where large share issues are involved, the risk of underpricing can be reduced by selling in

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1/ This statement is based upon the difference between the offer price and the market price of shares actually traded; a sale by tender may not have achieved a 100 percent premium on the actual offer price and a much higher fixed price offer may not have been fully subscribed.

small lots to establish a trading price before the majority of shares is placed on the market.

In the case of enterprises that are too small to market in parts, or where an enterprise will be sold directly to a single buyer, valuation will remain difficult. However, one possibility would be to yield control while selling in several phases. A straightforward relationship between sale price and financial performance might encourage deliberately poor initial performance. In such cases, the problem might be resolved by structuring the cost of sale so that long-term financial performance forms the basis for final costing, while an interim sale price is based on short-term performance. This would certainly make it easier to sell loss-making enterprises since no initial sale price need be stated at the time of change in management, and the ultimate price could take into account any turnaround in performance under private ownership.

Valuation problems are compounded in developing countries. In many cases neither the private sector of the economy nor the capital market is sufficiently developed to yield even an approximate valuation. While international markets could help in this respect, the restrictions that are often placed on the involvement of foreigners and nonresident nationals limit this possibility. And even where a market value can be established, the thinness of domestic capital markets necessarily places limits on the ability to finance privatization from domestic resources in any given time period.

b. Marketing

One of the objectives of privatization in the United Kingdom has been to widen the ownership of shares. Thus the U.K. Government has encouraged share ownership by individual investors. As indicated above, the initial results were poor, as individuals sold out their holdings mainly to the financial institutions. In part, this reflects the bias of the U.K. tax system against individual saving and in favor of collective saving (see Kay and King, 1983). But it is mainly a reflection of the profits to be made by purchasers as a result of the underpricing of shares. However, as indicated above, despite continued underpricing, privatization has recently achieved greater success in securing wider share ownership as shareholders have responded to incentives designed to discourage quick sales. Moreover, in the 1986 budget the U.k. Government introduced a personal equity plan giving tax incentives to hold shares.

Many developing countries wish to limit participation to particular groups of shareholders and, to this end, exclude potential buyers. In addition to foreigners and nonresident nationals, ownership by certain ethnic or social groups is often unacceptable. This is a principal reason why privatization is proceeding so slowly. Brazil, Kenya, and Malaysia are countries where restrictions on desirable shareholders have been a major impediment to privatization. However, these restrictions are not exclusive to developing countries. For example, Japan is not allowing foreign purchases of NTT (telecommunications) shares, and the French privatization program places restrictions on foreign ownership, initially 20 percent. In the United Kingdom, resistance to selling to non-British, and in particular American, buyers has obstructed the planned sale of the BL car manufacturing company.

c. Financing

The major constraint on privatization in developing countries is financing. In the United Kingdom and other industrial countries there are large, well established capital markets. Many developing countries do not have a stock market, and those that do exist are often very small. 1/ In Peru, for example, a privatization program was never implemented because the planned asset sales (equivalent to about 3 percent of GDP in the early 1980s (Berg, 1983)) were too large in relation to available private sector resources. The problem is compounded by the restrictions placed on ownership referred to above.

One possible solution to the financing problem, while not conceding control to foreigners or particular ethnic and social groups, is to allow them minority participation. For example, the Malaysian Government has been able to proceed further than other governments, despite restrictions on ownership, by fostering the creation of holding companies able to purchase shares that comprise an ethnic Malay majority together with less "acceptable", but financially more powerful, domestic and foreign interests.

Privatization may actually promote the development of capital markets. Any increase in the range of assets available to domestic savers may lead to increased saving and to the substitution of shares in privatized enterprises for cash holdings, and real and foreign assets. In Turkey, for example, the sale of bonds secured by revenues from the Bosphorus Bridge and the Keban Dam, financed largely by gold sales, is claimed to have been a major influence on the growth of the capital market. However, as in the Turkish case, a minimum income may have to be guaranteed to shareholders to induce them to participate in a market where the availability of, and access to, information is necessarily limited. This is especially important in developing countries where there is the risk that profits will be squandered rather than distributed to shareholders.

An often neglected source of finance is the work force of an enterprise. A privatization package could be set up allowing workers to receive shares in an enterprise in return for agreeing to repay the government, or to relinquish a claim against it. In practice, this

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1/ Even in industrial countries, except for the major ones, stock markets rarely have turnovers in excess of $5 billion. So the financing problem is not limited to developing countries.

could mean that a share of wages would go to the government for a specified period. In effect, the government would be bearing part of the operating risk even after privatization--it would not receive payment if the enterprise failed--and this could be seen as a way of compensating for informational inadequacies. Alternatively, workers could give up part of their accrued pension rights, which in many cases would be greater than if they had worked in the private sector.

Lastly, mention should be made of the potential offered by debt to-equity conversions. Some countries--e.g., Chile--have granted permission to foreign creditors to exchange their debt, usually at a discount, for equity in certain industrial and service activities. Clearly, such a procedure could facilitate the privatization process while, at the same time, reducing the country's debt burden.

IV. Privatization and Competition Policy

1. Privatization and efficiency

How can privatization be expected to make public enterprises more efficient? To answer this question, we need to distinguish between public enterprises that are already subject to national or international competition and those in a monopolistic position.

In the first case, the forces of competition should provide the incentive for enterprises to seek out opportunities to increase both productive and allocative efficiency. In general, there are no strong grounds for public ownership of such enterprises, and sale to the private sector should be both straightforward and uncontroversial. Of course, some enterprises will have survived competition only with budgetary support. There may be compelling reasons why this support should continue--where enterprises have social obligations or where they serve strategic interests, for example--but, otherwise, it seems appropriate that commercial considerations should determine the viability of such enterprises.

Clearly much of the privatization that has occurred, both in industrial and developing countries, falls into this first category. It will have led, or is likely to lead, to some gains in efficiency, but the aggregate impact of such privatization is necessarily small, given previous exposure to competition under public ownership, and the fact that, in general, competitive firms account for only a small share of the public enterprise sector. The greatest benefit resulting from the privatization of such enterprises probably derives from the initial momentum given to a privatization strategy. However, large efficiency gains can be expected to come only from the privatization of public monopolies, and in particular large monopolies. To the extent that privatized enterprises are able to retain most of their monopoly power--either because statutory protection continues or because their cost structure implies that they are natural monopolies--the scope for improvements in efficiency relates primarily to what can be done to enhance productive efficiency. There is no reason to believe that the product mix produced by a private monopoly is valued more highly by consumers than that produced by a public monopoly, in which case no improvement in allocative efficiency is likely to emerge from privatization.

When a public monopoly is transferred to the private sector, the privatized monopoly will typically have to accept regulatory surveillance. In the United Kingdom, the privatization of British Telecom was accompanied by the creation of a regulatory agency, OFTEL (Office of Telecommunications), in recognition of the monopoly position to be retained by British Telecom. The recent sale of British Gas is to be followed by the creation of a similar agency. The privatization of monopolies should therefore be seen as involving a change in the nature of regulation (Rees, 1986).

A number of different arguments suggest that the replacement of a public monopoly by a regulated private monopoly will increase productive efficiency. Of these, three--the impact of reduced political interference, a change in the structure of property rights, and more effective financial constraints--should be emphasized.

a. Reduced political interference

If public enterprise managers cannot make decisions independently of the need to meet the demands of political expediency, privatization should improve the quality of managerial decision making. The record of political interference in the operation of public enterprises is bad, and the fact that governments in many cases retain a controlling interest in privatized enterprises implies that considerable scope for political interference will remain, even after privatization. However, in attempting to exercise this power, politicians are likely to face two constraints.

