Chapter -III

STATE INTERVENTION AND PRIVATISATION:
HISTORICAL AND GLOBAL PERSPECTIVE

This chapter covers the role of the state in the economy of the country from the period of Adam Smith to J.M. Keynes to Margaret Thatcher and also presents the theory for existence of private sector, failure of the market, objectives of privatisation, methods of privatisation, an overall view of theoretical aspects of privatisation. Global experience of various countries in the process of privatisation has been explained.

ADAM SMITH

The famous eighteenth century political economist Adam Smith in his treatise "Wealth of Nations" published in 1776 stated that, "the duties of the state should consist of the provisions of defense, justice and some expenditure for economic and social ends". Which means that, the state has no business to do business.

Another most visible theory of Adam Smith was the theory of "Invisible hand". According to him, this invisible hand controls demand and supply and thereby the price mechanism. The production of goods and services takes place in order to satisfy the wants of the consumers expressed by the prices they are willing to pay. If these prices are bound to be profitable, the continued production of the commodity or services is assured. On the other hand, if the prices, which the consumers are willing to pay are insufficient to make further production worth while, the commodity or service will no longer be supplied. In the private sector, profitability is the motive force operating through price mechanism. Each purchase is a vote in favour of continued production of the commodity.
This theory of 'invisible hands' has been criticized on various counts. In certain cases, the criticism has been considered serious enough to warrant a transfer of a particular section of activity from the private sector to the public sector. A few of the important criticisms are:

1. Certain goods and services would not be supplied under pricing system. They are collective goods, which must be provided for the community as a whole. People who do not pay towards this provision can't be excluded from their benefit. For e.g., defense.

2. The monopolies form another bases of criticism of the private sector because they provide the opportunity for restrictive practices.

3. The private enterprise left to itself, the resulting distribution of income and wealth will be inequitable and since the goods and services depend on effective demand (demand backed by money) rather on needs, there will be social injustice.

CASE FOR PRIVATE OWNERSHIP

The case for private ownership and market allocation has been based on three well known theories.

1. Tragedy of commons.

2. Dispersed Knowledge.

3. Residual Claimant Theory.

According the neo classical property rights school, which suggests that, communal ownership (The lack of private property rights) will lead to dissipation i.e., the 'tragedy of commons'.
Hayek’s (1985) views of ‘Dispersed knowledge’ assumes: knowledge is widely dispersed in every society and efficient acquisition and utilisation of such knowledge can only be achieved through price signals provided to the markets. Alchian’s and Demsetz’s (1972) ‘Residual claimant theory’ suggests much in line with property rights school that private capitalist ownership of firms is predicated upon the need for residual claimant of income generating assets. In the absence of which, members of a coalition, for example a firm, would tend to free ride, thus leading to inefficient utilisation of resources.

Among other factors which tend to ensure that private sector ‘agents’ (managers) behave in conformity with the wishes of the ‘principals’ (shareholders), by maximizing profits in private firms, are, for example the concentration of shares in the hands of financial institutions; the emergence of M-form of organisation which tends to ensure that ‘divisions’ operate as profit centres; the possibility of ‘contestable markets’ that is markets where competitive forces operate through potential entry by new competitions, given free entry and cost less exit conditions. It is assumed public sector enterprises are not subject to such forces, not to the same degree anyway, which implies the possibility that managerial incentives for efficient use of resources and profit maximisation may be less present in public sector firms.

Many of the above factors are linked to the concept of competition and competitive forces, where again the claim is that public sector enterprises may be more insulated from such forces and are less likely to pursue efficiency and profit maximization. The latter will also be true if public sector enterprises simply do not aim at such policies for example, because they are used as redistribution vehicles by the government and/or other non economic reasons such as the need for electoral support and/or because they aim at correcting structural market failures (for example, the high prices of private sector monopolies). All these factors tend to establish the economic theoretical rationale for the
efficiency of private firms and therefore for privatisation (Vickers and Yarrow – 1988, Kay et al 1986, offer extended discussion on the assumed superiority of the private versus state firms).

J.M. KEYNES in his book entitled "The General Theory of Employment, Interest and Money" published in 1936 drew attention to the probable causes of the "trade cycle" and pointed the ways to possible remedies. Private enterprise economies are subject to periodic booms and slumps in trade. During the depression phase of cycle there is considerable waste of both human and non-human resources. During the boom phase, inflation produces problems of different kind followed eventually by the collapse of the prices which accompanies the movements of the economy in the direction of slump. Various kinds of activity in the public sector are necessary to stabilize the economy on a steady course of expansion at full employment.

It may be said, therefore, that the public sector is an essential part of the economy. The public and private sector are interdependent. Their functions in the economy are complementary. In this sense, the economy is truly mixed economy. Nevertheless, there is considerable interest in the size of the public sector in relation to the rest of the economy.

The failures of the market and need for state intervention:

In mainstream economic theory, the first fundamental theory of welfare economics shows that, market can allocate resources efficiently without state intervention, provided that market failures do not exist. Such failures, however, are widely observed, famous instances being the existence of externalities (interdependence not conveyed through prices); public goods (goods which are jointly consumed and not excludable); and monopolies which tend to increase the prices above the competitive norm.
The great depression of 1920s, devastating effect of World War II automatically gave a great push for the increasing role of state intervention in the economy. Rebuilding the infrastructure, increasing the employment opportunities, mobilising the resources of huge scale and nation building as the motive, instead of profit motive created an opportunity for public sector growth in 1950s to 1980s. Britain spearheaded the nationalisation. Many developed countries and most of the developing countries followed suit.

