PRIVATISATION: A SURVEY OF LITERATURE

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DEDICATION

I dedicate this dissertation to my late mother,

who had been ensuring that I receive the highest possible education,

and whose encouragement and kindness has made

me through my academic career.

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I am however personally responsible for all typographical and any other errors that might appear in the work.

DECLARATION

With the exception of quotations

Specifically acknowledged in the text, this

dissertation is entirely my own work,

and has not been submitted

in any other

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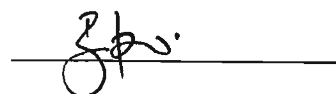

Bathandwa N.P Nogwanya

TABLE OF CONTENT

		Page
Dedication		i
Acknowledgements		ii
Declaration		iii
Table of Contents		iv
List of Tables		vi
Abstract		vii
Chapter One :	**Introduction**	1
	1.1 Motivation of the Study	1
	1.2 Objectives of the Study	5
	1.3 Organisation of the Thesis	6
Chapter Two :	**Theoretical Aspects of Privatisation**	7
	2.1 Definition of Privatisation	7
	2.2 The Origin of Privatisation	9
	2.3 The Privatisation Issues	10
	2.3 Implementation Issues	16
	2.4 Privatisation and Deregulation/Liberalisation	25
Chapter Three :	**International Experience with Privatisation**	27
	3.1 Introduction	27
	3.2 Developed Countries	27
	3.3 Developing Countries	37

		Page
Chapter Four :	**Lessons To South Africa**	47
	4.1 Introduction	47
	4.2 Prospects	47
	4.3 Potential Problems	51
Chapter Five :	**Conclusions and Policy Recommendations**	55
	5.1 Major Findings	55
References		61

List of Tables

		Page
Table 1	Privatised Enterprises in UK, 1984-1987	28
Table 2	Privatised Enterprises in France, 1986-1987	33
Table 3	Privatised Enterprises in New Zealand, 1987-1989	36
Table 4	Privatised Enterprises in Chile, 1985-1986	39
Table 5	Privatised Enterprises in Malaysia, 1984-1986	42

ABSTRACT

The Government of National Unity (GNU) came into power in 1994 and was immediately confronted with severe problems. In particular, the government was faced with the problems of high rate of unemployment, low economic growth, high rate of inflation, and high fiscal deficits. As part of the measures to address the fiscal deficits problem, the government has approved a process of privatisation and restructuring the state assets. To this end, sector specific task teams have been established and given the mandate to develop major options for the privatisation and restructuring process.

There are some issues of concern in the planning of privatisation and restructuring process. The major issues of concern include, the identification of enterprises to be privatised and when and how to privatise public enterprises. Further, privatisation transactions, like any other sale, require a buyer and a seller. Here, the process raises three fundamental questions: (a) should the state-owned enterprise be sold ? If yes, should it be disposed of in its entirety or sold off in segments ?; (b) to whom should state assets be sold ?; and (c) at what price should the assets be sold ? There is also a distributional problem which often results from the pricing of asset being privatised. Discounts on the market and underpricing of asset often result in the transfer of wealth to the new owners from the wider public and tax payers. The process can also affect consumers through changes in both the level and structure of prices of the newly privatised enterprises. It can also be costly to employees of the enterprises being privatised if there are layoffs by the new owners unless they are offered severance packages. That is why privatisation is, sometimes, open to opposition by unions and public in general

This study reviews literature on privatisation with the aim to bring about the issues, processes, and problems involved in the process. In doing this, the study examines the privatisation experiences of some developed and developing countries with a view to providing

some lessons that South Africa could learn from these experiences.

The review suggests that South Africa can reduce its stock of debt and finance its expenditure by utilising proceeds from the sale of some of the state assets. In addition, the efficiency of the state enterprises can be enhanced if the ownership of some of them is transferred to the private sector. Privatisation of state assets, however, comes with costs. The critical concerns regarding the implementation of the process are; the openness of the process to political opposition for fear of economic concentration of wealth to rich individuals and public sector unions opposition for fear of job losses of their members ; the setting and determining the market price of the public enterprise in advance of sale. In some cases the tenders fail to reach the reserved price whereas in others the offers are oversubscribed. In the former case, the risk is perceived to be greater that in the latter. Although public offering may be a preferred method, in an economy with underdeveloped financial markets, flotation of shares to the public may not be feasible. Despite these likely problems, privatisation can bring productive gains if it is well planned and managed.

CHAPTER 1

INTRODUCTION

1.1 Motivation of the study

In both developed and developing countries, many public enterprises exist and nationalisations of strategic industries have taken place. The objectives and constraints of nationalisation and/or public ownership in developed countries, however, differ from those in developing countries. In the UK, for example, the rationale for the large public enterprises sector included the need to centralise production, reap economies of scale, encourage innovation in the electricity and gas industries and save the declining coal and railway industries. The need to ensure adequate investment and to enforce safety standards were also a factor (Curwen, 1986).

The growing appeal of state-owned enterprises or assets in developing countries, on the other hand, can be traced in the main to the economic development strategies of the 1960s and early 1970s. Rapid public sector expansion during these periods was seen as a major contributor not only to economic growth but also to social and political stability. The existence of public enterprises also provided avenues for governments to use public production to serve non-commercial objectives. Such objectives as the promotion of regional development, job creation, income redistribution, etc., were common with public enterprises in developing countries.

At first sight, public ownership appears to be a straightforward solution to the allocation problem where industrial technology or input is associated with market failure. In practice, however, the public production experiment has been less than successful for a number of reasons. First, the absence of clear and commercial principles for public production contributed to the difficulties that surrounded the operation and direction of public enterprises. Through public

ownership many enterprises became isolated from the competitive market forces. In the output market, many became monopolistic suppliers of their products and enjoyed protection from international competition. These enterprises often take on or maintain redundant workers, price goods and services below market levels (and sometimes even below costs), locate plants in uneconomic areas, or keep open uneconomic facilities (Domberger and Piggott, 1985). Second, many public enterprises lacked the incentives or penalties for achievement or failure to meet targets. This results in managers of these enterprises to often fail to order objectives in terms of priority and seldom evaluate the social costs and benefits of non-commercial activities. With such lack of concern for profitability, public enterprises tend to overspend by raising wages, employment and investment simultaneously. Third, many managers in the public sector lack managerial and technical skills, making them to often take poor investment decisions which impair efficiency and lower productivity of investment (Nellis, 1986). When state enterprises are required to keep prices artificially low, not only do budget deficits and debt grow and shortages worsen, but public and private investment decisions are distorted and the underpriced resources waisted. Where state enterprises hire excess workers to promote employment, labour productivity falls and unskilled labourers may end up earning more than in the private sector at the taxpayers' expense. Also where state enterprises receive subsidies for non-commercial objectives, management tends to become lax, and the resulting inefficiencies create shortages and bottlenecks throughout the economy (Shirley and Nellis, 1991).

In the mid 1970s when the inability of many economies to adjust to external price shocks led to a marked deterioration in the macroeconomic performance of many countries, the idea of having large public sector changed drastically (Hemming and Mansoor, 1988b). The failure of

state-owned enterprises to deliver and to stand on their own without budgetary support has led to a reassessment of the appropriate size and scope of government intervention. As a result there have, in recent years, been major reversals of policy stance. Today the concept of privatisation of state assets enjoys significant recognition with a growing number of countries undertaking structural adjustment programmes with privatisation as an integral element (Nankani, 1990).

In the ex-socialist countries privatisation has been viewed as an integral element in the process of transition from a centrally planned to a market-oriented economy, although the contribution of privatisation to move towards a market economy has varied. For instance, in the highly centralised states of Eastern Europe and former Soviet Union, where the state sector had accounted for between 65-95% of gross domestic product (GDP), privatisation has been seen as a means of private sector development. In contrast, in many of the Asian transitional economies, where the non-state sector remained a significant component of GDP, privatisation has been viewed as a means of strengthening the private sector (Cook and KirkPatrick, 1995).

While the motives for privatisation may be similar in different countries, differences in the debate and results are driven by the differences in the historical and institutional context and in the initial scope and nature of the state sector. Each privatisation seems to have its own history and dynamics, requiring the need to adopt a case by case approach rather than trying to formulate a simplified model of privatisation. The record of those countries that undertook privatisation programme during the 1980s is quite mixed, and even for the successful ones, no clear blueprint for success is available. Even so, there are good lessons to be learnt from these countries experiences.

In South Africa, privatisation has assumed a centre stage in the economic debate in recent

years, but not much has been achieved in terms of actual divestiture of state assets. Privatisation was high on the country's policy agenda during late 1970s. The 1979 Economic Development Programme of the government, for example, drew attention to the rising claims of the public sector on the resources of the country and the effect this was having on the performance of the economy at that time. The programme document pointed out that the rise in the share of the public sector in the financial resources of the country (from 20 % in 1950 to 30% in 1978) was one of the important causes behind the imbalances between domestic saving and investment and decline in the job creation during the period. The programme therefore called for reductions in the rate of growth of public expenditure and in the tax burden through a privatisation of government activities and a reduction of the share of public investment in gross domestic investment to the level that prevailed in the 1960s.

The reduction of the public sector's involvement in the economy was also an important element of the long-term economic strategy formulated by the Economic Advisory Council in 1986 and was adopted as government policy in 1987.

A White Paper on privatisation and deregulation published in 1987 reaffirmed the government's commitment to the process. In February 1988, the government announced plans to privatise many of the state-owned enterprises, including those involved in transportation, steel, post and telecommunications and electricity (Brand, 1988). The first major privatisation took place in late 1989 with the sale of the iron and steel company (Iscor) following the sale of some shares of Sasol to the general public in 1979 (Leach and Vorheis, 1990). Since then no significant state assets had been privatised.