The first constraint is the regulatory framework, which is concerned not only with policing anti-competitive practices, but also with eradicating other sources of economic inefficiency, including attempts by politicians to affect economic decisions. However, the regulatory agency should be invested with sufficient autonomy to limit the possibility of its being captured by particular interest groups. The second constraint is the existence of private shareholders, who can monitor the conduct and performance of the enterprise. While, in effect, every taxpayer/voter is currently a shareholder in the public enterprise sector, an explicit shareholding may induce those voters who hold shares to take a greater interest in the performance of public enterprises; politicians may therefore be required to act more responsibly as a result of privatization. However, if ownership is widespread this may not be an effective constraint. More effective control might result if the majority of shares were in the hands of major financial institutions, which of necessity must monitor their investments very closely, indeed, this is one reason individuals prefer to hold shares in financial institutions rather than in specific companies. It should be noted, however, that the resulting concentration of share ownership defeats another stated objective of privatization, namely the achievement of broad-based share ownership.

b. Change in the structure of property rights

It has been suggested that a change in ownership will affect the structure of property rights and thereby overcome existing bureaucratic failures. Shareholders will be aware of the possibility of takeover, and will set up incentive systems--featuring bonus payments or profit sharing, for example--that put pressure on managers to be more efficient. While shareholders may be better informed and more demanding principals than government because they share both the benefits and costs of the way a firm is managed, if the structure of operational control is largely unaffected by a change in ownership, there may remain a problem of asymmetric information. Thus, property rights theory suggests that managers of private monopolies are also able to take out part of the benefit a monopoly confers in the form of a quiet life. However, because private managers typically have greater discretionary power than public managers, they will, according to the theory, take advantage of the opportunity this presents to pursue goals that promote their own position and reputation, and so increase their personal rewards.

c. More effective financial constraints

Upon privatization, an enterprise should relinquish access to direct financial support from the government. It will, therefore, be subject to the discipline imposed by the private capital market and the market for corporate control. However, the effectiveness of this financial constraint will depend upon the government's resolve in resisting claims for direct support, or indirect support in the form of preferential treatment by the private capital market.

Although none of the above arguments unequivocally implies that privatization will significantly increase productive efficiency, some improvement is likely to result. While politicians may continue to interfere in privatized enterprises and while inefficient enterprises can satisfy their creditors and not be threatened by takeover, private monitoring of managers is probably more effective than public monitoring. Moreover, without the financial backing of government, the capital market will impose some pressure on enterprises to be efficient. Even so, substantial efficiency gains may well fail to be realized. Moreover, even if productive inefficiency is reduced considerably, allocative efficiency may be conceded in the process, and the actual gains in economic efficiency resulting from a change in ownership may prove relatively modest. 1/ However, the size of likely efficiency gains cannot be determined a priori, nor is there sufficient quantitative information on which to base a judgement.

2. Privatization and liberalization

While changes in ownership may be expected to produce some gains in productive efficiency, there is no reason to expect improvements in allocative efficiency. Allocative efficiency is a function of market structure rather than ownership. In the initial absence of competition, gains in allocative efficiency can be expected only if privatization is accompanied by liberalization policies to remove any market restrictions. Moreover, the pressure of competition, which requires private enterprises to seek out opportunities to make profits in order to minimize the risk of takeover, rather than changes in ownership, may be a more significant source of productive efficiency. Given the importance of competition, the question then arises as to the relationship, if any, between privatization and liberalization.

A number of arguments suggest that liberalization cannot proceed successfully without privatization. The most important economic argument relates to the possibility of predation. A public enterprise, backed by government resources, may be able to engage in practices designed to deter new entrants, for example by reducing prices to close to or below costs. Predation can obviously coexist with liberalization in the public sector, as in the case of coach transport in the United Kingdom (see Rees, 1986). But predatory practices are more likely to occur in the private sector--indeed, it is in the context of business strategy in the private sector that predation has been a major issue--and this has been recognized in the formulation of regulatory policy in many countries. While the possibility of predation does not imply that privatization is necessary for liberalization, it does suggest that liberalization is unlikely to successfully foster competition unless accompanied by regulation to deter anti-competitive practices. In the case of public enterprises, this may require cutting off access to government financial resources to finance such practices. 2/ Further, while liberalization with appropriate regulation will promote competition and lead to increased economic efficiency, if publicly owned competitive enterprises are assured of financial support from the government, they may lack incentive to seek productive efficiency. Competition among private enterprises secures full economic efficiency. However, when publicly owned enterprises compete in the market, economic efficiency can be maintained only if the government,

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1/ This is simply the other side of the argument for and against public ownership, namely that it is necessary to improve allocative efficiency, but productive efficiency is conceded in the process. For an illustration relating to medical care in the United States, see Klein (1984).

2/ See Vickers (1985) for further discussion of predation.

while retaining ownership, requires such enterprises to remain commercially viable. If such a condition is not imposed, liberalization and regulation are unlikely to be fully effective without privatization.

While other considerations--e.g., political expediency--might suggest that liberalization is to a degree dependent on privatization, considerations relating to predation suggest that liberalization can proceed without privatization. However, to maximize efficiency gains (subject to the qualifications outlined in the next section), privatization and liberalization (accompanied by regulation) are desirable, although, under some circumstances, it may not be in the government's interests to pursue both. For example, one of the objectives of privatization may be to generate budgetary resources. Clearly the market value of an enterprise is determined by its current and future profitability. Governments, therefore, may be motivated to protect privatized enterprises from competition to boost their market valuation. It has been argued that this was the case with the privatization of British Telecom in the United Kingdom, where competition was also resisted by incumbent management (Kay and Silberston, 1984). The restriction of competition to boost budgetary revenue, to placate management, or to meet other short-term objectives, has potentially long-term implications; it makes any future introduction of competition difficult in that this would automatically lower the value of shares in privatized enterprises (Kay and Thompson, 1986). Therefore, as a general rule, where privatization and liberalization come into conflict, the latter should be preferred since privatization can more readily follow liberalization than vice versa.

3. Competition and efficiency

It has been argued that, where increased efficiency follows privatization, it results from a consequent increase in competition more often than from a change in ownership. This in turn suggests that the scope for enhancing efficiency through privatization is limited by the extent to which markets can be made more competitive. Among the factors that may constrain market competition, three stand out. First, public enterprises often owe their existence to market failure and, this being so, opening up a market to competition may achieve little, or may even prove counterproductive. For example, where a public enterprise is a natural monopolist, opening up a market is unlikely to attract competition, and privatization may result in a monopoly position being more fully exploited. Second, competition may not be appropriate, expecially when enterprises cross-subsidize loss-making activities--a situation that often arises when enterprises have significant social and other noncommercial objectives--and the private sector can engage in "cream-skimming." In such circumstances, the private sector will undertake only profitable activities; the public sector will be left with loss-making ones, for which budgetary support will be required unless concessions are made in respect of social objectives. The third factor that may limit competition is the difficulty of designing effective regulatory regimes. These issues are discussed in more detail below, following a discussion of contestability.

a. Contestability

It is important to note that full competition is not essential to achieve desired efficiency gains: the threat of competition may be sufficient. Much has been made of an argument based upon the theory of "contestable markets" (Baumol, Panzar, and Willig, 1982), according to which a monopolist is said to operate in a contestable market when his behaviour approximates that of a competitive firm. Such a situation exists only in the absence of entry-restricting barriers to exit; in other words, sunk costs must be low. If such a condition holds, and if a monopolist is behaving as if he were not subject to competition, then other firms can raid the industry for part of the monopoly profit. It is therefore the fear of entry that induces the monopolist to keep prices close to costs. For the traditional public monopolies--characterized by high levels of capital investment that cannot be recovered on exit--contestability is unlikely to be a relevant issue. However, it could potentially take on greater significance if the public enterprise sector contains many smaller commercial enterprises, although even when this is the case, it is difficult to think of many activities for which the assumption of costless exit is appropriate. 1/

b. Natural monopoly

The efficiency gains resulting from competition policy in a market dominated by a natural monopolist are restricted by the limited opportunities for new entrants. The core activities of these enterprises tend to resist competitive pressures, and a change in ownership through privatization will involve no more than a change in the form of regulation, with little expected impact on economic efficiency. However, a flexible approach to privatization may stimulate competition in a natural monopoly setting, and thereby promote both productive and allocative efficiency. As described in Section III, privatization need not involve a sale of public sector assets, and other forms of privatization may create an environment of contestability. Although natural monopoly tends to be defined by the core activity--in particular access to a network such as an electricity grid--many associated activities, such as maintenance, can be contracted out to the private sector through competitive bidding. Contracting out is perhaps the most common form of privatization, having been widely used in the local public services (e.g., refuse collection, catering, cleaning and laundering in hospitals, etc.).