Public sector undertakings which became pillars of economy contributed substantially for economic development. In the meantime, private sector developed strength, capital markets became strong, technology was upgraded, managerial talent enhanced and on the other hand public sector became bureaucratic, rule ridden, insensitive (to customers needs), loss making and inefficient. The Government is no more in a position to meet the losses out of their budget allocation. Government has fundamental duty of providing basic necessities like drinking water, food, shelter, basic education, roads, transport, power, poverty alleviation and social security.

MARGARET THATCHER

In 1980s Margaret Thatcher headed the British Privatisation. Britain became champion of privatisation. Various methods were followed to privatise the public sector.

Margaret Thatcher said in her biography "Margaret Thatcher – The Downing street years (p676)"

"Privatisation, no less than tax structure was fundamental to improving Britain's economic performance. But for me it was far more than that: it was one of the central means of reversing the corrosive and corrupting effects of socialism. Ownership by the state is just that: ownership by an impersonal legal entity: it amounts to control by politicians and civil servants; and it is a misnomer to describe nationalisation as the Labour Party did, a 'public ownership'. But
through privatisation — particularly the kind of privatisation which leads to the widest possible share ownership by the members of the public— the state’s power is reduced and the power of the people enhanced”.

The explanation of the drive for privatisation is more complex and more political, than pure ‘market versus planning’ consideration might suggest. Vickers and Yarrow (1988:157) offer the following classification of the objectives of privatisation.

- reducing government involvement in industry;
- improving efficiency in the industries privatized;
- reducing the public sector borrowing requirement;
- easing problems of public sector pay determination by weakening the public sector unions;
- widening share ownership;
- gaining political advantage.

The objectives of privatisation have been clearly spelt out by Vickers and Yarrow. Privatisation without achieving these objectives is more catastrophic than the ill effects of public sector. Hence privatisation to satisfy political bosses or to keep happy the bureaucratic babus totally fails in its approach and brings discredit to the process of privatisation.

It is clear from the above, that, economics and politics go hand in hand. In the 18th century where the economic world was more stable, state had little role to play. But in the 20th century due to industrialization, democratisation, economic depression, world wars and global markets created a need for state intervention. At the end of the 20th century, the scale which had swung extremely towards public sector, started moving towards the other end of the scale i.e. private sector due to various reasons. Hence privatisation is a subject matter of political economy.
TWO HORSE CART

International Finance Corporation (A member of the World Bank Group) in its publication “PRIVATISATION: Principles and Practices”, 1995 explained in an illustrative manner how difficult it is to privatise.

"To privatize is to drive a two horse cart. The cart is the enterprise in question. One horse is called Political Goals and is flighty and fickle; the other is called Economics, and is slow and steady. They have to pull the cart along the Road to privatization, which is a rough, boulder-strewn track. The cart is full of cases of vintage wine, which is unfortunate because the horses, as often not, are pulling in different directions. The bottles of wine, which can be enjoyed only when the cart reaches its goal, are labelled improved efficiency, high sales price, effective corporate governance, economic investment and so on.

Only the most skillful driver can negotiate this track: up the hill of vested interests (cases have to be Jettisoned there, and some horses are not strong enough to make it), across the stream of Xenophobia (another case or two bumps off the track). Some carts are too weak and fall apart before they get to privatization. Sometimes it makes sense to give the flighty horse its head and fly the trail headlong, abandoning case after case on the way; some times it is possible to whip him into shape to follow his steadier partner. And many drivers simply give up, cut the horses loose; limp down and start back down the trail, hoping to find solace in the odd bottle that has not smashed".
GLOBAL PERSPECTIVE OF PRIVATISATION

Privatisation of state-owned assets became a major economic policy of many countries in the 1980s and in some cases amounted to a conscious attempt to roll back the frontiers of the state and return to the market. This was a part of the reconsideration of the nature and role of the state sector in developed and less developed market economies that was resolved in favour of the view that government involvement has been excessive. At the end of 1980s the demise of central planning in Eastern Europe led to an attempt to create markets there and, in a sense, to privatise the whole economies.

In this chapter, the attempts made by various countries to privatise has been presented. The countries that are covered had distinctive feature of privatisation which is an outcome of peculiar country specific problems. The countries covered are Canada, New Zealand, Germany, Italy, Japan, Poland, Romania and Czechoslovakia. A study of this chapter contributes substantially to the objective of this study i.e., finding an Indian model of Privatisation on the basis of global experience.

Privatisation In Advanced Industrial Economies

Though the policy of privatization has received substantial public attention in most of these countries the results of that policy range from minor experiments in privatization as in Sweden, Spain and Holland to significant programs as in Japan, New Zealand and the UK. Similarly the approach to privatization has differed greatly; only in the UK among OECD countries it has been driven by the ideological zeal found in Eastern Europe; in contrast, most OECD economies have remained pragmatic and selective in their implementation of privatization. As the table reveals the scale of privatization has varied considerable in different parts of the OECD countries. With notable exception of the United States, which never developed significant public sector industries, most OECD countries retain
significant public sector activities in key industries. Plans may exist for further extensive privatization, but these are ever acted upon may depend upon emerging evidence concerning their performance of privatized sectors.