Since the Government of National Unity (GNU) took power in 1994, privatisation of state-

owned enterprises has once again received much attention. The privatisation drive has been renewed as a result of the need to restructure state functions and assets to improve their efficiency and to contribute to the achievement of the goals of the reconstruction and development programme (RDP). To this end, the government announced plans in 1995 to privatise some of the state-owned enterprises (Government of South Africa, 1995). According to the Government's 1995 Discussion Document on the Consultative and Implementation Framework for the Restructuring of the State Assets, the process is intended to achieve four main objectives: to generate funds to finance the RDP and reduce public debt; to facilitate economic growth and reduce unemployment by creating more jobs; to spread share ownership; and to promote black economic empowerment and enhance the competitiveness of state-owned enterprises.

Although the business sector welcomed the government's privatisation proposal on the ground that it would generate revenue to the government and hence reduce the tax burden, the labour unions oppose it because they fear job losses (Mail and Guardian, July 19-25, 1996).

This conflict of opinions led the government to negotiate with the business community and labour unions, culminating in the formulation of the National Framework Agreement (NFA) in 1996. The NFA addresses matters that specifically concern government and labour in the state asset restructuring process and to establish an agreed objectives and principles between the parties (Government of South Africa, 1996).

1.2 Objectives of the Study

The objective of this study is to review literature on privatisation with the view to providing some insights into the issues, processes and problems of the process. The study will also examine the

privatisation experiences of some industrial and developing countries to bring out some lessons to South Africa in its attempt to privatise some of its state assets.

1.3 **Organisation of the Thesis**

The thesis consists of five chapters. Following the general introduction in chapter 1 is chapter 2, which discusses the theoretical issues of privatisation. Section one of the chapter reviews the definitions of privatisation, while the origin of the concept is covered in section two. Section three deals with the process of privatisation. The debate on privatisation process is reviewed in the last section of the chapter. In chapter 3, we review the privatisation experiences of some developed and developing countries. Chapter 4 discusses the lessons that South Africa can learn from the privatisation experiences of the countries reviewed. Chapter 5 concludes the study with some policy recommendations.

CHAPTER 2

THEORETICAL ASPECTS OF PRIVATISATION

2.1 Definition of Privatisation

The word "privatisation" became popular only recently and the activities with which privatisation has become most closely associated with is the sale of state-owned assets.

Hemming and Mansoor (1988a), define privatisation as nothing more than a transfer of activities from the public to the private sector with particular reference to asset sale. Domberger and Piggott (1985) are more general in their definition of privatisation. They define the concept as any attempt to improve public sector performance. Jones (1991) refers to privatisation as any shift in activity from the public to the private sector, and more typically the transfer of ownership of public enterprise to the private sector. This definition is supported by Kusi (1992), who defines privatisation as the transfer of assets and activities from the public to the private sector.

According to Kay and Thompson (1986), there is a need to define privatisation more broadly so that it covers several distinct and a range of possible alternative means of changing relationships between the government and the private sector. They emphasise that the transfer of state-owned assets to private sector should be accompanied with deregulation, liberalisation and franchising. Beesley and Littlechild (1983) provide even a more broader definition. They use the term to refer to the handing over of some part of the welfare and production services of the state to the private sector.

In the "Discussion Document on the Consultative and Implementation Framework for the Restructuring of the State Assets", the Government of South Africa (1995) referred to

privatisation as the sale of a public corporation to the private sector in full and/or the handing over of a public sector activity to the private sector. This involves a systematic transfer of appropriate functions, activities or properties from the public to the private sector.

According to Truu (1988), although the word privatisation lends itself to several interpretations, to most people it conveys a changing relationship between the public and private sectors of the economy. More specifically, it is a process mainly characterised by the transfer of assets from government to priv combined effect of which is to reverse a long-term policy of greater government control of the economy.

The word "privatisation" is a challenge to the expanding role of the public sector. Defining privatisation as comprising multifaceted ate ownership and the replacement of state planning by competitive markets, the aspects, such as ownership transfer, promotion of competitive behaviour through deregulation and discontinuation of public provision of services, could produce contradictory policies. Privatisation is a concept containing a variety of diverse elements, ranging from specifics to general. In many countries, privatisation has intended to deal with and, in some cases, specifically target the inefficiency of public corporations.

From the definitions given, privatisation can be seen as a process of partial or full transfer of public enterprises from public ownership to private ownership and/or sale of state assets either to private individuals or the public at large. The aim of the process is to improve the operating efficiency of public sector enterprises through increased exposure to competitive forces and to mobilise the private sector to take the lead in entrepreneurship and industrial development. Privatisation thus involves a reduction in the size of the public sector.

2.2 The Origin of Privatisation

Privatisation seems to claim its own history and dynamics. After the second world war, government intervention in national economies expanded. In the 1960s and early 1970s, the public sector was seen as a major contributor to economic growth and stability. Two primary concerns of developing countries (LDCs) triggered the predominant role for the public sector in their economies. First, there was ostensible commitment to the provision of basic services in the areas of health, education, transportation, and public utilities. Second, there was the recognition by LDCs governments that rapid economic growth is the only solution to the problems associated with poverty and underdevelopment. Public enterprises were therefore seen as vehicles of resource mobilization, capital accumulation and economic development (Sattar, 1989).

According to Brand (1988) and Jones (1991), privatisation emerged in a variety of countries from fiscal pressures experienced by the governments. When countries face heavy debt burden they consider privatisation as a relatively quicker way to reduce public debt. In UK and other countries, privatisation is seen as having arisen from the conflicts between the aims of meeting expanding demands for government expenditure on one hand, and that of restricting the tax burden, on the other.

Although some of the objectives of government intervention have been achieved in many countries, other problems have also emerged from public ownership. In many countries, either politicians interfered with the operations of public enterprises or managers were inadequately monitored, or because of the nature of importance of public sector activities, labour unions tended to become unusually powerful. In pursuing their personal goals, politicians, managers and workers watered down some of the top priority objectives of public ownership.

Many authors also subscribe to lack of market discipline doctrine and the inability of state firms to respond to the requirements of competition.

After the major economic setbacks of the 1970s when many economies failed to adjust to external price shocks, the weakness of public sector institutions and operations began to show. This called for a reform of the public sector in many developing countries. The reform efforts have centred mainly on public enterprise management systems, with a view to creating more independent and entrepreneurial enterprises capable of operating efficiently in an environment of high competition. It was also thought that such reform efforts could correct the problems of the state-enterprise sector without dismantling it. The public sector reform have led to improved enterprise performance in some countries, leading to a worldwide shift from a preference for the public sector to an emphasis on private options, (Shirley and Nellis, 1991).

2.3 The Privatisation Issues

The economic crises confronting both developed and developing countries have influenced the popularity of the privatisation policy. The major issues in the privatisation process are concerned with its fiscal impact, economic efficiency, political economy, and the distributional impact of the process. In what follows we examine these issues.

(a) Fiscal Impact

Privatisation or the sale of publicly owned assets is frequently associated with reducing public sector deficits. If the sale price of a public enterprise exceeds the net income generated for the government by the enterprise in the year of the sale, then the fiscal deficit will be reduced once

and for all (Hemming and Miranda, 1991). This, however, may not necessarily reflect a change in the fiscal position of the government. If the government uses the sale proceeds to purchase financial assets or to retire a portion of its debt, then the government and the private sector have simply exchanged assets. But if the government uses the sale proceeds to finance current expenditure, then the deficit in the year of the sale would be unaffected, but the future deficit will be larger (Galal, 1990, Hemming and Miranda, 1991, and Kusi 1992). In this case, the real economic gains will only be limited to the productive and allocative efficiency improvements. Thus, in examining the fiscal impact of privatisation, it is necessary to distinguish between cases in which privatisation is likely or unlikely to have a significant impact on productive and allocative efficiency.

It is frequently argued that a major economic gain from privatisation is the revenue to be accrued to the government from the sale of assets. According to Kusi (1992) this conception can be illusory. He explains that, if the sale value of the asset to be transferred is equal to the present value of its expected public ownership profit stream, then the net worth of the assets would not be altered through the privatisation process. The net impact of privatisation thus depends primarily on the value of the asset sold, the increase or decrease in productivity resulting from the transfer of ownership and the way state uses its proceeds from the sale.

(b) **Efficiency Gains**

There is a view that privatisation contributes to economic efficiency. There are three possible sources of increased economic efficiency that can be derived from privatisation: productive efficiency, allocative efficiency, and non-market efficiency gains (Hemming and Miranda, 1991).

The productive efficiency requires that whatever is produced should be achieved at a minimum cost. Allocative efficiency, on the other hand, implies that what is done should meet consumer needs and at prices that reflect the cost of provision. Basically, allocative efficiency is concerned with the determination of prices that reflect scarce resources, while productive efficiency, is concerned with costs minimisation. If the factors of production are misallocated, allocative efficiency will not be achieved, i.e.; resources are not allocated to their most productive uses and the public sector will not earn appropriate rates of return on its capital, or the rates of return will not reflect the best use of capital.

Improvement in allocative efficiency can result if privatisation is accompanied by the exposure of privatised firms to competition. That is, privately-owned firms must have the incentive to achieve both productive and allocative efficiency. The incentive to achieve productive efficiency comes from the requirement on private firms to achieve profits, to stay in business in competitive product markets and to avert the threat of takeover. The privatisation process also provides the means for owners to monitor, assess and control the performance of managers who effectively run their enterprises (Borensztein and Kumar, 1991).