In the case of natural monopoly, franchising offers some interesting possibilities (Kay and Silberston, 1984). A franchise

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1/ See Shepherd (1984) and Vickers and Yarrow (1985) for a critical discussion of contestability.

involves inviting the private sector to compete for the right to operate a natural monopoly. Franchising is probably more appropriate where a natural monopoly can be decentralized, since it is better, in terms of efficiency, to have small rather than large monopolies operated by the private sector. For example, many network services can in part be operated on a regional basis. In order to maximize productive and allocative efficiency, franchises could be awarded on the basis of price and service offered rather than, as is customary, of payments made by the franchisee to the government. However, the a need for extensive regulation remains, to ensure that franchisees meet their obligations. In addition, unless entry costs are low, a franchisee is in a strong position either to amend the contract or disregard it. 1/ Moreover, franchising, (and contracting out) is particularly susceptible to abuse. Thus, in practice, franchising is likely to have limited appeal, and activities that tend toward natural monopoly will probably continue to be undertaken by the public sector. 2/

c. Social objectives

If an enterprise has social or other noncommercial objectives, efficiency is necessarily sacrificed and often losses are incurred. In principle, if these objectives are sufficiently compelling it should be possible to accommodate them--especially those that embody implicit subsidies--as part of both privatization and pro-competition strategies. For example, the government could contract with the private sector to deliver essential services, keep prices below costs, and provide employment. Private sector suppliers could bid for a government subsidy, in return for which they would guarantee that the above requirements were met. However, any attempt to replace the subsidies implicit in existing arrangements with explicit subsidies that draw attention to the cost of meeting a particular objective are likely to meet strong resistance. Moreover, placing a value upon social objectives is a subjective exercise, fraught with conceptual and technical difficulties, and one that is likely to encounter strong political opposition.

Public ownership will continue to further certain social objectives, although with some loss of efficiency which calls into question the cost-effectiveness of pursuing these objectives. A rigorous cost/benefit analysis of all such objectives is clearly impossible; however, the "compelling" nature of the objectives referred to above--namely, those objectives that cannot be met as effectively and efficiently by other means--should be used as a criterion. There are others that even without any detailed technical analysis, are clearly ill-defined, inappropriate, and non-cost-effective.

1/ This has been a general problem in the case of cable television in the United States.

2/ For a more detailed discussion on franchising, see Sharpe (1983).

The impact of adverse economic developments on employment and the associated demands for intervention really test a government's commitment to privatization. Privatization, especially in industrial countries, is currency being facilitated by favorable economic developments. However, since privatization makes enterprises more responsive to market forces, an economic downturn could result in severe employment losses. The consequent temptation to renationalize privatized enterprises should be balanced against the probability that the government will, as a result, not only be deprived of some income in good years but will also continue to bear losses in bad years. To pursue a privatization strategy is to accept that less successful enterprises will fall by the wayside and that some, at least short-term, unemployment will result.

d. Regulation

It has been pointed out that regulation is essential to effective competition policy. Where competition is admissable (other than in the case of natural monopolies), liberalization will result in the removal of barriers to competition, such as statutory monopoly and other forms of protection. However, the removal of such barriers will not necessarily lead to an increase in competition. Monopolistic enterprises in both the public and private sectors, especially if they are large relative to the size of the potential market, can erect strategic price and nonprice barriers. Therefore, an appropriate regulatory regime is crucial. However, the design and enforcement of regulations in the private sector have proved difficult. It is well known that predation is difficult to establish. Often, regulators do not have sufficient information to decide whether a particular activity is anti-competitive. Moreover, once an anti-competitive practice has been identified, it may take so long to curtail that it will already have had its intended effect. 1/ Regulators' decisions may also be be influenced by pressure groups, or by the government or the enterprise itself.

Clearly the impact of competition policy--and privatization--on the efficiency of privatized enterprises with dominant positions in potentially contestable markets will depend upon how well the regulatory regime functions. Regulation will also determine the efficiency of privatized natural monopolies. Thus, the success of the current shift in the emphasis of industrial policy toward private competition depends largely on the effectiveness of regulation. The design of appropriate regulatory regimes will not be discussed here, although it should be noted that public ownership, despite its shortcomings, often appears to

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1/ The allegations made by Laker Airways that some major trans-Atlantic carriers had forced it into liquidation through predatory pricing and other anticompetitive practices led to long court battles in the United States and an eventual settlement out of court, by which time Laker Airways was unable to resume business.

be relatively efficient in regulating monopolies (Papps, 1975). It is especially efficient in the case of natural monopolies and elsewhere that markets are unlikely to be contestable. Thus, again, it appears that privatization is likely to be more successful where public monopolies are sustained by statutory protection.

V. The Fiscal and Financial Impact of Privatization 1/

1. Asset sales in government accounts

Recommended Fund practice, as described in A Manual of Government Finance Statistics is to treat the proceeds from asset sales to the private sector as either capital revenue or a loan repayment in government accounts. If the government sells fixed assets that it previously held for its own use, land, or intangible assets such as mineral rights, the sale proceeds are recorded as capital revenue. If the government sells part or all of its interest in a public enterprise, the transaction is treated as a sale of equity and the proceeds are recorded as a loan repayment. These conventions apply when considering both the government accounts (either central government or general government) and the public sector accounts (i.e., after consolidation of general government and the public enterprise sector).

As in the discussion above, asset sales will be equated with sales of public enterprises. In an accounting sense, the immediate fiscal impact of an asset sale is straightforward: if there are no other budgetary changes, the overall deficit--that is the difference between total expenditure and total revenue--will be reduced by an amount equal to the sale proceeds. To the extent that the timing of an enterprise sale implies that revenue in the form of profit normally remitted to the government by an enterprise is foregone in the year of sale, the reduction in the government overall deficit will be lower by the amount of this unremitted profit.

This means that in general asset sales would tend to lead to a once-and-for-all reduction in the overall deficit unless the sale price was less than income that would have accrued to the government. In practice such an outcome would be possible if a firm had sufficiently large liabilities that future discounted earnings were negative while current earnings were positive. However, such an enterprise would probably be a candidate for liquidation rather than privatization.

The overall deficit provides a guide to a number of aspects of the relationship between government activities and the economy as a whole. Most importantly, since the deficit measures the difference between government expenditure and government revenue, changes in the overall

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1/ This section is an abbreviated version of Hemming and Mansoor (1986).

deficit, after suitable adjustments, are often regarded as indicating changes in the government's fiscal stance, e.g., whether demand management policy has become expansionary or contractionary. 1/ In addition, since the government must borrow to finance the overall deficit, its size has monetary and associated financial policy implications. The size of the overall deficit, and the way in which it is financed, also has balance of payments consequences. This section focusses on the overall deficit as an indicator of fiscal stance in the context of asset sales, and discusses briefly their financial implications.