Estimated Percentage share of state-owned assets in selected sectors for various OECD countries (about 1990/1)

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<th>Steel</th>
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<th>Rail ways</th>
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Note: *Former Federal Republic
Key:

a) State has significant holdings in the banking sector, for example Commonwealth Bank of Australia, which is among the four largest in Australia.
b) Substantial state interests also in metals, chemicals, electrical engineering, electronics and mechanical engineering.
c) Savings banks and credit institutes are semi-public.
d) The country's four largest companies are in public hands. The portfolio includes, among others, base metals, textiles, machinery, petrochemicals, chemicals, and forestry.
e) Substantial state interests in insurance, aerospace, electronics, chemicals.
f) State plays dominant role in manufacturing, including textiles, metals, pulp and paper.
g) Important state interests in, among others, engineering, electronics, chemicals, textiles, metals and cement.
h) State retains some interests in chemicals, aircraft manufacture, banking.
i) Substantial state interests in, among others, chemicals, fertilizers, base metals, breweries, tobacco, cement, pulp and paper, and insurance.
j) State has largest holdings in, among others, textiles, chemicals, metals, food and tobacco.
k) Nordbanken, the second largest of the country's banks, is state owned.
l) Total corporate assets owned by the state are estimated at SKr250 billion (24b pounds). The portfolio contains, among others, interests in pharmaceuticals, forestry mining and naval shipyards.
m) District banks owned by regional authorities.
n) State interests in four major banks.
o) The state's portfolio included petrochemicals, textiles, cement, telecommunications equipment, electronics and chemicals. It is estimated to account for 25 percent of manufacturing capacity and half of total fixed investment.
p) The state's portfolio includes petrochemicals, textiles, cement, telecommunications equipment, electronic and chemicals. It is estimated to account for 25 percent of manufacturing capacity and half of total fixed investment.
q) The Amtrak railway is Federally owned.
r) Whilst the Federal government owns very little state and city governments have substantial interests in a wide range of businesses, notably power utilities, airports, water utilities and posts. The value of these is estimated at about $225 billion (L130 b), around 4% of GDP.
TABLE-2

The scale of privatisations in selected OECD Countries, 1980-91

<table>
<thead>
<tr>
<th>Country</th>
<th>Privatisation period</th>
<th>Accumulated privatisation proceeds absolute (#equivalent)</th>
<th>As percentage of average annual GDP over the privatization period</th>
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<tbody>
<tr>
<td>Austria</td>
<td>1987-90</td>
<td>Sch. 12.7 billion (0.6b)</td>
<td>0.9</td>
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<tr>
<td>Canada</td>
<td>1984-90</td>
<td>C$3.1 billion (#1.6 b)</td>
<td>0.6</td>
</tr>
<tr>
<td>France</td>
<td>1983-91</td>
<td>FF82.4 billion (#8.24b)</td>
<td>1.5</td>
</tr>
<tr>
<td>Germany*</td>
<td>1984-90</td>
<td>DM9.7 billion (#3.34b)</td>
<td>0.5</td>
</tr>
<tr>
<td>Italy</td>
<td>1983-91</td>
<td>LI3,500 billion (#6.25b)</td>
<td>1.4</td>
</tr>
<tr>
<td>Japan</td>
<td>1986-88</td>
<td>Y11,000 billion (#47.8b)</td>
<td>3.1</td>
</tr>
<tr>
<td>Netherland</td>
<td>1987-91</td>
<td>FL4.9 billion (#1.5b)</td>
<td>1.0</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1987-91</td>
<td>NZ $ 9.0 billion (#3.0b)</td>
<td>14.1</td>
</tr>
<tr>
<td>Portugal</td>
<td>1989-91</td>
<td>Esc 364 billion (#1.5b)</td>
<td>4.3</td>
</tr>
<tr>
<td>Spain</td>
<td>1986-90</td>
<td>Ptas 207 billion (#1.2b)</td>
<td>0.5</td>
</tr>
<tr>
<td>Sweden</td>
<td>1987-90</td>
<td>SkR 14 billion (#1.3b)</td>
<td>1.2</td>
</tr>
<tr>
<td>Turkey</td>
<td>1988-91</td>
<td>TL 3500 billion (#0.3b)</td>
<td>1.6</td>
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<tr>
<td>UK</td>
<td>1979-91</td>
<td># 44.5 billion</td>
<td>11.9</td>
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# Pounds
Source: Stevens 1992:6
Note: * Area of Federal Republic of Germany before unification.

Canada has not engaged in wholesale privatization but has scaled back and reshaped the state’s role in the market. Dis-investment in Canada was associated with the quest for improved strategic fit between organization and its changing environment to allow concentration on core skills. Jan Jorgensen and others argue that public sector divestment can also be viewed as means to achieve better “fit” between government and its environment. Effective management of public sector requires that government focuses its scares management resources on critical issues and disengages itself from non-essential activities.
In the case of Italy, privatization in the late 1970s was motivated by the need to get rid of financially troubled firms. From 1981, privatization became a part of the strategy to reduce the state's control of shareholdings in public enterprises. After 1984, public sector reorganization and rationalization regarding finances and core businesses made further use of privatization. The increasing velocity of changing ownership arrangements were influenced by the capacity to generate internal funds and the search for external funds and out of this process emerged the widespread utilization of the public enterprise as a Joint Stock Company in Italy.