Improvement in allocative efficiency can also be obtained to the extent that the monopolistic behaviour of public enterprises is weakened. The product market determines profits and the capital market determines whether sufficient profit is made to stay in business (Hemming and Miranda, 1991). This influences the decision of whether or not certain resources should be used in the provision of particular goods and services, as well as the particular combination of resources and technology to use (Brand, 1988). If a greater proportion of available resources is used in the private rather than the public sector, a greater proportion of allocative decisions will be taken in

the private sector by decision-makers who will bear the entire risk of the outcome of their decisions, as opposed to civil servants who are less accountable for their influence on the use of resources.

Domberger and Piggott (1985) add that the efficiency of state enterprises are usually impaired due to the absence of a clear cut profit objective and the general tendency on the part of government to direct management of public enterprises to pursue non-commercial objectives. Further, if state-owned enterprises operate as monopolies they tend to be protected and their prices controlled, since subsidies or loans are usually available to pay for past mistakes, while penalty for failure is remote.

The relaxation or abolition of statutory monopolies promotes efficiency through competition in the market place. Denationalization also restores market discipline, and partial denationalization will, by introducing pressures to attract and maintain private capital, increase incentives to operate efficiently and make government intervention more difficult. Privatisation can also contribute to increased productive or X-efficiency. Production in the private sector is subject to the pressures of competition, therefore privatised firms are more likely to remain close to the production possibility frontier set by the chosen combination of technology and resources (Knight, 1987).

(c) Political Economy Issues

Countries that have socialist programmes and have accorded considerable legitimacy to private sector activity can promote privatisation on efficiency grounds. On the other hand, countries that have emphasised the redistributive role of the state in pursuit of social justice will find it difficult to reduce state intervention and to privatise without calling the legitimacy of the regime into

question (Bienen and Waterbury, 1989).

The perception exists that private ownership is only a way to enrich the rich. Opponents of privatisation argue that privatisation is an attempt to delay the control over accumulated wealth by the poor majority. They contend that the control of government assets will be passed on to the wealthy who can afford to partake in the privatisation process while the large majority of the poor are excluded (Bienen and Waterbury, 1989). In addition, privatisation is seen as a process of promoting profit-seeking behaviour. There is argument that first world countries are profit-seeking societies which make individuals invest their time and resources into raising production. Consequently, these economies develop and grow. Third world countries on the other hand, are largely rent-seeking societies where individuals focus on protecting what they have, and even redistribute wealth in their favour. This rent-seeking behaviour makes resources to be used in an a manner that causes the "economic pie" to shrink. Hence profit-seeking economies grow and rent-seeking economies stagnate. Since profit-seeking behaviour exists in private ownership, privatisation can promote profit-seeking behaviour (Vorheis, 1990).

There is also the social pacts argument. That is, organized labour and lower and middle income groups may have been part of social pact through which they trade political support for protection of their standard of living and continued state commitment to redistribution. In some developing countries, the social pact has often consisted of a package of free health and educational services, high levels of consumer subsidies, guaranteed employment, and implicitly indexed wages. Job creation is also a crucial part of social pacts of many developing countries.

Social pacts have proved to be costly both in terms of economic efficiency and political credibility. Under these pacts the state takes upon itself the role of redistributing income and

providing social welfare. Privatisation in this light may be seen as a means of relieving the state of some of these social obligations. It enables the private sector to shares not only in the benefits of state patronage, but also in the risks and social costs of development (Bienen and Waterbury, 1989).

There are also some political constraints to privatisation. Privatisation has distributional consequences and favours certain groups within society at the expense of others. The losers can be expected to organize against privatisation, particularly if the negative impact of the process is spread over a relatively small group. Privatisation is likely to undermine trade union power, as it is typically concentrated in the public sector.Unions may react strongly against the process, not only because of its direct impact on employment, but also because of a fear that the union's political power will shrink in the private sector. Much of the political opposition to privatisation has crystallized among the management of the concerned public enterprise. In some cases, they have been able to block privatisation. In other cases, these groups have been able to limit the impact of privatisation on competition and economic efficiency by exerting influence on the regulatory environment, making sure that they will continue to play a managerial or regulatory role over the privatised firms (van de Walle, 1989). The political impact of privatisation, however, depends in part on the state's ideological investment in public production in the past. Countries that promoted social, redistributive and economic role for the state under socialism or nationalisation are likely to find privatisation more politically sensitive.

(d) **Distributional Impact**

It is argued that public enterprises have not had a very good record of reaching the poor. They

often reflect an urban bias and inadequately serve the rural population where poverty abounds (van de Walle, 1989). Privatisation may also have a negative effect on the poor, and in the case of public enterprises that are natural monopolies (eg. electricity and gas industries) privatisation can worsen allocative efficiency to the extent that the resultant private firms tend to restrict output and raise prices (Hemming and Miranda, 1991). Prices for services, for instance, may increase dramatically after privatisation if cross-subsidization practices common to public enterprises are abandoned . In such cases, it may be necessary to regulate the newly privatised enterprise in order to maintain allocative efficiency. This, however, is an argument against privatisation only if it can be shown that public provision is the most effective and efficient manner of reaching the poor. If not, poverty alleviation measures that target the poor directly are likely to be more cost effective than maintaining the public enterprise.

Privatisation may also have an impact on the employees of the public enterprise if, subsequent to the privatisation, the firm goes bankrupt, or government subsidies decrease, or there are layoffs by the new owner. The counter argument put forward by the proponents of privatisation is that it is unlikely that the process will make public enterprise employees worse off, even though it may bring about real hardship for certain laid off employees. This is because public enterprise employees are not typically among the poorest in most countries (van de Walle, 1989).

2.4 Implementation Issues

Though various benefits are likely to flow from privatisation, the path to privatisation is not easy. The mechanics of sale of state-owned enterprises begs a number of implementation issues. Issues, such as which industries and services to privatise, when to privatised, how to privatise, to whom

should the enterprises be sold and at what price, and whether an enterprise should be disposed of in its entirety or sold off in segments immediately come to mind (Kusi, 1992).

According to Sattar (1989), the process of privatisation may take two forms. First, it may be a step by step strategy, whereby the process proceeds gradually under a long-term plan. Second, a public enterprise might be considered for privatisation and the government may take a bold step of wholesale privatisation within the shortest possible time. Another alternative is that, the government may choose to maintain a majority ownership interest in a firm being privatised. In others, the government may retain a single "golden" share with special voting rights that can be used in well defined circumstances to protect public interest (Jones, 1991).

Heald and Steel (1982) point out that there are two main elements in the government's programme to privatise public enterprise. These include, denationalization (the sale of an enterprise's assets or shares) and liberalisation (the relaxation or abolition of statutory monopoly powers). As far as denationalization is concerned the entire assets of an enterprise or all of its shares are sold off. In other cases, the government may convert the public corporation into a listed company and then sell a proportion of the company's shares. The new company will then raise its capital from the capital market and will therefore be free from any form of control by ministers other than that applied to all companies.

(a) Approaches to Privatisation

The issue of how public enterprises are to be privatised has attracted some concern in the literature. According to Domberger and Piggott (1985), there are mainly three broad approaches to privatisation. These are transfer from the public to the private sector (generally through sale),

deregulation or liberalization, and contracting out the provision of marketable goods and services to private firms. To these, Kusi (1992) adds franchising, contracting out production activities or contracting out management to the private sector, and joint-venture ship. Vuylsteke (1988) points out that, the most commonly used methods of privatisation are public offering of shares, private sale of shares, new private investment in a state-owned enterprise, reorganization of state enterprises into component parts, management buy out and lease, and management contract.

(i) Offer of Shares

Decisions about the percentage of shares to offer to domestic versus foreign buyers, the timing of the share sale, and the budgetary impact of the sale are all issues that need careful consideration. Whichever method is used, the setting of a price for the company to be privatised will always be difficult and controversial because there may not be a directly comparable company currently operating in the private sector. Further, it may be difficult to predict stock market movements in the period prior to flotation (Darko, 1992). In the United Kingdom, for example, where sales of public sector assets have been extensive, the process was achieved mainly through sales of equity by tender or through offers presented at fixed prices. In each case of the sale process, there were some problems. In the former case, most tenders failed to reach the reserved prices, while in the latter case, offers were oversubscribed. This underscores Domberger and Piggott (1985) argument that determining the market price of a public enterprise in advance of sale is difficult since there is very little information on which to base an estimate. Factors such as the size of the enterprise 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 privatisation

and the extent to which the private sector sees opportunities to improve the efficiency of privatised enterprises that the public sector ignores, contribute to this difficulty (Hemming and Mansoor, 1988b). On the other hand, disposal of assets through offer for sale at a set price can also raise problems of price determination. The UK's experience suggests that the risk of setting the price too high so that underwriters are left with large quantities of unsold shares are perceived to be greater than the risk of getting the price too low so that the issue is oversubscribed.

Where widespread share of ownership is desired, a public offering would be the preferred method. But in an underdeveloped economy with underdeveloped financial markets and concentration of domestic private capital and entrepreneurial expertise, flotation of shares to the public may not be feasible. Furthermore, where transfer of ownership is not desirable or feasible at the initial stage, leases and management contracts followed by transfer of ownership or a joint - venture ship may be adopted as a first step to total privatisation (Vuylsteke, 1988).

According to Vuylsteke (1988), shares can be offered publicly or privately, full or partial. The offering may also be on fixed price, or on a tender basis, and may be marketed internationally or domestically. There may be restrictions on the size of individual share holdings and on purchases by foreigners. In certain instances, shares may be distributed to employees or the general public for a token price. If the public enterprise is a well-performing entity with an established record of profitability, the process will be straightforward and relatively simple. Otherwise the offering may have to be underwritten by some agents. Where there are no underwriting capacity to support an offering, the government, as seller, will necessary have to take the risk of the sale on its own account.