2. Asset sales and fiscal stance

Assume that a public enterprise is sold to a private buyer at a fair market price. Such a price is defined as being equal to the present value of the discounted stream of after-tax net earnings of the enterprise. 2/ Further assume that this stream is positive in all future years. As indicated above, all other things being equal, the overall deficit would be smaller at the time of the sale. But the counterpart to this initially smaller deficit will be larger deficits in all future years, reflecting the loss of revenue in the form of remitted profit. However, if the discount rate embodied in the sale price correctly reflects financial opportunity costs, these larger future deficits would be exactly offset if the government used the sale proceeds to purchase other financial assets or to retire an equivalent amount of outstanding debt. In such circumstances, the government and the private sector are simply exchanging financial assets and liabilities, and this should not affect the demand for real resources at the time of sale, or in the future. Fiscal stance is therefore permanently unaffected by the asset sale.

If the government uses the sale proceeds to finance a temporary increase in current expenditure or a temporary reduction in taxation (or both), the deficit in the year of the sale would be unaffected while future deficits will be larger. However, whichever combination of tax cuts and expenditure increases is chosen, there will have to be a corresponding contraction in the future. If the expenditure increase and tax reduction are intended to be permanent, there will be both an immediate incease in expenditure or reduction in taxation (or both) and a reduction in the deficit, and the impact of these changes will fall between the outcomes just described. The same will also be true in future years. Clearly, whatever the use made of the sale proceeds, the resulting changes in the current overall deficit fails to reflect the macroeconomic consequences of the sale in the medium term.

1/ Such adjustments reflect factors such as the phase of the business cycle, the treatment of unemployment compensation, and inflation (see Heller, Haas, and Mansur, 1986).

2/ It is assumed that tax liabilities are the same within public and private sectors.

The above argument holds in the case of both profit-making and loss-making enterprises. If an enterprise requires a subsidy on a transitory basis, but the present value of its net profit stream is positive, the only difference is that in some future years the deficit will be smaller rather than larger. However, the more interesting case, since it is one where privatization is widely advocated, is when an enterprise not only makes losses but also the present value of its net profit stream is also negative. In such cases the first part of the above argument applies symmetrically (there is no possibility of financing an increase in current expenditure or a reduction in taxation in such cases). If the enterprise is sold at a competitive market price, this too will be negative, and a buyer will have to be paid an up-front lump sum subsidy equal to the negative present value of the enterprise's future net profit stream, or a stream of marginal subsidies will have to be guaranteed.

The precise pattern of subsidies will determine the resulting time profile of deficits, but unless the transaction is extremely artificial--with a positive sale price and correspondingly larger future subsidies--the most likely outcome is a larger initial deficit and smaller deficits in future years. However, the government will have to finance the larger initial deficit, and the need to service the additional debt will return future deficits to their higher original levels. Again, the public and private sectors have simply exchanged financial assets and liabilities, and fiscal stance will not be affected. The notion that privatization without changes in performance--as opposed to liquidation which in many cases may be more logical--offers permanent financial dividends to the budget where enterprises are heavily subsidized, is misleading. This would only be the case if enterprises can be run more efficiently in the private sector.

Given that in most frequently encountered circumstances the change in the overall deficit is taken as a reliable preliminary guide to fiscal stance, a question naturally arises as to why this is not the case where asset sales are concerned. According to Hills (1984) the source of the problem is that by focusing exclusively on cash flows, standard budgetary accounts fail to reflect what is happening to government or public sector net worth. Thus, when reference is made to the government's balance sheet, it is clear that if an asset sale involves a change in the composition of assets but net worth is unaffected, then despite resulting changes in deficits such a transaction has no fiscal impact. Similarly, when the sale proceeds are used to finance current expenditure or reduced taxation, and there is no change in the deficit, the resulting reduction in net worth indicates the initial expansionary impact of the transaction, and the consequential need for subsequent contraction, to compensate for the income that would have been generated by the lost wealth.

In suggesting that attention should be paid to the net worth of government in assessing the fiscal impact of asset sales, any implication that it is necessary to construct a full balance sheet where future impact of all government activities is represented in present value terms is not intended. Such an exercise raises methodological and practical problems that would make it an enormous, and in many cases fruitless, undertaking. Nevertheless, an exercise of this sort has been advocated, and partially completed, by others, for example Buiter (1983a, 1983b), and Hills (1984), with a view to determining, amongst other things, whether government consumption is consistent with estimated net worth. The requirements of the aforementioned exercise are more modest. There is no suggestion that the overall deficit be attached any less significance than is the current practice. Rather, the suggestion is that in certain circumstances additional information is needed in order to assess the fiscal implications of certain budgetary changes. In the case of asset sales, and a wide variety of other cases, this additional information relates to the underlying changes in government net worth, or the extent to which the government is saving or dissaving.

3. The financial implications of asset sales

If an asset sale is used to reduce the overall deficit, while other revenues and expenditures are held constant, there will be no financial impact in the medium term, provided the asset is sold at market value. As indicated above, selling an asset is equivalent to borrowing against its future income stream. However, if the government sells a bond, it is also borrowing against future income. In both cases, the government is accepting an obligation to raise taxes in the future, in the first case to replace a forgone income stream, and, in the second case, to service debt repayments. The division of financial flows between the public and private sectors is not significantly affected by the form of borrowing (Buiter, 1983). When the sale proceeds are used to increase current expenditure or reduce taxation, bond financing and asset sales are also equivalent, and in this case future resources have to be diverted from the private to the public sector to pay for current expenditure increases or tax reductions. 1/ 2/

1/ In the argument that asset sales are akin to bond issues, all the problems associated with Ricardian equivalence--that is, whether taxation and debt should be treated symmetrically--arise. Barro (1984) contains one of the strongest statements of the Ricardian position. See Atkinson and Stiglitz (1980) for further discussion.

2/ In many developing countries, with inadequate financial markets, asset sales may offer an alternative to bond financing, and can therefore be regarded as a substitute for domestic financing that is consistent with restrained monetary growth, and balance of payments adjustment.

4. Qualifications

The above conclusions clearly require modification to the extent that the explicit and implicit assumptions underlying them are inappropriate. Hemming and Mansoor (1986) explore a range of qualifications in detail. These relate to: the different tax regimes that may confront private and public enterprises; the implications of uncertainty and imperfect markets; market discounts on sale prices; and the impact of second order effects arising from, inter alia, the impact of asset rates on private sector liquidity, on the riskiness of private sector portfolios, and on the capital structure of privatized enterprises. It is shown that the fiscal and financial impact of asset sales is potentially quite sensitive to the above considerations, but that few general results emerge. Their precise impact has to be assessed on a case-by-case basis. However, the analysis does serve to emphasize the basic point that the initial effects of asset sales on the overall deficit can be misleading in evaluating the fiscal and financial impact of asset sales.

A key assumption not mentioned above, but one which requires more extensive discussion, relates to the impact of the sale of an enterprise on its expected income stream. One of the strongest arguments used in support of privatization is that the income stream will improve if ownership is transferred to the private sector because of increases in efficiency. Morever, one of the reasons why governments tend to underprice assets may be that the private sector sees opportunities to improve efficiency that the public sector ignores. However, these potential improvements in efficiency should be viewed cautiously. They do not arise simply from a transfer in ownership but from concrete actions that raise the productivity of the enterprise and/or reduce unit costs. Such actions can be taken in either the public or the private sector, and when they occur in the public sector they will directly benefit government and public sector finances. When efficiency gains are judged to be feasible only under private ownership, government and public sector finances will benefit to the extent that the government can share in these gains by setting asset prices to reflect at least part of the improvement in performance and by taxing the higher profits that result. Indeed, in budgetary terms, this should be the whole point of the privatization exercise.

VI. Main Conclusions and Their Implications for Adjustment Programs

1. Main conclusions

We have argued in this paper that privatization should be assessed in terms of its effect on economic efficiency. Economic efficiency is not only the key to improving the performance of the public enterprise sector, but is also the source of other gains often attributed to privatization, in particular, its favorable budgetary impact. Many of the other benefits attributed to privatization--for example, reducing the power of public sector unions and widening share ownership--are unlikely to be related to efficiency gains, and, if they ware indeed desirable, are probably more effectively achieved by other policies, such as trade union reform and tax incentives to promote saving.