In New Zealand a different path has been pursued to induce greater commercial efficiency in the public sector. The corporatization policy has been extensively applied since 1985 and that managers are required to run state owned enterprises (SOEs) to set performance targets by Ministers which they have to achieve without competitive advantages. The clear objective of maximizing commercial performance is encouraged by company boards which have the authority to make strategic decisions.

**CANADA**

The methods followed in Canada were at two levels i.e., Federal level and Quebec level.

**Federal Level:**

The Federal process for privatization under OPRA (Office of Privatization and Regulatory Affairs) emerged in 1986. OPRA is a central agency responsible for privatization to resolve conflicting departmental goals and to act as repository for learning about the privatization process.
Federal process for privatization under OPRA had five formal stages. (Canada OPRA 1990, Mc Dermid 1989):

1. Primary analysis co-ordinated by OPRA to determine the candidates commercial viability, public policy role, feasibility of privatization and approval by Cabinet.

2. In depth review by a team consisting of government advisers, reporting to the minister of state responsible for privatization and regulatory affairs to examine the mode of sale, participation by foreign buyers, bilingual policy issues, and decision by Cabinet.

3. Passage of legislation including review of sale by Parliament and drafting of covenants to meet policy goals.

4. Preparation for sale including managerial, legal and financial steps required for disinvestment.

5. Implementation of sale according to the mode of sale; Share offering, employee buyout, or third party sale.

Quebec Level:
Management of the disinvestment process was entrusted to a ministry for privatization within the ministry of finance. The ministry reviewed the role of Crown Corporations within a socio-political climate where the state sought a reduced economic role because of deficits and confidence in a viable private sector.
The formally structured process was as follows (Quebec, Minister Responsible for privatization 1986)

1. Review of the Crown Corporations dossier by the standing Cabinet committee on economic Development (CMPDE)
2. Analysis of four options: total or partial privatization, reorganization followed by later privatization, re-orientation or turn-around, and the status quo -for the firm by a joint Committee consisting of
   a. the minister responsible for the firm
   b. the minister of state for privatization
   c. one or more representatives from the firm, and
   d. representative from other departments.
3. Development of consensus and plan for realization of the chosen alternative
4. Joint submission of the plan by the Minister for privatization and the responsible minister for the firm to the CMPDE and then the whole cabinet for review and approval.
5. Implementation by the Ministry for privatization assisted by an operational task force, with legislative scrutiny and approval where needed.
6. Formal review of the programme as a whole by the minister for privatization.

PROCESS:
Across the cases studied by, Jan J. Jorgensen in the 'context and process in privatization; Canada/Quebec' they found processes similar to those identified by Gilmour (1973) and Kingdom (1984).

1. Problem recognition: Perception of an anomalous condition or discrepancy.
2. Proposal formation: development and examination for solutions.
3. Political process; support gathering, bargaining, commitment building.
4. Implementation process; Packaging, valuation, enabling legislation (unique to public sector), marketing assets and handling bids and coping with stakeholder obligations.

5. Learning process; perceived lessons, spill over effects, and consequences for other cases.

**Method followed and companies privatised:**

i) Retrenchment through the closure of mining activities.

ii) Sale of the firm through a public shares offering - Air Canada.

iii) Disinvestment through the private sale of the firm or subsidiary units - sale of Canadair

iv) Franchising of postal outlets - Canada post Corporation.

v) Joint venture - Eldorado Nuclear (38% federal govt. 62% Sas-Katcheuan Govt.).

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**NEW ZEALAND**

**CORPORATIZATION: (SOE MODEL)**

Enacted State Owned Enterprises Act 1986 to promote improved performance.

The **SOE Act**,

a) Specified principles governing the operation of state enterprises; and

b) Authorize the formation of companies to carry on certain govt. activities and control the ownership thereof; and

c) Establish requirements about the accountability of state enterprises and the responsibility of ministers.

The Act provided for the appointment of Board of Directors, accountable to the Ministry of Finance, and a further responsible minister who would hold the shares and who in turn would be responsible to Parliament for the performance of the enterprise. Thus minister could not sell or allot these shares. If the
Crown wished the state owned enterprises to provide non-commercial activities, it would need to contract it specifically to do so. The enterprise was to compose a statement of corporate intent including corporate objectives, the scope of activities, accounting policies, performance targets, estimated returns, commercial valuations and other information. The Act also specified that SOE would deliver annual, half yearly and other information to the share holding minister.

The Act subjected SOE's to the same antitrust and company legislation as the private sector. SOE's brought in line with private sector labour legislation.

Key objectives of corporatization process in New Zealand:

1. SOE managers are meant to have single clear objective; the maximization of commercial performance. This is intended to provide a direct and unambiguous focus, facilitate monitoring, improve accountability and prevent inconsistent political objectives.

2. SOE board of directors is meant to have authority to make the decision necessary to meet the objectives. They are responsible for major investment, recruitment and other strategic decisions. Ministers retain overall responsibility for the firm’s performance but should not be more closely involved.

3. Management performance should be closely monitored by minister, the Treasury providing advice-against the objectives achieved; some private sector monitory also occurs.

4. There is an improved system of managerial rewards and sanctions to reinforce the incentives for performance. Salaries and employment should be linked to performance.