Public offering requires that the enterprise be a sizeable going concern with a reasonable

earning record or potential to ensure a maximum success. The main advantage of public offerings are that they permit widespread share holding, allow the resources of the general investing public to be targeted, and are normally characterised by openness and transparency (Vuylsteke, 1988). If the objective is to achieve widespread share ownership or to target certain segments of the investing public, then specific mechanisms such as incentives, restrictions, etc., need to be introduced to ensure that these objectives are attained.

Under private sale of shares, the state sells all or part of its share holding in a wholly or partly owned-state owned enterprise to a pre-identified single purchaser or group of purchasers. The transaction can take various forms, such as a direct acquisition by another corporate entity or a private placement targeting a specific group. The privatisation can be full or partial, with the latter resulting in joint-ownership enterprises.

Private sales of shares are often used as a first step to/or in conjunction with public offering. Because of their flexibility private sales are the preferred method for weak-performing state enterprises. Another advantage of a private sale of shares is that the prospective owner is known in advance and can be evaluated (Vuylsteke, 1988).

(ii) **Franchising/ Contracting Out**

Franchising is an appropriate mechanism for privatising state enterprise when the market is inherently monopolistic and/or when the government desires to retain control over output and/or price. Under this process, the government accepts that the private sector can undertake public services or activities on its behalf for a consideration. However, in such cases the public sector remains responsible for the services or activities.

Franchising was first propounded by Chadwick (1859) and was promoted as a serious alternative to regulation by Demsetz (1968). However, in a Demsetz version, competition takes place through bidding for the franchise and the winner is the contestant who bids the minimum supply price. That is, the winner is the contractor who undertakes to supply the good or service at the lowest unit price. An alternative award mechanism involves granting the contract to the producer bidding the highest capital sum for the franchise. Such franchising schemes ensure that competition is present in the market, and thus the service would be provided efficiently. In this process, subsidy payments are minimized, while public regulation of the level of service and perhaps also fares would not be affected.

Nankani (1990) considers contracting out as some sort of privatising management without the involvement of assets sales. Brand (1988) sees contracting out as a process where the private sector undertakes public sector services or activities on government's behalf for a consideration. According to Domberger and Piggott (1985), franchising is particularly suitable in circumstances where the government wishes to control the characteristics of the service or product to be provided, or where provision is to be financed through explicit government subsidies. To them, one of the most serious problems associated with contracting out is that of the contract specification. They argue that franchising is likely to work best for goods and services which can be specified with precision and without ambiguities about characteristics of supply and bidding of the contract must be competitive. Another potential problem with contracting is the contract duration. Identifying the optimal contract length can be difficult and yet may be crucial to the success of the franchise scheme. In principle, contract involves a minimum regulation but problems can arise when contractors' performance falls below the specified standards.

(iii) **Leases and Management Contracts**

The most commonly used methods of privatisation have been leases and management contracts. These instruments do not involve the sale of assets, at least in initial period and they enjoy a relatively clear legal framework because of the well-defined contractual relationship between the state-owned enterprise and the management group. Vuylsteke (1988) sees leases and management contracts as often used as temporary measures. To him, the injection of private management, presumably selected for its operational or other skills, represents an important and effective non - sale form of privatisation.

Under a lease, the lessee hires its personnel. Under a management contract, the contractor may have wide powers over existing personnel but they remain employees of the enterprise and are often subject to government pay scales and conditions. Another distinguishing feature of a lease is that the lessee has unfettered control over the operation of the assets, while the management contractor has only that control and authority specifically granted under the contract. While the contractor might be given extensive management powers and operational control, it has no financial exposure and receives its fee regardless of the profitability of the enterprise. The state-owned enterprise continues to bear the full commercial risk and is responsible for all working capital and debt financing. The advantages of this arrangement is, however, that ownership is retained, a defined degree of control is maintained, and a high level of management and other skills is injected into the enterprise, thereby enhancing its overall efficiency and profitability.

(iv) **Joint-Venture ship**

In some instances where it would not be acceptable to transfer an existing state enterprise to the

private sector in its entirety, or where the nature or extent of a new enterprise would require the involvement of the state, such an enterprise could be managed by a partnership between the state and the private sector. A partnership of this nature could have the benefit of effectively reconciling private sector participation and a private sector approach to management with public sector strategic interest in such a joint-venture ship.

The manner in which such a partnership is structured would probably differ from enterprise to enterprise and could include: (a) the acquisition of shares by the private sector in existing or new state undertakings but with the public institution retaining its share holding until such time as full ownership can be transferred to the private sector; (b) the acquisition of shares by the private sector in an existing or new state enterprise in which the public institution maintains a permanent involvement. Such a partnership between the public and private sectors may be appropriate in the case of natural monopolies or when, for special reasons, full private ownership is deemed not to be in the interest of the country; and (c) the phasing out of share holding by the public institution in undertakings as and when it has fulfilled its responsibility from a development point of view (Government of South Africa, 1987).

(b) To whom to sell

In designing a privatisation programme, the government can identify two categories of potential buyers. These include domestic and foreign buyers. Kusi (1992) suggests that sales to foreigners would be highly advantageous from superior management skills, and technical know-how. He explains that privatisation raises the fear of concentration of ownership. This invariably puts governments contemplating privatisation into a difficult position of deciding whether to seek for foreign buyers or sell domestically. If the government decides in favour of the latter, indigenous capital accumulation may be lacking and/or the private sector may be quite small resulting in few

people buying, thereby ending up with the concentration of ownership in the hands of a few rich individuals. On the other hand, if the government finds foreign investment acceptable, this may lead to the transfer of ownership, control, and profits outside the country, or there may be very little to privatise which may be of interest to foreign investors, or domestic resources and infrastructure may be so underdeveloped that foreign interest becomes minimal.

A related problem here is the question of credibility. The privatisation process should be made as transparent as possible to forestall the lingering experiences of some countries where state enterprises were alleged to have been sold cheaply behind closed doors to favoured cronies or where large kickbacks were accepted from foreign investors and the enterprises dished out to them (Kusi, 1992).

According to Nankani (1990) the sale of shares to private buyers often serve as the only alternative in the absence of equity markets. It presents the only alternative for weak-performing enterprises, or for those too small to justify a public offering. It also provides an opportunity to evaluate new owners and offers flexibility in negotiating the operating rules that the purchaser brings to the divested state-owned enterprises.

(c) **Labour Issues**

Privatisation tends to be associated with layoffs. Severance packages for employees are therefore very important for two reasons. First, few countries have a social safety net for laid-off workers. Second, retraining and redeployment schemes have a poor record of placing workers, partly because privatisation tends to occur during periods of economic contractions.

2.5 Privatisation and Deregulation/Liberalization

The various forms of privatisation differ in their effects on competition. The complementarity of privatisation and liberalisation need to be carefully considered. Liberalisation, in this context, refers to the opening up of an industry to competitive pressures. The important question here is whether to privatise with deregulation or without deregulation?

State-owned enterprises have been among the major barriers to self-sustaining growth in many developing countries. These enterprises monopolise production, distribution, pricing and other economic activities best performed by the private sector. Experience has shown that this often results in waste, inefficiency and heavy demands on overburdened developing countries resources (Sattar, 1989). Invariably, public enterprises enjoy statutory monopoly powers in the domestic market and limit consumers freedom of choice. Therefore individual freedom is fostered by extending competition and by reducing the public sector so as to allow individuals to keep a higher proportion of their wealth in the form they themselves choose. Domberger and Piggott (1985) put forward deregulation as a key role in the removal of entry restrictions into the market. They argue that where public enterprise operates in a highly protected or regulated environment deregulation or liberalization of the market may generate a substantial improvement in public sector performance without ownership transfer. They explained that the removal of entry barriers will ensure socially desirable behaviour even in cases of natural monopoly, provided it can be shown that the monopoly is perfectly contestable. A crucial assumption is that entry must be costlessly reversible, that is, the entrant must be able to exit from the market at no cost when it is no longer profitable to remain. Regarding productive efficiency gains, much depends on whether deregulation is accompanied by asset sales. Finally, revenue to the government following

asset sale are likely to be small if investors expect a deregulated enterprise's dominant position to be short lived. But where the incumbent's dominance is expected to be longer lasting, revenue could be substantial and perhaps not much smaller than where deregulation is altogether absent (Domberger and Piggott, 1985).

Kay and Thompson (1986) support the view that privatisation will tend to improve performance in a company only if it is supported by liberalisation. They argue that the regulation of private firms, which do not face competition, sometimes distorts incentives in ways that lead to higher cost levels than those of directly controlled public enterprises. The crucial assumption is that under competition private firms are likely to do better, but if there is little competition regulated private firms do not perform better than public firms. It is even possible that they can be worse. This belief is also shared by Domberger and Piggot (1985). However, it is entirely possible to privatise without liberalizing, as the Conservative Government of UK demonstrated by selling shares of British Telecom and British Gas without significantly subjecting either industry to competitive forces. Conversely, it is possible to liberalize without privatising, that is, to introduce competition to the public sector without transferring ownership.

Although some authors suggest that privatisation should be accompanied by deregulation, deregulation has its own problems. For example, an incumbent firm which has achieved dominance in a period of statutory protection enjoys considerable advantages-technical, financial and political. These financial and technical advantages are reinforced by the political skills and influence that incumbents have normally acquired. In addition to that, liberalization is likely to be resisted by management and labour, since it could threaten tenure and impose more rigorous performance requirements.