To public enterprises that are subject to national or international competition, privatization offers the possibility of increased productive efficiency as government financial backing is withdrawn and bankruptcy and takeover become possibilities. However, if a public monopoly is transferred to the private sector with its monopoly power left intact, there may be no additional incentive to improve efficiency, although the risk of bankruptcy and takeover may prevent excessive inefficiency in small monopolies. But far more success can be expected to come if privatization is accompanied by increased competition, and privatization of public monopolies will lead to more competitive or contestable markets only if accompanied by active competition policy. Privatization is neither necessary nor sufficient to create a competitive or contestable market. The question that does arise, however, concerns whether privatization facilitates the promotion of competition. Recent discussions of privatization have certainly increased awareness of competition policy issues. Moreover, from a political point of view, it may be easier to liberalize in the context of a privatization strategy. However, it is necessary to warn against the temptation (observed in some cases) to restrict competition--for example, to make public sector assets more attractive to private buyers--and to note that market failure may prevent the emergence of competition, while in other cases competition may be inappropriate or difficult to enforce. The impact of privatization on economic efficiency in one of the few countries with sufficient history of privatization--the United Kingdom--is difficult to assess. For example, Brittan (1986) concludes that the choice is between "slightly better than nothing" and "slightly worse than nothing". His own verdict is the former, based upon his observation that "faced with the charge of simply creating private monopolies, the Government is impelled to introduce some competitive elements...Some moves to promote competition are better than none at all" (p.38). Does this conclusion necessarily extend to privatization in general, and the impact of privatization in developing countries in particular?

The admissibility and desirability of privatization, as well as what types of enterprise should be privatized ought to be determined by similar considerations in both industrial and developing countries. However, given the different structure and objectives of the public enterprise sector in developing countries, the character of any privatization program is likely to be very different from that of the United Kingdom, or those programs contemplated by other industrial countries. 1/ The excesses of the public enterprise sector--i.e., political interference, gross mismanagement, and the proportion of resources devoted to its support--are far greater in developing countries than in industrial countries. Many enterprises are simply not viable and should be disposed of, while a significant proportion of commercial enterprises face or could face competitive pressures, but currently benefit from budgetary support or artificial barriers that protect them from competition. Unless a strong case, based on social or other noncommercial objectives, can be made for retaining such enterprises in the public sector, privatization would appear appropriate. On these grounds, the scope for efficiency-enhancing privatization therefore appears to be greater in developing countries than elsewhere.

As regards public monopolies, privatization is appropriate to the extent that private shareholders can motivate managers better than governments, and competition can be effectively introduced. Private ownership is usually presumed to be more efficient, and the evidence, which principally relates to industrial countries, does not contradict this view. However, in developing countries market failure is usually more prevalent than in industrial countries, and greater importance is attached to social and other noncommercial objectives; hence, the relatively large public sectors found in many of these countries. There is only limited scope for privatizing natural monopolies and other enterprises owing their existence to market failure. Moreover, where enterprises have been used to meet social and other noncommercial objectives, it is unlikely that privatized enterprises can be required to operate according to market criteria without sacrificing some of the more compelling objectives. These considerations would seem to suggest that privatization may be less appropriate in developing countries than in developed countries. Whatever the merits of privatization, and the scope for its implementation, it seems inevitable that public enterprise sectors will remain large in both industrial and developing countries and, where opening up the public sector to domestic or international competition is judged difficult or inappropriate, inefficiency will continue to be a problem. In such cases, efficiency can be increased only if enterprises are substantially freed from political interference and existing incentive and control mechanisms are directed toward requiring enterprises, as far as their social and other noncommercial objectives permit, to function along commercial lines and to become financially independent. This will continue to be the main thrust of public enterprise policy.

1/ The issue of priorities is further discussed in general terms by Paul (1985) and in some detail in the United Kingdom context by Beesley and Littlechild (1983).

2. Privatization and adjustment programs

Privatization has been mentioned as an element in the structural adjustment efforts of many countries, and this has been addressed in a number of recent adjustment programs of the Fund and the Bank. However, it was noted above that, except the United Kingdom, little privatization in general, and denationalization in particular, has actually occurred. Questions therefore arise as to whether privatization should be advocated more forcefully.

This paper has argued that while the economic impact of privatization may be beneficial its net effect, in the absence of measures to promote competition, is probably small. Privatization is, therefore likely to be dominated in economic terms by other policies, in particular liberalization and regulation, and more effective variants of the incentive systems and control mechanisms, both statutory and administrative, currently in place. The merits of privatization are thus likely to be influenced by the economic, social, and political factors that are appropriate to the country concerned.

The conclusions of this paper point to the issues that ought to guide national authorities in their discussions of privatization. In particular, one should stress the importance of competition policy and the modest efficiency gains that could result from privatization alone. However, where competition already exists, the presumption should be that privatization is appropriate. For public monopolies, the key issue is the extent of the market failure being compensated for. The potential for increased competition, the way in which it is to be secured, and, in particular, the extent to which privatization is consistent with increased competition need to be assessed on a case-by-case basis. Special attention should be paid to cases in which privatization is used primarily to generate budgetary revenue, emphasizing two points. First, changes in ownership alone probably offer few lasting benefits to the budget: these can come only from improvements in efficiency. And second, one should view negatively government attempts to restrict competition in order to attract buyers and boost sale prices, as an approach to privatization.

In general, privatization should be supported, in all its forms, as a positive step toward dealing with the problems of public enterprises. However, to repeat the main point of this paper, privatization must be accompanied by other policies--to promote competition and to improve the efficiency of enterprises that must remain within the public sector--if a significant turnaround in the performance of public enterprises, and the productive sector of the economy as a whole, is to be achieved.

Some Recent Experience with Privatization 1/

Africa

Cameroon

1. Number of firms in public sector 2/

Fifty-eight nonfinancial public enterprises and nine financial institutions.

2. Privatization intentions

Twelve sales have been targeted since 1984.

3. Implementation of privatization

Five firms have been liquidated since 1984, including a brick manufacturing company (SIRICOM) and a fertilizer company (SOCAME). None sold as of end of 1985. (Sixteen management contracts have been placed with foreign companies covering a rubber company (HAVECOM), a sugar company (SUCUCOM) and a shipping line.)

Côte d'Ivoire

1. Number of firms in public sector

Forty-two nonfinancial public enterprises and six financial institutions.

1/ The principal sources of information used in deriving Appendix I are: Berg (1985), "Privatization: Everybody's Doing It, Differently", The Economist, December 21, 1985, and "Private Affair in Asia", Far Eastern Economic Review, July 25, 1985. These sources have been supplemented with material from periodicals, newspapers, wire services, and various unpublished reports. Among the countries not referred to in this review, Australia and New Zealand are notable by their absence. In both of these countries, the focus is on giving public enterprises the freedom to operate commercially and thereby improve their financial position rather than on changes in ownership.

2/ Here and elsewhere, data on the number of firms in the public sector are in general taken from the 1985 Government Finance Statistics (GFS) Yearbook. The GFS coverage is incomplete for a number of countries because subsidiaries, firms owned by holding companies and various commercial enterprises, may have been excluded. In some of these cases the data are based upon fuller but not necessarily complete coverage.

2. Privatization intentions

Twenty sales have been planned since 1977/78.

3. Implementation of privatization

About 15 firms have been closed and 4 sold since 1978: IVOIROUTIL (tool company), SUCATCI (rubber), SUNAGECI (construction), and BNEC (housing bank).

Guinea

1. Number of firms in public sector

One hundred one nonfinancial public enterprises.

2. Privatization intentions

A privatization program is being formulated as part of the rehabilitation of public enterprises. Up to 43 enterprises have been identified for possible privatization.

3. Implementation of privatization

Seven enterprises were closed in December 1985, and a brewery (DONAGUI) was sold in 1986; ten more enterprises are in the process of being sold.