5. In the factor markets, SOE's now raise funds in capital markets rather than at subsidized rates from the State, without explicit government
guarantees on debt (and indeed the government has tried to remove any implicit guarantees). They must earn a rate of return on equity capital in line with the market, and pay dividends and taxes to government. In most cases they employ labour on a similar basis to the private sector with comparable union coverage. They can purchase material and other inputs from any source rather than be required to use other government services.

6. Most SOE's no longer have statutory monopoly protection of preferential access to government business. Therefore in those markets where potential competition exists, they are exposed to it.

Even after corporatization certain weakness of pre corporatisation era are still observed

➢ Monitorial check through share market not possible.

➢ Little threat of take over or bankruptcy.

➢ Political intervention still exists.

➢ SOE's are not as decentralized as private sector in case of disinvestment, diversification, acquiring merger, going out of business or to reorganize.

In terms performance, Labour productivity has generally improved, but financial performance, depends upon whether restructuring took place before or after the SOE was established. Some SOEs have turned around, while others are still to turnaround.
Techniques used for transfer of complete ownership.

Equity Route ———— Assets Route

- Sell some Shares
  (Bank of NZ)
- Partial stock floatings
  (AIR NZ)
- Sell all shares
  (Petro Corp)
- Sale followed by Partial float (Telecom)
- Complete public Issue
  (None)
- Close some assets
  (NZ POST)
- Divest some physical Assets
  (Railways Corp.)
- Divest financial assets
  (Govt. Property Services.)
- Sell all assets
  (Shipping Corp.)
- Sell usage right
  (Forestry Corp.)
- Sell Corporate Entity
  (State Insurance)
ITALY

In Italy the public sector is a three-tier structure.

First Level: operating (Joint stock) companies with their share capital wholly or partly owned by the State.

Second Level: State holding companies, (anti di gestione) holding share in public sector companies. There are three such holding companies. IRI (Instituto per la Ricostruzione Industrial), ENI (Ente Nazionale Idrocarburi), EFIM (Ente partecipazioni e Finanziamento Industria Manufatturiera), EAGC (Ente Autonomo di Gestione per le cinema)

Third Level: Ministero delle partecipazione statale (Ministry of State Holdings), whose task is to define the general direction and policy of the enti di genstione.

The initial privatization, relating only to the first of these three levels, were realised through the sale of shares held by the enti di gestione, in some instances, this involved the transfer of the entire stock of shares, in others only part.

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To name few of the companies that shifted from public to private are Alfa Romeo which IRI made over to Fiat in 1986; Lanerossi, the textile group, which ENI transferred to Marzotto in 1987; the Commercial bank, Mediobanca, in which the three state-owned banks controlled by IRI had a majority share, which IRI reduced to half share in 1988. Cementir transferred on the recommendation of CIPI (the interdepartmental Committee for Coordinating Industrial Policy) in February 1992 from IRI to the private sector group, cattagirone.

Six chief characteristics in this phase of privatization are as follows:

**First**: Privatization never overtly formed part of government policy.

**Second**: The choice of transfer to be made was agreed neither by Government nor in Parliament. The enti themselves, the holding companies, decided on the particular set of shares to be sold, with a government authority subsequently coming in to ratify the decisions.

**Third**: The sale was in every case carried out by the public sector company, not by Treasury Ministry or by other ministerial bodies.

**Fourth**: The enti de gestione had complete latitude in devising the procedure adopted. This single common element was the fact that privatizations were approved by CIPI (the interdepartmental Committee for Coordinating Industrial Policy); otherwise the transaction was conducted by the state holding company on its own terms.

**Fifth**: The proceeds of privatization went not to Treasury but to the holding companies themselves.
Sixth: In each instance, privatization consisted in translating public ownership into private ownership, hence in increasing private shareholding, with the input of private capital.

GERMANY

The privatization of state-owned enterprises in the former German Democratic Republic (GDR) is presumably the most crucial and difficult part of transformation of the East German economy.

The task of privatisation of the former state-owned enterprises was assigned to a state trustee agency, the Treuhandanstalt (Treuhand). It is responsible for more than 8000 enterprises, 10,000 small shops, restaurants and service firms, 2.3m ha of arable land, 1.9 m ha of forest, and the assets of former GDR parties, mass organizations, the army, and the GDR security service.

Treuhand’s objectives of privatisation were as follows:

1. Transfer the state owned wealth into private ownership.
2. Achieving competitiveness in respect of as many companies as possible.
3. Supporting a structural change in the economy.
4. To provide capital to companies which can be restructured successfully.

The task of Treuhand was to sell the enterprises to private investors. If a company can’t be sold, there is a strong indication that it is not viable and should be liquidated.
The majority of the companies have to restructured that is, reorganised and retooled, before they can possibly generate profits. However, it was not the task of Treuhand to engage itself in restructuring.

Treuhand also had its own share of criticism. A large portion of the population blames Treuhand for the miserable state of East German economy especially for the raising unemployment. In the public eye, Treuhand is criticized for acting too fast as well as acting too slow. Some say it spends too much time searching for the highest possible price, others say it sells off the country’s wealth below its value. These conflicting criticisms originate in East and West Germany.

**JAPAN**

The word privatization which reminds Japanese people of the transfer of government companies to the private sector. In contrast to Britain’s privatisation, which includes three concepts – denationalization, liberalisation or deregulation and contracting out – it can be said that Japanese-style of privatization is much narrower in scope.