CHAPTER 3

INTERNATIONAL EXPERIENCE WITH PRIVATISATION

3.1. Introduction

The debate about the role of the government in production has been raging for years. Various countries have undergone waves of nationalisations and/or creation of public enterprises and almost every country has some nationalised sections of its economy at one stage or another. Since the 1970s, however, there has been a strong push for privatisation of state enterprises, caused by the many disastrous effects of nationalisation-economic decline, inefficiency, disappearance of the market mechanism, and misallocation of resources. The international wave of privatisation began in the UK and thereafter spread rapidly to the other industrial countries. The process of transferring public enterprises to private ownership, however, began more slowly in the developing countries, but the pace accelerated in the 1980s. In what follows, we review the privatisation experiences of selected developed and developing countries.

3.2. Developed Countries

(a) United Kingdom

The UK was the first and most active champion of privatisation. According to Galal and Shirley (1994), when the privatisation programme started in the UK in 1979, the country was moving into a deep recession with high unemployment, high inflation and a tight government budget. The country was thus under severe fiscal constraints. State-owned companies that were largely self-financing had difficulty getting additional funds from the Treasury. Immediately after coming into office in May 1979, the Conservative Government initiated a radical programme of deregulation,

denationalization, and privatisation of some enterprises and services.

The main objective of UK privatisation was to increase competition (Beesley and Littlechild, 1983). The Conservative Government believed that a shift from a welfare culture to an enterprise culture was necessary to restore the competitiveness of the British economy. Another goal of the privatisation programme was to encourage a wider share ownership (McKinlay, 1987). The privatisation of state enterprises in Britain was undertaken to improve both the efficiency of resource allocation within the economy and industry performance by increasing the role of market forces. It was also expected to play a significant role in achieving reduction in the size of the government.

Table I presents some of the enterprises that were privatised during the 1984-1987 period.

Table 1. Privatised Enterprises in UK, 1984-1987

Privatised Enterprises	Nature of Enterprise	Year of Privatisation	Method of Privatisation	Market Price (£'000,000)
British Telecom	Communication	1984	Public offering	3.9 00
Sealank	Harbour and Ferry Operation	1984	Private sale	66
British Gas corporation	Gas	1986	Public offering	5.4 00
British Airways	Airline	1987	Public offering	0.9 00
National Freight Company	Road Haulage	1987	Management/ employee buy out	6.5

Source:Candoy-Sekse and Palmer (1988)

Table 1 shows that the sale of a majority stake in British Telecom yielded £3.9 billion, while the sale

of British Gas and British Airways yielded £5.4 billion and £0.9 billion, respectively. The sale of National Freight Company also yielded £6,5 million and Sealank £66 million. Kay and Thompson (1986) also reveal that asset sales by the central government increased progressively from £370 million in 1979/80 to £1,142 billion in 1983/84, and this included large sales such as British Telecom, British Gas, Jaguar and Sealink.

According to Hemming and Mansoor (1988b), the privatisation programme led to nearly 40% of the state-owned industrial sector being transferred to the private sector by the early 1988.

In the UK, the privatisation was done through the sale of equity by tender or offer for sale presented at a fixed price or a combination of both. Both types of sale, however, had some problems. In most cases tenders failed to reach reserve prices and, most notably, offers were oversubscribed as the market initially established large discounts making the offer prices to fall significantly below the market price (Hemming and Mansoor, 1988b). British Telecom and British Gas Corporation were privatised through public flotations (Candoy-Sekse and Palmer, 1988). This approach was taken probably to encourage a wider share ownership (Hemming and Mansoor, 1988b). National Freight Company was privatised through a leverage buy out by employees, while Sealank was sold to a private buyer (Candoy-Sekse and Palmer,1988).

The sale of British Telecom was one of the largest in UK and the most successful. For this company, the main winners were consumers and those who purchased the stock, including the employees to its employees (Darko, 1992). The privatisation of National Freight through leverage buy out to employees was also a major success both to the company in terms of productivity gains and to the new owners in terms of capital gains and dividends. Thus, while the shareholders won the government lost, although by a small amount because the value of the assets at the time of

privatisation exceeded the sales price (Galal and Shirley, 1994). In the case of British Airways, the company merged with British Caledonia, a merger unlikely to have occurred had British Airways stayed in the public hands. The merger brought a substantial gain to both the buyers and the government. The buyers benefited from the reduced effective exchange rate at which the assets were acquired and also from the underpricing of the company's shares. In addition, a mechanism was set up which allowed the workers to buy shares in the company and to pay for them over a specified period with part of their wages (Hemming and Mansoor, 1988b). This arrangement meant that the government had to bear part of the operating risk even after privatisation.

The privatisation process in UK encountered other problems. First, was the implementation process of the privatisation. It was difficult to establish the market value of an enterprise before its sale since the undervaluation of assets could be costly. For example, the British Telecom sale may have costed the UK government as much as £3-4 billion in forgone sale proceed due mainly to the underpricing of issues (Hemming and Mansoor, 1988b). This suggests that where large share issues are involved, the risk of underpricing can be reduced by selling in small lots to establish a trading price before the majority of shares is placed on the market.

Another problem that the UK government encountered was how to ensure that the privatised companies will not exploit their monopoly position by overcharging. For example, the pricing structure of British Telecom before privatisation contained some distortions. The Telecom's tariff structure subsidised local calls at the expense of long distance and international calls, both of which were highly profitable. As technological change rapidly reduced the costs of long distance and international calls, the cost of local calls was held down instead of reducing long distance or international charges. Some of the cross-subsidisation also went to uneconomic but socially desirable

services such as public call boxes. To resolve these issues, it was suggested that several regional companies be established, which would enable the regulatory authorities to compare relative costs. In addition, competitive bidding for the right to operate the companies was also thought would introduce contestability. In the latter case, once the franchise had been granted, the holder would enjoy a monopoly within its area because it was required to bid for the right. These suggestions were, however, not followed by the Government. Instead the Government decided to privatise British Telecom as a single entity but subject to some regulation. The office of Telecommunications (OFTEL) was established to regulate telecommunications and was given the power to licence telecommunication operators. A major problem with the privatisation of British Telecom was therefore the failure to introduce in the industry some form of competition and price and cost structures which could be compared. These regulatory difficulties were attributed to the lack of information needed to make judgements about the costs of the different activities (McKinlay, 1987).

A problem was also encountered in the privatisation of British Gas Corporation. There was a problem of how to break down the monopoly privileges which it previously enjoyed. There was the suggestion that the British Gas Corporation should be broken up into a series of regional distribution companies to ensure that the corporation's monopoly privileges would not be inherited by its privatised successors. Despite this suggestion British Gas was privatised as a single entity (McKinlay, 1987).

Notwithstanding the problems associated with their sale, the privatised enterprises in UK have improved their performance. Managers of some of these enterprises attribute the improvement mainly to the freedom to pursue commercial objectives without government interference in decision making (Hemming and Mansoor, 1988b). The initial sale results were, however, poor

due to the underpricing of the shares. Despite this, the process achieved great success in securing wider share ownership.

(b) **France**

As a means of creating jobs most of the country's large engineering companies and almost all of the major commercial banks were nationalised by the socialist government in 1982. As a result, these industries became overstaffed and inefficient, and their prospects for introducing new labour-saving techniques essential to international competitiveness remained limited. The principal goal of the privatisation programme, therefore, was to widen the share ownership of the enterprise in order to enhance efficiency and competitiveness (Anastassopoulos, 1985). The government saw the privatisation programme as a way of widening the private shareholder base (Vuylesteke, 1988). Against this background, the Chirac government, on coming to office in 1986, began transferring ownership of public assets to private investors. In 1986, the government announced its intention to sell shares in 65 public enterprises, primarily banking, insurance, and the major industrial groups. As Table 2 shows, thirteen enterprises were sold by June 1987, which fetched proceeds of over FF 55 billion to the government (Hemming and Mansoor, 1988b). Saint Gobain (a glass making company), Credit Commercial de France, Elf Aquitaine, Champagne Financiere de, Banque Industrialle, and Agence Havas were amongst the enterprises that were privatised in 1986-1987.

In the case of Saint Gobain, 73 % of shares were offered to the general public, 10 % to employees, and 17% to foreign investors. For Credit Commercial de France, 43 % of the shares were offered to the public, 10 % to employees, 17 % to foreign investors, and 30 % to

institutional investors. In Elf Aquitaine, the shares were reserved for its employees (current and previous employees who have worked for at least five years) a 10 % discount in one deferred payment. In Banque Industrielle and Havas the sale was through both public and private offering to the public and employees (Candoy-Sekse and Palmer, 1988).

The entries in Table 2 also shows that the sale of Saint Gobain, Elf Aquitaine, Credit Commercial de France, and Havas, together yielded FF 18.3 billion while the sale of Banque Industrielle yielded only FF 0.5 billion. The proceeds from the sale of these enterprises were used to repay the public debt and to recapitalize the remaining public enterprises (Hemming and Mansoor, 1988b).

2. Privatised Enterprises in France, 1986-1987

Privatised Enterprises	Nature of Enterprise	Year of Privatisation	Method of Privatisation	Market Price (FF Billion)
Banque Industrielle	Bank	1986	Public offering/private sale	0.5
Elf Aquitaine	Energy	1986	Public offering	3.2
Saint Gobain	Glass maker	1986	Public offering	8.2
Commercial de France	Financial Corporation	1987	Public offering/private sale	4.3
Agence Havas	Advertising	1987	Public offering/private sale	2.6

Source:Candoy-Sekse and Palmer (1988)

In general, the problems associated with privatisation in the UK were largely avoided in France,

except in the case of St. Gobain, where the market discount appeared to have been very small (Hemming and Mansoor, 1988b).