Kenya

1. Number of firms in public sector

One hundred thirteen nonfinancial public enterprises and 24 financial institutions.

2. Privatization intentions

A 1983 task force identified 20 enterprises for sale.

3. Implementation of privatization

None of the targeted enterprises has been sold.

Liberia

1. Number of firms in public sector

Twenty-one nonfinancial public enterprises and five financial institutions.

2. Privatization intentions

Seven divestitures are targeted under World Bank Structural Adjustment Loans.

3. Implementation of privatization

None of the targeted enterprises has been sold.

Madagascar

1. Number of firms in public sector

Sixty-eight nonfinancial enterprises and eight financial institutions.

2. Privatization intentions

As part of its rehabilitation program for public enterprises the government is accepting up to 49 percent foreign equity participation in selected enterprises.

3. Implementation of privatization

Equity participation up to 49 percent of capital is being offered to foreign private partners to rehabilitate enterprises. Several agreements have been or are being concluded with firms in food processing, sugar, public works, matches and soap.

Mali

1. Number of firms in public sector

Between 40 and 50 nonfinancial enterprises and six financial institutions.

2. Privatization intentions

The Government commissioned a study which was completed in 1982. This study served as the basis for a comprehensive rehabilitation project being prepared in cooperation with the World Bank. In this context, the Government intends to maintain certain viable public enterprises, to liquidate the nonviable enterprises, and to transfer the remaining enterprises to the private sector.

3. Implementation of privatization

By mid-November 1985, seven public enterprises had been liquidated, and various others are in the process of being liquidated or privatized. The following enterprises have been liquidated: SAT (road transport), SCAER (agricultural equipment), SEBRIMA (brick manufacturing), SOCOMA (food processing), SOCORAM (radio assembly), SOMBEPEC (livestock), and SONEA (marketing of hides).

Mauritania

1. Number of firms in public sector

Thirty-two nonfinancial enterprises and seven financial institutions.

2. Privatization intentions

Ten enterprises were identified for privatization out of 30 studied in 1984/85.

3. Implementation of privatization

ONC (cinema) was sold in 1984 and the M'Pourie state farm is being sold to peasant organizations over a five-year period starting in 1985. SNC (textiles) is being liquidated.

Niger

1. Number of firms in Public sector

Between 40 and 50 nonfinancial enterprises and 10 financial institutions.

2. Privatization intentions

The Government has formally decided to maintain only 25 enterprises in the public sector, to privatize partially or fully 22 enterprises, and to liquidate any of the latter for which divestiture proves impossible. The Government has prepared an action program that defines specific steps and a timetable for the implementation of the rehabilitation, privatization, and liquidation programs for the individual enterprises. The privatization of selected parastatals was started in January 1985.

3. Implementation of privatization

To date, three enterprises have been totally privatized and private sector management contracts have been signed for three others. Negotiations are under way for the privatization of three additional enterprises likely to be completed in 1986. Furthermore, in October 1985, the Government initiated a program to reduce its share holdings in nine semipublic enterprises, which is expected to be completed in 1986. The Government has already begun liquidation proceedings for four enterprises and is committed to liquidate those additional parastatals for which private investors cannot be found.

Senegal

1. Number of firms in public sector

Ninety public enterprises (public agencies, national corporations, and mixed capital corporations).

2. Privatization intentions

Twenty-eight enterprises have been identified by the authorities for possible divestiture, and five will be liquidated.

3. Implementation of privatization

Five previously mixed companies were privatized: SIV (textiles), SISCOMA (farm implements), IRANSENCO (petroleum distribution), SNCDS (tuna canning), SNTI (tomato canning), and SONAFOR (drilling of water holes). SONAR (seed and fertilizer distribution) and STN (development of new territories) have been liquidated.

Sierra Leone

1. Number of firms in public sector

Twenty-one nonfinancial enterprises and seven financial institutions.

2. Privatization intentions

Ten enterprises have been recommended for privatization by the World Bank.

3. Implementation of privatization

Four hotels have been leased.

Somalia

1. Number of firms in public sector

Forty-five nonfinancial enterprises and five financial institutions.

2. Privatization intentions

A privatization program is being considered as part of the development strategy.

3. Implementation of privatization

Land of former state farms is being leased to private farmers and joint industrial fishing ventures were set up in 1984.

Sudan

1. Number of firms in public sector

Forty-four nonfinancial enterprises and five financial institutions.

2. Privatization intentions

The Government has been considering privatization for some time.

3. Implementation of privatization

Seven enterprises are believed to have been privatized, and others have been announced.

Togo

1. Number of firms in public sector

Thirty-nine nonfinancial enterprises and eight financial institutions.

2. Privatization intentions

A special Ministry of State Enterprises has identified 40 enterprises for privatization.

3. Implementation of privatization

As of the beginning of 1986, 4 state enterprises had been leased to private interests (including the 2 largest industrial enterprises--a steel mill and the storage tanks of a defunct petroleum refinery); in addition, 11 enterprises had been closed down, and 11 others, including 5 closed enterprises, have been offered to private interests.

Uganda

1. Number of firms in public sector

Seventy-two nonfinancial enterprises and eight financial institutions.

2. Privatization intentions

Sixty-seven planned divestitures include 21 planned joint ventures, 15 to be sold to their former owners, and 31 to be sold or closed.

3. Implementation of privatization

In May 1986, committees were set up to formulate the modality and time frame for the sale of nonrepossessed properties and nonstrategic public enterprises. The National Textiles Board has been abolished.

Zaïre

1. Number of firms in public sector

Forty nonfinancial enterprises and five financial institutions.

2. Privatization intentions

Thirty-seven enterprises, mainly small farms, have been identified for privatization.

3. Implementation of privatization

Twenty-six small enterprises have been sold and the management of five others has been privatized. CMZ (the shipping company) was restructured with the help of a foreign company. Air Zaïre is managed under contract by a foreign airline. Twenty percent of the shares in Shell-Zaïre was sold in 1985, reducing the Government's share to 40 percent.

America

Argentina

1. Number of firms in public sector

Forty-seven nonfinancial, 42 financial, 24 mixed, 11 military factories, 74 radio stations, 12 TV stations, and 3 intergovernmental enterprises.

2. Privatization intentions

According to the Wall Street Journal (January 30, 1986), the Argentine Government will soon announce a major privatization program.

3. Implementation of privatization

No major action has been taken as of April 1986.

Bolivia

1. Number of firms in public sector

Thirty-one nonfinancial and 16 financial enterprises (including the Central Bank).

2. Privatization intentions

Supreme Decree No. 21060 of August 29, 1985 mandates the dissolution of some state enterprises and the reorganization and decentralization of some others, including the transfer of the distribution and commercialization of petroleum products from the state petroleum company (YPF) to the private sector.

3. Implementation of privatization

The road transport corporation (ENTA) has been dissolved and its vehicles have been transferred to the municipalities, which were free to establish their own companies or sell the assets to the private sector. The assets of the companies fully owned by the Bolivian development corporation (CBF) have been transferred to the regional development corporations.

Brazil

1. Number of firms in public sector

Two hundred thirty-six nonfinancial, 13 financial, and 351 state government enterprises.

2. Privatization intentions

The "destatization" program of July 1981 identified 61 firms to be privatized. In 1985, 77 firms were targeted. (The overlap between the two lists is unclear.)

3. Implementation of privatization

Seventeen enterprises grouped in 12 holding companies have been sold and 9 more liquidated. No foreign capital in purchases. Includes sale of 5 billion Petrobras shares for US$400 million. Of the enterprises 3 were in textiles, 3 in petrochemicals, 2 in paper, and the rest diverse. Most of these were either originally private companies in which control had been assumed by financial institutions owing to credit problems or state enterprise subsidiaries in which the company already had a substantial private sector minority.

Canada

1. Number of firms in public sector

In the federal sector, there are 57 parent Crown Corporations and 191 wholly owned subsidiaries. Their activities range from services (mail delivery, broadcasting, and transportation) to manufacturing and mining operations.