The background for the Japanese privatisation is as follows. (An analysis of the privatisation of Japan National Railway by Tetsuzo Yamaoto in political economy of privatisation Routledge, 1993)

1. **Socioeconomic Change:** Rapid technological changes in the field of high tech industries and their diffusion in to nearly all industries, not only brought about environmental changes in market conditions and structures where government’s monopolistic services were hitherto deemed indispensable, but also required the improvement of efficiency and service in the fields of industrial infrastructure.

2. **Fiscal crisis and raising financial cost of the public corporation.** Between 1974 and 1979 the Japan’s national deficit rose from 1.6 to 6.1
percent of GNP, with national debt service burden also increasing from 5.3 percent of general account expenditures in 1975 to 11 percent in 1979. The government examined fiscal conditions to reduced expenditures and was in line to sell off the government affiliated enterprises. In particular JNR's financial losses were regarded as one reason for the national fiscal deficits.

3. **Maturity Conditions:** Various factors such as socio economic charges, the rapid progress of new technologies and fiscal crisis, all required administrative reforms. Added to this foreign pressure – pressure from America was conceded to avoid escalating trade friction and booming capital market acted as a catalyst.

Study of Japan's privatisation process is the study of privatisation of Japan National Railway. This is the biggest attempt made by Japan.

In 1950s JNR accounted for 55 percent of passenger transport market and 52 percent of freight market. Because of motorization and urbanisation, its share in 1960s started declining. In comparison with private railways, JNR could not maintain the advantage. In 1980 its deficit reached 100 billion yen. The company's share of transportation decreased to 24.7 percent (passenger) and 8.4 percent (freight) in the same year.

The causes of JNR's decline are exactly like the causes of Indian public sector's decline.

□ **External Intervention:** JNR was subjected to excessive Government intervention, particularly by politicians with various 'local' concerns. Faced with these pressures, it was forced to engage in large scale investment for which tariffs and fares were to be set by the government to cross-subsidize one line by another. The result was that JNR was compelled to operate a number of deficit rural lines.
Organisational Inefficiency: Management's accountability was very vague. Management's concern with efficiency was lessened by its expectation that whatever financial loss it made was likely to be made up by the government.

Lack of competitive pressures: JNR never realised the need to operate in competitive environment.

Fiscal crisis and rising financial costs of the public corporations:
Between 1974 and 1979, Japan's national deficit rose from 1.6 to 6.1 percent of GNP, with the national debt service burden also increasing from 5.3 percent of general account expenditure in 1975 to 11 percent in 1979. In particular Japan National Railway's (JNR) financial losses, non profitability and inefficiency, which tended to eat up public money, were regarded as one reason for national fiscal deficit.

Marketing Conditions
The government failed to improve the performance of the public sector in the 1960s. In 1970 when the Prime Minister Nakasone orchestrated the process of privatisation he was supported by the views of the people who were complaining about inefficiency of public sector. The decline of Japan's Socialistic Party and trade unions facilitated the process of privatisation.

Foreign Pressure:
Japan conceded to America's pressure of privatisation since it is believed to increase competition and accelerate market growth and there by increase demand for imports.
**Boom in Capital market:**

In the mid-1980s Japanese capital markets developed rapidly and sale of public assets promised to be highly profitable to the state, as well as to the financial intermediaries involved in the underwriting firm.

**Privatisation of JNR:**

In privatising JNR, the following steps were adopted as transitory measures:

- The establishment of rules in the workshop (abolition of implicit agreement)
- Reduction of employees.
- Discontinuance of capital investment.
- Rationalisation of the freight sector.
- The adjustment of special rural lines.
- Entrance in to profitable business.
- Control of wage increases.
- Freezing of tariffs and fares.

The JNR was split up and privatised in 1987. The regional division was decided on the following criteria.

1. To realise the appropriate size of management
2. To respond to the economies of the region.
3. To introduce competition.
4. To guarantee accountability in each region.

As far as the long term debts are concerned it created following companies to take over the debts. They were also given share in the land owned by earlier JNR.

1. JNR settlement corporation.
2. Seven railway companies
JNR assumed burden of yen 25.5 trillion, seven companies yen 5.9 trillion, Shinkansen Holding Corporation yen 5.7 trillion of debts.

Overmanning problems were sorted out by:
1. Suspension of further recruitment.
2. Surplus workers were handed over to JNR settlement corporation
3. JNR Sc was responsible for promoting re-employment through activities such as job-training.
4. The JNR settlement under a special law designated to promote recruitment (1987) took care of employment of those who had lost the jobs. The shortage of workers in a prosperous Japanese economy greatly assisted this effort. Though the special law ended in 1990, by that time the number of surplus workers had been reduced from about 1900 in 1987 to 1000; these were finally dismissed with compensation by the Corporation.

JNR Settlement Corporation held shares of seven companies worth yen 459.5 billion and a part of railway lands.

The shinkansen Holding Corporation was established to deal with debts related to the Shinkansen. It owned four Shinkansen lines and began to lease them to J.R. the debts related to the shinkansen are expected to be made up from the lease proceeds.

Effects of Privatisation:
It is said that the industrial behavior of JR has changed remarkably since 1987. According to the observation made by some researchers principal-agent relationship have changed to some degree and the financial conditions of the corporation have improved gradually.
The primary plan of eliminating the long term liabilities has not proceeded according to schedule. Even though JNR Sc. was supposed to sell the land on competitive tendering, it could not sell because of governments fear of sudden rise in land prices.