(c) New Zealand

According to Nankani (1988), the public sector's share of marketable activities in New Zealand in the mid-1980s amounted to about 12 % of GDP. Since 1984, however, the government has tried to extricate itself from many commercial activities, with the objective of improving cost efficiency. The debate on public sector performance was triggered by the perceived inefficiencies with the traditional system of Parliamentary appropriation and control of expenditure (McKinlay, 1987). The Labour Government, which came into power in 1984, was confronted with an economy weakened by protectionism, extensive government intervention and suppressed inflation. In addition, large government budget deficits had persisted since the mid 1970s.

The New Zealand approach to reform was different from that followed by the other developed countries. Instead of privatisation, the Labour Government adopted a process of corporatisation. It was believed that corporatisation would provide clear commercial mandate that would enable managers to identify the true costs of producing goods and services and to make their own decisions in response to the demands of the market place (McKinlay, 1987). To this end, the government transformed the state trading enterprises into limited liability companies. The restructuring was thought would be sufficient to overcome the structural problem which had stood in the way of improving the performance of the country's state-owned enterprises. Even after the radical restructuring of the state-owned enterprises, it was still recognised that the public sector has no comparative advantage in supplying commercial goods and services. The corporatised public

enterprises were not faced with the threat of takeover and, therefore, were not subject to full market discipline. The government felt that by selling some of the state-owned assets it could reduce the public sector deficit, which at that time was about 85 % of GDP, and 21% of its spending was used to pay interest on it (McKinlay, 1987).

The main goal of the privatisation programme was to use the proceeds to reduce the large public debt rather than to use the proceeds for increased expenditure or tax reduction. Another goal of the programme was to create a regulatory regime that would promote contestable markets. As a first step in the process the government instructed all the state-owned enterprises to operate on commercial basis with the aim to improve both the financial and service performance while still retaining ownership. In April 1987, nine large government departments were transformed into public corporations. In December 1987, a formal announcement was made that these enterprises were to be sold to reduce public debt. The corporations put up for sale were engaged in sectors such as steel, oil,insurance, hotels, computing services, forestry, banking, telecommunications and airlines. The financial reports for 1988 showed that eight of the nine enterprises were operating profitably, although the rates of return on capital were still below those in the private sector (McKinlay, 1987).

As shown in Table 3, New Zealand Steel and Petrocorp companies were sold in 1987/88, yielding NZ $ 327 and NZ $ 801 billion, respectively. Air New Zealand and Post Office Bank Limited yielded NZ $ 660 and NZ $ 665 billion respectively while Health Computing Service yielded 4,2 billion. The sale agreement for Air New Zealand was signed in December 1988 for NZ $ 660 million, with 65% of the shares sold to domestic buyers and 35% to foreign buyers (OECD, 1989).

In New Zealand, various methods of privatisation were tried, with varying degrees of success.

These included full sales of equity, combination of strategic stake sales, share floats in both the domestic and international markets, full sales to single buyers and to consortia, and sales of rights. New Zealand Steel and Post Office Bank Ltd were sold to private owners, while Air New Zealand and Health Computing service were sold to the general public. Petrocorp were sold through both public offering and private sale.

First, the sale of the enterprises benefited from extensive research by the consortium of partners, who provided detailed information on the financial worth and potential of the enterprises. Second, firm agreements were reached on the details of the sales prior to their announcement.

Table. 3 Privatised Enterprises in New Zealand, 1987-1989

Privatised Enterprises	Nature of Enterprise	Year of Privatisation	Method of Privatisation	Market Price (NZ$'000)
New Zealand Steel	Steel	1987	Private sale	327 224
Petrocorp	Oil Company	1988	Public offering/ Private sale	801 059
Health Computing Service	Computer Service	1988	Public offering	4 250
Air New Zealand	Transport	1989	Public offering	660 000
Post Office Bank Ltd	Banking	1989	Private sale	665 400

Source:OECD (1991)

With the proceeds from the sale, the government was able to reduce the public debt by nearly

12% (Nankani 1988). By late 1988, the extensive privatisation had greatly enhanced the operation of market forces and increased competition, the fiscal deficit had fallen by some 6-7 %, productivity had picked up, and better resource allocation as well as benefits, in the form of more rapid output and employment growth have been achieved (OECD, 1991).

3.3 Developing Countries

(a) Chile

The history of privatisation in Chile has been a troubled one, characterised by government reacquisitions of previously privatised enterprises, some policy reversals and later a string of success. The macroeconomic crisis that confronted Chile in the early 1980s sent many of its industrial and financial conglomerates into bankruptcy. To salvage these companies the government re-took control of most of the enterprises it had sold in the 1970s and absorbed their large debts. The government assumed the management and debt but not the full legal ownership of these enterprises. Between 1985 and 1986, however, companies were sold again to the private sector, although the privatisation of these enterprises was delayed until the companies were restructured and the performance of the economy improved.

Chile's privatisation process has passed through several phases. In the first and second phases, the government sought to undo the socialist reforms of the Allende government so as to bring the public debt under control. In the first phase,(i.e, in 1974), the government returned 325 companies that had been nationalised by the Allende government to their previous owners. In the second phase, which run from 1975 to 1980, the state sold 207 enterprises, mostly acquired during the Allende administration. By the end of the second phase in 1980, the government had reduced

the number of state enterprises from 580 to 48. During this phase, the proceeds of the sale were used to pay the public debt (Pinheiro and Schneider, 1995).

The final phase, which started in 1985, involved the sale of large state enterprises created or nationalised by law. These enterprises formed the core of public enterprise sector. During this phase about 20% of the shares of the enterprises were sold to workers, 50% on the stock exchange, and 18% to pension funds. Foreign participation increased significantly in the 1980s when investors could use foreign debt to pay for privatised shares. The revenues from the privatisation became more important after 1986 when government expenditures had already declined. The proceeds were therefore used to reduce domestic public debt (Pinheiro and Schneider, 1995).

The reform of the public sector was not restricted only to the sale of assets. The government also revamped the state enterprises that remained the public sector, cut personnel, de-emphasised their non-commercial objectives and submitted them to the same rules that applied to private firms. The authorities also allowed the enterprises to increase their prices substantially and subjected new investment to prior central approval.

The instruments of privatisation employed include public auction, sale of shares to small investors, workers and large investors. Public auction was mainly employed in the first and second phases. This mechanism was used because the potential purchasers were generally large entities (large domestic and foreign corporation, employee co-operatives) and few in number. The sale of shares to small investors dominated in the second phase. The primary objective behind this approach was to promote economic democracy through broader participation in the ownership of national assets.

Worker participation in the privatisation process took three forms. They included employee buy outs, share purchases by individual workers, and blocks of shares purchased by organised groups of workers. Employees were usually the first to be offered shares in an enterprise being privatised and they were allowed to use their retirement funds to purchase the shares. Unlike the second phase, privatisation in the third phase involved large and foreign investors and were therefore effected through careful selection of prospective buyers to ensure that they had the financial strength to establish reasonable debt/equity ratios and to function successfully after privatisation.

Table 4. Privatised Enterprises in Chile, 1985-1986

Privatised Enterprises	Nature of Enterprise	Year of Privatisation	Method of Privatisation	Market Price (CP .'000)
Banco De Chile	Commercial Bank	1985	Public offering	228 000
Emec	Electricity	1986	Private sale	609 000
Lan Chile	Airline	1986	Private sale	38 100
Ecom	Computer Services	1986	Employee buy-out	300 000
Telex Chile	Telecommunicatio ns	1986	Private sale	2 400

Source:Candoy-Sekse and Palmer (1988)

Chile's privatisation programme was extensive, covering not only enterprises in competitive sectors producing tradable goods like steel, textiles, fertilizer, and sugar, but also enterprises in monopolistic

markets, such as the electricity and telephone companies (Galal and Shirley, 1994).

Table 4 shows that enterprises that were privatised in the mid-1980s included Banco de Chile, Commercial Bank, Ecom , Telex Chile , Lan Chile, and Emec. In 1985, Banco de Chile was privatised through public offering, with the sale of shares to small investors, while Ecom, (a computer firm) was privatised through the sale of shares to employees. Both Telex Chile (telecommunications), Emec (electricity) and Lan Chile (airline) were privatised through private sales. The sale of Banco De Chile and Ecom yielded CP 228 and CP300 billion, respectively. Telex Chile yielded CP 2.4 billion, while Emec and Lan Chile yielded CP 609 and 38.1 billion, respectively.

(b) **Malaysia**

Privatisation in Malaysia began in 1983, with the initiation of a new policy of co-operation between the government and the private sector. This policy stemmed from the disappointments with the performance of the state-owned enterprises in the 1970s.

By the end of 1982, it had become clear that heavy participation of the Malaysian government in the economy could no longer lead to sustained economic growth. The new regime which came into office in 1981 was confronted with a severe and worsening fiscal crisis and balance of payments disequilibrium. In addition, external price shocks led to a marked deterioration in macroeconomic performance and debt crisis. In the face of these crisis, it became clear that loss making public enterprises could no longer be supported by government resources. As a result, the government began in 1982 to focus on two sets of corrective measures. The first category of reform aimed at a number of structural problems, such as the unsatisfactory performance of public enterprises and rigidities in wage and pricing policies. The second set initiated a fundamental reassessment of the public sector's

role, with the aim of reducing both the level and scope of public spending (Staatz, Dione and Dembele, 1989). Privatisation, thus, became an important component of the new strategy.

The privatisation process in Malaysia was aimed at relieving the financial and administrative burden of the government, promoting competition, improving efficiency, and increasing the productivity of the services. In addition, the process was expected to assist in reducing the size of the public sector and the level of government borrowing (Cook and Kirkpatrick, 1995). To this end, some public enterprises were restructured to improve their financial performance, while others became candidates for complete divestiture.

Another important goal of the privatisation in Malaysia was the redistribution of economic power. To achieve this objective, special guidelines were developed to ensure that employees did not lose the benefits they held and also were absorbed into the divested firms under terms "no less favourable" than those they previously enjoyed.