2. Privatization intentions

The federal government announced its intention in November 1984 to review the activities of federal Crown Corporations and to earmark for sale those that had commercial value but no longer served public policy purposes. Those that had neither a public policy purpose nor commercial value would be dissolved. In July 1986, the Government established a ministry for privatization.

3. Implementation of privatization

Six corporations have been dissolved. Four corporations have been sold (Northern Transportation Company, Canada Development Corporation, Canada Arsenals Ltd., and de Havilland). Negotiations for sale continue for Teleglobe Canada, El Dorado Nuclear, and Canadair.

Costa Rica

1. Number of firms in public sector

Fifteen nonfinancial, including 1 holding company (CODESA) comprising 14 manufacturing enterprises, and 10 financial institutions.

2. Privatization intentions

Most of the manufacturing enterprises under the holding company (CODESA) are to be sold or liquidated under a program financed and supervised by USAID. Proceeds from the sales are to be used to reduce CODESA's indebtedness with the Central Bank.

3. Implementation of privatization

One aluminum plant (ALUNASA) was sold in December 1985 to a private trust managed by USAID, which in turn will offer the plant to domestic or foreign investors. Most of the other subsidiaries of CODESA are in the process of financial evaluation and are expected to be sold before the end of 1987

Chile

1. Number of firms in public sector

Twenty nonfinancial and seven financial. These figures include radio and television stations.

2. Privatization intentions

In 1984 the Government announced plans to sell shares in the Banco de Santiago and the Banco de Chile (taken over in 1983), shares in 2 large pension funds (AFP Santa Maria and AFP Provida), and up to 30 percent of shares in 15 state-run companies held by the Chilean Development Corporation (CORFO).

3. Implementation of privatization

In the mid-1970s extensive denationalization of firms taken over by the Allende--Popular Unity--Government was undertaken. More recently, shares in the power company, Chilec, have been on sale since 1985, and by the end of 1985 the Banco de Santiago had sold 56 percent of its shares and the Banco de Chile had sold 49 percent of its shares.

Dominican Republic

1. Number of firms in public sector

Forty-four nonfinancial enterprises and ten financial institutions.

2. Privatization intentions

No specific program.

3. Implementation of privatization

One thousand hectares of land was leased by the state sugar company to Limited Brands, a foreign multinational, for conversion to pineapple and oil palm.

Grenada

1. Number of firms in public sector

Twenty-one nonfinancial enterprises and four financial institutions.

2. Privatization intentions

No specific program.

3. Implementation of privatization

The Grenada Beach Hotel (only large hotel) was leased for 99 years.

Honduras

1. Number of firms in public sector

Eleven nonfinancial enterprises and four financial institutions including CONADI, a state holding company.

2. Privatization intentions

In 1984 the Government announced intentions to sell several loss-making subsidiaries of CONADI. In September 1985 the legislative assembly approved a law authorizing such sales.

3. Implementation of privatization

As of mid-1986, CONADI had sold 12 small firms of a total of 66 subsidiary firms targeted for privatization. The Government expects the whole divestment process to be completed in the next four years with technical assistance from USAID. In addition, FINAVI, a state financial institution, was liquidated at the end of 1985.

Jamaica

1. Number of firms in public sector

More than three hundred nonfinancial enterprises (including subsidiaries) and 20 financial institutions.

2. Privatization intentions

Forty-one enterprises were identified for privatization in 1980-81.

3. Implementation of privatization

Six enterprises were sold between 1981 and 1982.

Mexico

1. Number of firms in public sector

Eight hundred forty-five were identified in February 1985 as group a from which candidates for privatization should be selected. Includes 258 nonfinancial public enterprises, and 74 financial institutions wholly owned by the central government.

2. Privatization intentions

Two hundred thirty-six enterprises were targeted in February 1985.

3. Implementation of privatization

Nacional Hotelera chain sold in October 1985 for Mex$27.2 billion (US$84 million). Renault de México and Vehículos de Automotores Mexicanos were sold to Renault of France. Thirty-one of 236 targeted entities were sold following cabinet decision of February 6, 1985.

Panama

1. Number of firms in public sector

Twenty-eight nonfinancial enterprises and nine financial institutions.

2. Privatization intentions

In January 1986 the Government announced intentions to sell a number of state enterprises. This followed a presidential speech on November 2, 1984, announcing sales of Air Panama, Lobana, Endema, and Citricos de Chirique.

3. Implementation of privatization

A major unprofitable hotel was sold to Japanese investors for US$34 million compared with a cost to the Government of US$54 million.

Peru

1. Number of firms in public sector

Thirty-five nonfinancial enterprises and nine financial institutions.

2. Privatization intentions

Sixty to seventy enterprises to be sold for US$400-600 million (equivalent to 3 percent of GNP).

3. Implementation of privatization

Three (out of 60 targeted) enterprises--PESCA-PERU, PEPESA, EPSEP--have been partially privatized to reduce employment. PESCA-PERU laid off 4,800 employees; PEPESA 1,800; and EPSEP 500.

United States

1. Number of firms in public sector

Fifteen nonfinancial enterprises and 30 financial institutions.

2. Privatization intentions

Sales of federal land in western states including 86 percent of Nevada and 47 percent of California, have been proposed, but the Government has not taken any action to pursue these proposals. Similarly, early proposals to sell weather satellites seem to be abandoned. Consideration has been given to selling off the Naval Petroleum Reserve, the Tennessee Valley Authority, and portions of the US Postal Service. Privatization of federal loans to students, homeowners, and small businesses has been proposed.

3. Implementation of privatization

Between 1982 and 1985, US$422.6 million of federal property was sold, toward the goal of raising $9 billion. Conrail, Dulles Airport, and Washington National Airport are in the process of being sold.

Asia

Bangladesh

1. Number of firms in public sector

Thirty-eight nonfinancial and 15 financial institutions.

2. Privatization intentions

Most privatization has already taken place, although partial privatization of up to 49 percent of Bangladesh Biman (Airline), shipping lines, and telephone operations is being considered.

3. Implementation of privatization

Under the 1982 New Industrial Policy, enterprises in jute, textile, steel, engineering, chemicals, and food sectors were sold. By the end of 1983 701 enterprises had been sold (including 33 jute mills and 26 cotton textile mills). 1/

India

1. Number of firms in public sector

One hundred and ninety-nine nonfinancial enterprises and 18 financial institutions. Two hundred seventy five state government enterprises.

2. Privatization intentions

Closure or sale of 26 out of 100 "sick" textile mills (out of a total of 600). Liquidation or sale of nonviable enterprises such as the Hindustan Works Construction and 2 bicycle manufacturing units (Cycle Corp. of India and National Bicyle Corp.); diversification with private sector capital of firms such as Hindustan Machine tools.

3. Implementation of privatization

Implementation has not yet started.

Japan

1. Number of firms in public sector

Thirty nonfinancial enterprises and 27 financial institutions (excludes local government enterprise).

2. Privatization intentions

Up to US$40 billion of shares in Nippon Telegraph and Telephone (NTT) will be sold over the four-year period which started April 1, 1985, Japan Tobacco shares will be sold after April 1, 1987. Japan

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1/ Most of these were units "abandoned" in the 1971 "liberation" and which were "vested" in the Government and sold between 1972 and 1982.

Airlines (JAL) could have all of its 35 percent government stake sold. In April 1987 Japan National Railways will be split into six private regional firms, plus a national private firm with ownership of the bullet train network and a private national freight firm.

3. Implementation of privatization

NTT (telecommunications) is being privatized, with up to US$40 billion of shares to be sold, none to foreigners. Sales started in April 1985 and are planned to continue until after 1990.

Malaysia

1. Number of firms in public sector

About one hundred fifty relatively large nonfinancial enterprises, in which the Government's equity exceeds 50 percent. Including subsidiary companies and companies with government equity, there are about nine hundred public enterprises.