POLAND

The new law establishes a Ministry of Property Transformation, to oversee the transformation of state enterprises into share companies initially held by the Treasury as single shareholder, followed within two years by the sale of shares to domestic and foreign investors, mostly by public offer at a prefixed price. The initiative to privatize a given enterprise can be taken by management, workers, or the 'Founding organs' (that is, the central body or bodies exercising authority on the enterprise to date) and is subject to government authorization.

Up to 20 per cent of shares are reserved for workers of the privatized enterprise at a 50 per cent discount on the price of issue; the discount however cannot exceed half of the buyer's salary over the last six months. This is an ingenious constraint which broadly equalizes access to capital by employees in enterprises characterized by different amounts of capital per person.

This reserve creates a potential class of 4 million small investors but excludes from the discount the other 13 million working in state agencies other than enterprises and in the private sector; however, a portion (expected to be 10-20 per cent) of the shares of companies undertaking privatization is to be distributed freely and equally to the general public. Moreover, access to capital ownership is facilitated by the fact that shares can be purchased on credit, if so decided by the Minister of Property Transformation and the Minister of Finance. In order to limit nomenclature acquisitions only physical persons can acquire shares at the time of privatization.
Enterprise is in State hands, one-third of the board of directions is to be elected by workers.

Foreign investors can freely purchase state company shares subject to an overall ceiling of 10 per cent, which can be raised by the Agency for Foreign investments (transferred to the Ministry of Property Transformations from the Foreign Trade Ministry), Dividends and the proceeds of subsequent share sales may be repatriated abroad without special permits.

An alternative form of ownership transformation is through liquidation—that is, selling or leasing all or part of the enterprise assets to employees or external entrepreneurial groups, preferably at public auction, with a view to facilitate the creation of new private enterprises.

CZECHOSLOVAKIA

People were offered books of vouchers at a price corresponding to one week's average wage. They could use these vouchers to invest in state owned enterprises.

ROMANIA

Citizens are to be given 30% of the capital of the commercial enterprises to be held on their behalf in Mutual and private Ownership Funds. The remaining 70% of the capital is to be offered to foreign and other investors.
CONCLUSION

Adam Smith, J.M.Keynes and Margaret Thatcher represent three different phases of government’s intervention in economic development of a country. The role of the government is a changing role. Involvement of government in economic development is contingent in nature. Now the world is witnessing a stage of gradual withdrawal by the Government which is popularly known as "Privatisation".

Privatisation of public sector undertaking is a worldwide phenomenon today. Governments in various countries are applying different privatisation methods to suit their country situations. Many countries have successfully applied right methods or applied methods which were not suitable. Right methods/models as well as fallout of not so right methods give valuable information for India to pickup a suitable Indian model.

The crucial issues involved in the privatization experiment of different countries have been summarised by shri.V.V.Ramandham in his book “Privatisation – a global perspective” published by Routledge.

1. While the country experiences indicate differences in the way in which privatization is conceived and implemented, there is, analytically, a difference between countries in which the public enterprise sector is relatively large in the national economy and those in which it is not. The macro implications of privatization assume far greater prominence in the former category than in the latter and correspondingly complicate both policy formulation and implementation. Eastern Europe is a special case of the former type, in that privatization concerns the total transformation of a government owned and government-directed/managed economy into a market economy. No wonder one has to be mindful of the impacts of individual measures of privatization on various distinct parameters of the national economy.
2. Many developing countries and East European countries have the concept of 'core' sectors of enterprises, over which the government wishes to retain significant, if not, total ownership. The demarcation of enterprises into different categories of equity unloading illustrate this point. The 'core' is flexible in application; but it signifies basically that, in a given situation of national development, investment and operating policies of certain enterprises have implications for the rest of economy, which the government fights shy of leaving totally to market forces. Besides, public interventions deemed necessary in the working of such enterprises, if left to the private sector, might prove to be difficult, cumbersome or ineffective.

3. Where a country has a development plan and many developing countries do there are in-built-limits to privatization, especially the divestiture. The plan ordinarily implies a deliberate ordering of investment priorities, as well as certain enterprise operations differently from what market forces by themselves lead to. To the extent that the plan transcends being merely indicative and postulates definitive lines of development in different sectors, limits to privatization tend to be implicit and wholesale divestitures might not appear to be desirable. Even in such a situation it would be useful to take a rigorous look at the planning approach itself so as to introduce the maximum possible elements of liberalization and impetus to market forces, without sacrificing crucial social goals. It would then be possible to undertake not only effective non-divestiture measures, but also divestitures themselves in a well-sequenced manner.

4. Country experiences clearly suggest that in the developing countries and certainly in the least-developed countries the government has a continuing role in making privatization effective both as a process and in results. Paradoxically the market forces are too weak to operate as a dynamic engine
for privatization, whatever its option or technique; and in several cases divestitures, if left totally to private initiative, could present certain ugly facets which the government can ill afford to ignore. Large-scale unemployment, under priced transfers of property, and corruption are examples. The need for continuing government initiative subsequent to privatization is likely to be substantial in most countries, through regulation of enterprise activities, creation of safety nets for the affected groups, and structural changes in government budgeting. The UK experience amply evidences the 'regulation' need; but countries standing at lower levels of development - for example, Eastern Europe and Africa - clearly need governmental attention to 'safety nets' and 'budgeting' as well. We cannot overlook that the capacity of the government to cope with these requirements, while showing effective respect to market disciplines, is a precondition for the success of privatization. No wonder, the pace of privatization is rather slow and unimpressive in countries where this requisite is not in full evidence.