According to Table 5, public enterprises that were privatised in the 1984-1986 period include Malaysian Airlines System (MAS), Jabatan Telkom Negara, Port Kelang Container, Keratapi Tanah Melayu, and Recreation facilities. As the table shows, the sale of Port Kelang Container, Malaysian Airline System and Jabatan Telekom Negara yielded M$ 700 billion, M$ 44.8 billion and M$ 6.2 billion, respectively, while Keratapi Tanah Melayu yielded M$ 1 billion.

In both MAS and Jabatan Telekom Negara, public issue of shares was used to privatise them. Some shares were also offered to some institutions investors, leading to the sale of about 5% of MAS to the Brunei government in 1986.

Contracting out of public services previously provided by the public sector was also adopted. For example, the various local government authorities' activities, such as parking services and

garbage disposal, telecommunications development, and Port Kelang's container terminal services were contracted out.

Table . 5 Privatised Enterprises in Malaysia, 1984-1986

Privatised Enterprises	Nature of Enterprise	Year of Privatisation	Method of Privatisation	Market Price (M$.'000)
Recreation facilities	Park facilities	1984	Lease	
Malaysian Airline system	Airline	1985	Public offering	44 8 00
Port Kelang Container	Container services	1985	Private sale/ lease	700 000
Jabatan Telekom Negara	Telephone, Telex	1986	Public offering	6 2 00
Keretapi Tanah Melayu	Railways	1986	Private	1 000

Source:Candoy-Sekse and Palmer (1988)

In areas where the public sector previously enjoyed a monopoly an attempt was made to introduce some competition. The launching of a third television channel (TV 3) in 1984, for example, was aimed at introducing competition into television broadcasting (Cook and Kirkpatrick, 1995). Schemes to draw private financing into construction projects were also made available. Such projects as the North Port Kelang toll road bypass, Japan Kuching toll flyover and North-South Highway as well as the low-cost housing scheme, were some of the projects which attracted private financing.

The sale of shares via a public offering was used in the partial privatisation of the Malaysian Airlines System (MAS). In the case of MAS, the government retained 42 % of the shares, while

10% was sold to other public enterprises, 10% to state governments, 5% to employees, 15% sold on the stock market, and the remaining 18% to foreigners. Although the privatisation of Malaysian Airlines Systems was significant, in terms of the reduction in government ownership, it did not result in increased competition or significant changes in the operations of the company because of the countries aviation policy that gave the government the veto power.

The privatisation of the container terminal at Port Kelang was initially made through a combination of an outright sale of movable assets, leasing of immovable assets, and a management contract. Two years later 49% of the shares were sold to the old port authorities, 41% to a general transport company, and 10% to an Australian shipping company. According to Galal and Shirley (1994), the overall profit of the enterprise after privatisation rose from about 2% a year to about 12%, productivity growth jumped from about 5% to 18 % annually, and real wages rose by some 70%.

Like in other countries, the privatisation in Malaysia had its own problems. First, the significant increases in consumer prices for privatised utilities or soon to be privatised utilities, services, and infrastructure were reluctantly accepted by consumers. For example, the unit charge for local telephone calls was increased by 30% just before System Television Malaysia Berhad (STMB) was incorporated (Cook and Kirkpatrick, 1995).

Second, the privatisation process did not involve the formalities of an open tender system, as sanctioned by the official "first come, first served" policy. Therefore, many beneficiaries of privatisation in Malaysia were believed to have been chosen on the basis of political and personal connections (Cook and Kirkpatrick, 1995). For example, in 1986, it was announced that M$1.4 billion worth of supply projects involving 174 schemes had been awarded to Antah Biwater, without

an open tender (Cook and Kirkpatrick, 1995).

Third, most public sector employees were threatened by the privatisation of the state enterprises but the government ensured employment security for five years and offered better service terms and conditions as inducements to workers not to resist privatisation. The workers were also given the option of continuing with the government's scheme of service or accepting the new company's scheme.

The privatisation in Malaysia claimed several successes. The first were the efficient gains, improvements in television broadcasting and telecommunication services, and reduction in the average vessel turnaround time at the Kelang Port Container. Second, the processes stimulated economic growth by providing greater opportunities to the private sector. For example, TV3's stimulated domestic film making and advertising and encouraged private entrepreneurship. Third, was the reduction of the government's administrative and financial burden. Through the process the public workforce was cut by 54,000. This saved the government between M$ 40 and M$ 60 million per year of development expenditure. Proceeds from the sale of government properties were estimated at M$1.18 billion, while revenues from taxation of the private operations and leases of government property were enhanced. Lastly, the privatisation is claimed to have improved the wealth redistribution objective, since the process had involved at least 30% of citizen's participation.

(c) **Algeria**

The Algerian policy toward the private sector followed by a succession of laws since independence. These laws outlined a set of objectives which included, among others (i) employment creation; (ii) complementing the public sector in the transformation of industry;

(iii) subcontracting activities; and (iv) filling the gap in regional development. For a long time, the private sector was ignored in Algeria.The existence and importance of the private sector in economic activity was seen mainly in the oil sector. Other private enterprises invested in short-term productive activities. Since the nationalization of foreign oil companies in 1967, oil income and external borrowing became the only sources of funds for private investment. Because the volume of private investment did not measure up to the government's expectation the public enterprises began to replace the deficient private enterprises. As the oil income depleted, the logic of the state control of economic activity was questioned.

Boukaraoun (1991) describes the Algerian economic system as one of state capitalism. Algerian public corporations have been required to be profit - making entities, and their operations regulated by civil and commercial laws. The public deficits they registered, however, led the government to implement a restructuring policy in 1980-1985. Another reason for the public sector restructuring in 1980-1986 was to increase efficiency and productivity in order to reduce the country's high dependency on foreign markets. The economic reforms were intended to make public corporations efficient and profitable. To start with, the government leased to individual farmers for perpetual use the lands it had nationalized in 1971 and all other factors of production were sold off, making them untransferable. In July 1988, a new law was promulgated to facilitate the promotion of private investment. The bureaucracy pushed for a policy of liberalization by (i) encouraging the private sector, (ii) undertaking extensive economic programmes, and (iii) emphasizing the privatisation of public enterprise management (Boukaraoun, 1991).

The privatisation process followed several steps. In 1981, the state sold the entire real estate it inherited after the departure of the French landlords. In 1987, the agricultural sectors were

entirely reorganised. This involved the privatisation of the state farms, which accounted for some 2.5 million hectares, or one-third of the country's cultivated acres. Public enterprises were rid off from the former bureaucratic tutelage and transformed into commercial enterprises. In 1990, shares of public corporations were allowed to be sold to workers.

CHAPTER 4

LESSONS TO SOUTH AFRICA

4.1 Introduction

It would not be possible to replicate a particular blueprint for the wholesale distribution of state assets. Each country needs to search for alternatives that best fit its particular legal, economic, social and political environment. Nevertheless, it is possible to identify some general requirements or conditions that any privatisation plan should satisfy if it is to produce an efficient market system.

A successful privatisation initiative should create conditions for the achievement of two essential objectives. First, it should create a management/ownership structure conducive to profit maximization. This condition is necessary to ensure that the price and market reforms needed to achieve an efficient resource allocation in the economy are successful. Second, the privatisation initiative should avoid potentially serious fiscal problems for the government. These problems could arise either because of the loss of incoming dividend flow or as a result of a sharp reduction in direct tax revenues from the privatised enterprises (Borensztein and Kumar, 1991). In South Africa, where political and economic discrimination have marginalised many people, any privatisation plan should in addition, aim at addressing the issues of poverty and racial inequalities.

4.2 Prospects

Job creation, provision of quality health services, housing and education are some of the basic needs of many South Africans. Meeting these basic needs is not simple because although South Africa has one of the strongest economies in Africa, its income distribution is skewed in favour of the white minority. The poorest 40% of household earns less than 6% of total income, while the richest 10%

(predominantly white) earns more than half (McGregor and McGregor, 1987). By carefully designing a privatisation process, therefore, the imbalances in the distribution of income and wealth can begin to be addressed.

Another dimension of the South African situation is that about 35% of all spending in the country is undertaken by the government. In 1996, the government spent R31 billion more than it raised from taxes and other incomes. In the same year, the government spent some R34.4 billion as interest on public debt. According to Mail and Guardian (July 19-25, 1996) interest payments on new debt alone would cost R63 billion by the year 2000, pushing up the country's total debt to R478 billion. To both the government and the business community, the solution to the fiscal crisis lies in selling some of the public assets to the private sector, thereby reducing the size of the public sector.

Privatisation appears to hold more potential for successfully alleviating poverty and encouraging economic growth. According to Leach and Vorheis (1990), the government has been subsidizing unprofitable public sector enterprises for decades. If these enterprises are privatised it may reduce the public sector borrowing requirements. The World Bank (1993) also conceives that to overcome the many poverty related problems of the country, the revival of the private sector is crucial. Vast amounts of capital will be needed to address inequalities in the society but this cannot be raised through nationalisations, because the very process of nationalisation will impose big financial burden on the government.

Given the difficulties to resist pressures to increase public expenditure on social services, it seems that public spending is likely to increase. But the scope for financing this increasing public expenditure through higher taxation or through borrowing seems rather restricted. Meanwhile, the gap between expenditure and revenue needs to be narrowed. Raising revenue

through selective sale of state-owned assets seems the only viable option available to the government. Already, one can point to one major example of successful privatisation in the country, i.e., the privatisation of Sasol.The privatisation of Sasol in 1979 witnessed an oversubscription of shares, and achieving of the profit targets. The privatisation of Iscor in 1989 also generated substantial proceeds which were used to redeem part of the public debt (McGrath and Holden, 1990).