2. Privatization intentions

Planned sales include telecommunications, lottery, hotels, car park, water supplies, and leasing of parts of road network. Further sales of shares in MAS (airline)--until government share is at 30 percent by 1988--are planned

3. Implementation of privatization

One general hospital, one private toll road between Port Klang and the Avionics Repair Facility, and Port Klang container operation have been sold. In October 1985, 30 percent of 350 million MAS shares were sold, with foreigners not allowed to participate.

Pakistan

1. Number of firms in public sector

Eighty-three nonfinancial enterprises and 29 financial institutions.

2. Privatization intentions

In 1985 the Government announced that state enterprises would be privatized gradually and in part, through stockmarket offerings. The Government will not relinquish control.

3. Implementation of privatization

Two engineering firms, one sugar mill, and two textile mills have been denationalized.

Philippines

1. Number of firms in public sector

Seventy-one parent nonfinancial enterprises (excluding companies acquired by public financial institutions as a result of bankruptcy, etc.) and 17 financial institutions.

2. Privatization intentions

The Development Bank of the Philippines and the Philippine National Bank are planning to sell hotels, sugar and coconut mills, cement plants, car factories, banks, textile mills, mining companies, shipping lines, and oil rigs.

3. Implementation of privatization

Five percent of P$65 billion in assets of the Development Bank of the Philippines (DBP) have been sold. This includes a 71 percent stake in the Century Park Sheraton Hotel, sold for US$8.5 million.

Singapore

1. Number of firms in public sector

Twenty-eight major nonfinancial enterprises and 8 financial institutions. There are also some 450 other government owned or controlled companies.

2. Privatization intentions

A 46 percent share in Mitsubishi Singapore Heavy Industries is up for sale, and shares in SIA (airline) are to be sold to bring the government share to 50 percent.

3. Implementation of privatization

Two hundred forty million dollars worth of shares (16 percent) in Singapore Airlines were sold (leaving a majority with the Government) in November 1985. The largest state investment company, Temasek, sold 45 percent of its share in Rank Hovis McDougall (food). Neptune Orient Lines (shipping) had its government shares sold in 1981.

Sri Lanka

1. Number of firms in public sector

One hundred twenty-seven nonfinancial enterprises and 16 financial institutions.

2. Privatization intentions

There are proposals to sell enterprises in telecommunications and the valuation of assets is proceeding. Possible targets for privatization include textile mills, plantations, a cement plant, and liquor stores.

3. Implementation of privatization

Eleven enterprises have been partially privatized, with the state retaining majority ownership. These include SRMC (rubber), four activities of the Cooperative Wholesale Establishment (CWE), Lanka Milk Foods, and the Department of Machinery and Equipment. Five textile mills have been handed over to foreign management under contracts. In 1986 the insurance industry was opened up to private sector participation, both domestic and foreign.

Thailand

1. Number of firms in public sector

Fifty-five nonfinancial enterprises and six financial institutions.

2. Privatization intentions

The bus authority in Bangkok is to be partly privatized before modernization; parts of the Electric Generating Authority and Thai Airways have been identified for possible privatization,

3. Implementation of privatization

The Bangkok Jute Mill and the Wire Diffusion Company were liquidated, and the Paper Factories of Industrial Workshop, Central Thai Industry Workshop, and Esarir Gunnybag Company Ltd. were privatized.

Europe 1/

France

1. Number of firms in public sector

Eight nonfinancial enterprises and 12 financial enterprises. 2/

2. Privatization intentions

The new Government has announced an extensive denationalization plan over the next five years. This covers 42 banks, including 2 large financial holding groups (Paribas and Suez), 9 industrial groups, and 3 insurance companies.

3. Implementation of privatization

In September 1985 Matra sold Comelin, its printed circuit subsidiary, and Robotronics, its experimental robot modules plant. Renault has sold assets, including Renix, an electronic component plant, to an American company, Bendix.

Federal Republic of Germany

1. Number of firms in public sector

Fifty-six nonfinancial enterprises and 39 financial institutions.

2. Privatization intentions

The Government's privatization intentions have been modest so far. In 1986, it plans to sell shares in the VIAG--which is engaged in energy, aluminum, and chemicals--and in the Industrieverwaltungs Gesellschaft (IVG)--which is responsible for the crude oil reserve of the federal government and is also active in transport and defense.

3. Implementation of privatization

In 1984, 4.4 million shares in the VEBA group (energy) were sold reducing government holdings from 43.7 percent to 30 percent. VEBA is itself a conglomerate company holding shares in 465 enterprises. Some shares in the Berliner Bank were sold in 1985.

1/ Excludes the United Kingdom.
2/ The GFS coverage in the case of France is particularly limited.

Israel

1. Number of firms in public sector

One hundred sixty-six nonfinancial enterprises and 17 financial institutions.

2. Privatization intentions

No organized program.

3. Implementation of privatization

In 1985 ELTA (electronic) was floated on the Israeli stock exchange with the objective of raising US$13 million. The employees were expected to assume 60 percent of the issue.

Italy

1. Number of firms in public sector

One hundred twenty-four nonfinancial enterprises and 16 financial institutions.

2. Privatization intentions

State holding companies like IRI and EFIM are in the process of divestiture. Over 1986-87 about US$2 billion of shares will be sold in companies such as Aeritalia (aerospace) and Selenia (electronics). The Banco Nazionale del Laboro (Treasury-run bank) is offering 25 percent of its shares to Italian investors and more shares to its employees, for up to US$250 million. About US$ 600 million is expected over 1986-89 from the sale of SIP (telephone utility); 64 percent of the share in SME (food) is to be sold by IRI if a controversy over bidding can be resolved.

3. Implementation of privatization

IRI (the main state holding company) raised the equivalent of US$1.59 billion between 1983 and August 1985. ENI (energy) sold 20 percent of its pipe laying subsidiary, SAIPEM, for the equivalent of US$67 million in 1984. Forty percent of SIRTI, a subsidiary of STET (telecommunications) was sold for the equivalent of US$111 million amid oversubscription. In September 1985, US$75 million worth of shares in SIP (telephone utilities were offered for sale. In May 1985 Banco di Roma sold its 74 percent share of Banco Centro Sud to Citibank for US$160 million.

The Netherlands

1. Number of firms in public sector

Twenty-five nonfinancial enterprises and 11 financial institutions.

2. Privatization intentions

In 1982, 14 targets for privatization were selected. Currently there is some discussion about selling the Government's 28.4 percent share in Hoogovens (steel).

3. Implementation of privatization

In 1985 the Government reduced its holdings in KLM from 78 percent to 55 percent and raised US$25 million.

Spain

1. Number of firms in public sector

Three nonfinancial enterprises and 16 financial institutions.

2. Privatization intentions

Instituto Nacional de Industria (INI), the state holding company is redefining its portfolio, and plans to divest itself of some holdings. Iberia (airline) may be privatized and high technology firms and a ball bearing factory are also likely to be privatized.

3. Implementation of privatization

INI (state holding company) sold Textil Taragona (textiles), its share in the Spanish subsidiary of SKF was sold to the parent company, and it reduced its holdings in the travel and tourist industry. In 1985 SEAT (motorcars) was sold to Volkswagen and ENASA (trucks and buses) to General Motors.

Turkey

1. Number of firms in Public sector

Thirty-one nonfinancial enterprises and ten financial institutions.

2. Privatization intentions

The Keban Dam will be fully privatized in the next few years. THY (state airline) and 32 state economic enterprises are being considered for privatization.

3. Implementation of privatization

In 1984 the Bosphorus Bridge and Keban Dam were privatized through revenue-sharing certificates, which provided some form of income guarantee rather than interest. Thirty four percent of the bridge revenues were sold for the equivalent of US$22.9 million and 22 percent of the Keban Dam income was sold for US$91.7 million.

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