5. A difficult issue limiting implementation of privatization in many countries—other than, say, in the UK, France or Canada - concerns the transferee: to whom are the public enterprise likely to be transferred. There are three broad possibilities: (I) to locals; (II) to foreigners; and (III) to joint ventures between locals (including the government) and foreigners. The first category itself is not as innocuous as it looks. There is an unmistakable distinction in the minds of government officials and the general public between indigenous locals and other citizens - particularly in African countries such as Uganda, Kenya and Tanzania. And then there is the more material question, which cuts across this distinction, as to the relative status of opulence of the cross-section (or the important section) of those who manage to get the enterprises into their hands. The divestitures might be responsible for aggravating the wealth and income skewness in the divestiture techniques

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themselves, the input/output policies of privatized enterprises, and the employment consequences.

7. There is an allied question concerning the efficiency orientation of the parties in whose favour divestitures are effected. In several developing countries, efficiency of private enterprise cannot just be assumed, unlike in developed market economies. Even where profits are being made by private enterprises and are likely to be made by privatized enterprises, it is not certain that they result from technical and managerial efficiency; monopoly markets, business-government connections, and irregular practices in the conduct of business are a major reason. Whether free markets will promptly develop and private entrepreneurs begin to earn through efficiency is a hard question.

It is complicated by the proposition that enterprise efficiency has to be understood in terms of micro as well as social efficiency; and the latter is, conceptually, very important in most developing countries.

8. Foreign capital is, no doubt, considered to be a powerful factor in making a success of divestiture programmes in many countries. However, public attitudes seem to be mixed because of perceived dangers, namely, that the best of the divested enterprises might end up in the foreign's lap, and that there might be an unacceptable degree of foreign control over the national economy. Governmental vigilance can help prevent this in theory; in practice many host governments turn out to be too weak or unskilled to exert the necessary safety mechanisms. Global experience also suggests that, while every country is racing to ease hindrances to the influx of foreign capital and offer incentives and concessions, the total quantum available for direct equity investment is nowhere near what the privatizing countries put together need. As a result, the opportunities of choice are heavily in favour of the foreign
investor; and he can easily improve upon the formal concession down the divestiture price itself.

9. Privatization by itself - the more so, divestiture alone - will prove ineffective in improving the nation's economic performance. To some extent the quest for foreign capital and/or foreign technology and management skills reflects cognizance of this proposition. But the more important requirement from the long-term point of view is that domestic technology and management should improve conspicuously. It is hoped, rightly, in developing countries, that the injection of foreign capital and joint venture collaborations triggers managerial upgrading at the domestic level. A fairly long learning curve is involved here; but one should constantly and dispassionately evaluate how the curve is moving and whether it is often taking the shape of a plateau. The longer the curve or the more nominal the achievements, the longer the real dependence of the national economy on the foreign expertise, a factor that originally triggered nationalization the world over.

10. It is commonly argued that the costs of divestiture are immediate through unemployment or closures of plants, whereas in the long run there are sure benefits through improved efficiency, output expansions, fresh demands for labour intake, increased tax revenues for the government, and so on. In theory, the argument is well founded. But there are two serious qualifications. The first refers to the length of the long-term when such benefits materialize. The other is more fundamental. How certain can we be, in the given context of a country, that, when market forces are permitted a free sway, there will be such second round effects as to absorb almost the entire segment of the initially unemployed? Does international competition ruin some industries? Do free markets damage small units as against large-sized enterprises within the range of domestic entrepreneurship itself? And how much of governmental intervention will be continually called for in order
to regulate the burdens of these occurrences and protect the affected groups or regions? Do we come back a part of the circle gradually?

11. There is another aspect of the long-run costs of privatization, which one might find it convenient to push under the carpet. Certain consequences of changes in the ownership structures, such as widened income disparities and foreign control over the domestic economy, will have a potential for economic difficulties as well as social tensions. Add to these the cruelties of the market system in a country whose production and export structures are not sufficiently geared to efficiency; several businesses, large and small, can fail, disturbing the credit agencies and aggravating the national burdens of unemployment. It is not easy to predict what the exact position will be in any given country ten to fifteen year from now. However, it will be helpful if reasonable (and dispassionate) estimates of the economic impacts of privatization measures are attempted ex ante, with reference to a bunch of measures contemplated for, say, a five year period particularly with reference export prospects, impacts on the exchequer, and movements of income/wealth distribution. The estimates have to be continuous. They help in formulating proper 'sequencing' of privatization as well, taken along with estimates of capital markets potential.

To conclude, there is an unmistakable and genuine enthusiasm in most countries for privatization. The concept is being implemented, rightly, through both divestiture and non-divestiture options. The pace of action is, however, behind the expectations of policy framers and implementers themselves. This is not surprising, in view of the complex issues surrounding successful privatization. Two simple caveats may be sounded: first, that the privatisation ought to focus steadily on efficiency gains as a result of privatization, rather than on a divestiture per se; and second, that no divestiture should be so conducted as to contain the seeds of tensions which will trigger a reverse action of some kind in the near future.