It is believed that considerable scope for privatisation exists in the country. In the housing sector, for example, the availability of private financing of home ownership within the residential reservoir would have a stabilising effect upon the economy. Although subsidised state loan schemes do allow for home ownership, nevertheless if these schemes could be privatised the need for funding from the government would not arise (McGregor and McGregor, 1987). It is also believed that considerable scope for privatisation exists in the health sector. Further, the benefits of greater private involvement in education are recognised. Though it is feasible for the state to dispose off educational assets to generate revenue, it is possible to restrict and even reduce the taxpayers commitment to education by transferring some of the responsibility to the private sector. The private sector can supply cheap and efficient education and training than the state. Many services in these sectors can be contracted out. Indeed, contracting out would create openings for the emergent black enterprises, thereby contributing to the empowerment of those that were previously disadvantaged.

Considerable scope also exists for privatising many of the state enterprises. Much of the distribution network and functions of Escom, for example, could be privately-owned or operated, which would reduce the company's administrative and financial liabilities. No cross-subsidisation would take place as consumers would pay the real cost of electricity consumption. Electricity also

would enter into competition with alternate forms of energy, such as liquid fuel, gas and solar power. In the case of Spoornet, carriages, freight trucks, and engines could be leased to the private sector. Trains could book track and stations time as airlines use airport facilities and shipping companies use harbours. The privatisation of South African Airways, for example, would enjoy the support of the existing staff and management if they could be given generous price preference. Alternatively, some shares could be sold to the existing management and employees at a discount and the rest to foreign investors and the general public. This would bring about a wider redistribution of wealth in the country.

There are other important lessons to be learnt from the privatisation of British Airways. First, the British Government elected to privatise British Airways as a single entity although it had a range of options. For instance, the government could have either split the ownership of the routes from the business itself, i.e., the government could have retained the ownership of the routes and leases them to British Airways or put the various routes out to tender, thus permitting the emergence of competitors. If the government of South Africa could lease its routes to the Airways companies, the monopoly returns made possible by restricting access to those routes will accrue to the taxpayer rather than to the Airways and its shareholders. Alternatively, if it sells the airline along with its routes that will produce the highest immediate return.

Other important lessons could be learnt from the international experience of privatisation. First, there should be co-operation between the existing management for privatisation to succeed. Where the previous state-owned enterprise is a monopoly its management may be the only people available, at least in the short term, who knows the business well enough to run it, have information and many other skills. Further, a successful sale of shares in a state-owned enterprise requires considerable

promotion, therefore senior management will be required to make presentations to potential investors and answer their questions.

Second, public services could be exposed to market forces by putting them out to tender. For example, the Government of South Africa can require the national health services to put out cleaning, laundering, and catering services to tender, and the local governments could similarly tender refuse collection. This process could, however, lead to conflicting opinions between public sector unions and proponents of the competitive tendering process. The public sector unions may resist the tendering process because of the fear that it will result in a reduced level of employment, exploitation of workers, and corruption in awarding the tenders. In dealing with such conflicts, the government must ensure that privatisation process is made as transparent as possible. The tendering processes could be opened to private sector firms, public sector units currently doing the job, and where the workers so wished, to worker co-operatives made up of the former employees of the public sector units.

4.3 Potential Problems

The possible danger of privatisation is the rapid squandering of capital gains from the sale of assets (McGregor and McGregor, 1987). Occasionally the debate on privatisation reveals that this is one of the greatest dangers of the process, namely, the possibility of a huge one-off capital gain to the public sector when it actually sells off a particular asset.

In South Africa, most state-owned corporations are protected by laws to maintain their monopoly status. Privatisation without deregulation will therefore mean changing from a state-owned monopoly to a private sector monopoly.

There are also the institutional or attitudinal obstacles to privatisation. Worldwide plans to privatise state enterprises have led to clashes between trade unions and governments. Resistance to privatisation may also come from some public servants holding managerial positions. To trade unions and public servants, privatisation means a loss of worker's rights and power, patronage and prestige. South Africa is no exception. The trade unions, such as Post and Telecommunication Workers Association (POTWA), have opposed any sale of state assets (Business Times, February 25,1996). Against this background, it is important to allow trade unions to participate in the planning of the process and be advised to focus their attention on how to make privatisation most effective rather than opposing it.

Experience from Britain suggests that governments should privatise public enterprise (s) through an offer of shares to the people who had worked for the corporation. In Britain, the principal union representing employees, such as the transport and General Workers Union, opposed the sale of National Freight Corporation. Despite their opposition, more than 50% of the employees subscribed for shares (McKinlay, 1987). Further, the British government's policy of requiring local authorities to put various activities (such as cleaning, catering, building maintenance) out to tender in 1984 met substantial opposition from the public sector unions). The success of the contracting out process in Britain was due to the fact that the tenders had included worker co-operatives or worker-owned firms formed from amongst the current and those retrenched from the affected enterprise. Also by putting the enterprises out to tender, the government exposed the public services to market forces (McKinlay, 1987). If the Government of South Africa can follow this process, it could give rise to considerable savings.

Another related problem is that, unless the status quo is maintained in the privatised concerns

and payments of severance packages are offered, unions are likely to show resistance to privatisation. Participation should, therefore, go all the way to include all the relevant trade unions and other worker representatives in the negotiation process. Also important are programmes to educate the public about the process, its effects, and costs of employing redundant workers in the state enterprise as well as their severance packages (Shirley, 1988).

An important feature of privatisation is that it is slow to get off the ground. Part of the explanation for this slow progress is related to the few enterprises that are usually suitable candidates for privatisation, the practical difficulties in effecting process and the sociopolitical obstacles to carrying through this type of programme. Besides, resources are often not available to finance privatisation or interested buyers may be unacceptable. In the case of South Africa, many of the most inefficient loss-making entities, such as Transkei Airways, may not be attractive to the private sector.

Another problem with privatisation is the pricing of the assets for sale. In some cases, some assets appear to have been transferred to private interest at less than market value and the privatisation has usually been partial. Hemming and Mansoor (1988b) point out that even in a sophisticated financial environment, where shares are routinely traded in large volume and high quality advice are readily available, it is difficult to establish the true market value of some enterprises before their sale. They argue that the valuation problems are likely to be compounded in developing countries. In these countries neither the private sector nor the capital market is sufficiently developed to yield even an approximate valuation. And even where a market value can be established, the thinness of domestic capital market necessarily places limits on the ability to finance privatisation from domestic resources. However, this is unlikely to happen in South Africa

because of its well established capital market.

CHAPTER 5

CONCLUSIONS

5.1 Major Findings

This paper reviews literature on privatisation with a view to providing some insights into the issues, processes and problems of the process. The study also examines the privatisation experiences of some industrial and developing countries to bring out some lessons to South Africa in its attempt to privatise some of its state assets. The major findings of the study are as follows:

First, the sale of public assets generates capital revenues which, may supplement current revenues and temporarily offset the deficit in public accounts. In addition, there may be a permanent gain if the process leads to restructuring of activities or public sector assets and liabilities so that, once privatisation is concluded, the deficit will decrease or the surplus will increase.

Second, at the macroeconomic level, privatisation can increase efficiency due to enhanced competition, additional investment; and less state interference in economic activities that accompany the process. At the microeconomic level, it is expected that efficiency will rise under private control due to greater clarity of objectives and greater discipline compelled by the market.

Third, privatisation leads to productivity gains. The gains come from three main sources: the reorientation toward commercial objectives; increased supervision of the performance of management; and increased competitive pressure, which privatised enterprises are exposed.

Fourth, the major problems of privatisation are found to often come from the implementation of the process. There is a fear of job losses by their members. The process is also open to political opposition, arising from the fear of economic concentration in the hands of few rich individuals, or large shareholders who would manage to buy the state enterprises sold. It is also feared that the

privatised enterprises may enjoy significant powers of monopoly and public regulation may be too ineffective. There is also an important problem of deciding on the sequence of the privatisation programmes i.e., whether an enterprise is to be privatised fully at one go or the process is to be phased out; whether there should be permanent public holding of equity in the enterprise; and whether the public should represent a majority share or a minority share. The question of who buys and at what price is also a major issue in the privatisation of the state assets.

Notwithstanding these problems, international experience shows that it is possible to undertake a successful privatisation programme. Through special participation incentives for small investors and employees, as well as through participation by large domestic and foreign investors it is possible to undertake a broad-based privatisation. In many countries, the privatisation occurred in an economic environment in which competitive forces, both domestic and international, were allowed to improve the prospects for growth. In addition, the longer-term gains of the process can only be unleashed if the mix of sectoral policies is appropriate. Much more importantly is the policy sequencing. While policy sequencing issues are very difficult to generalise, country experiences seem to suggest that privatisation efforts are likely to run into difficulties and not to yield their potential longer-term benefits unless they are preceded by macroeconomic and sectoral policy reforms, such as stabilisation, deregulation and liberalisation.

The government of South Africa has indicated its intention to reduce its involvement in certain areas of economic activity. Despite the likely institutional or attitudinal obstacles likely to emerge from the public servants and trade unions, in particular, privatisation can bring various socio-economic and political benefits to the country. Privatisation appears to hold more potential for a successful alleviation of poverty and encouragement of economic growth. The proceeds from

the sale of the state assets can go directly to increase government revenue, which in turn would help to reduce the public debt. Successful privatisation could offer scope for reducing taxes, which can have a beneficial supply-side effect. Privatisation may also provide opportunities for the provision of basic infrastructure and services, such as housing, health and schools in the historically disadvantaged countries. The disposal of state enterprises to existing employees and the black communities offers scope to spread share ownership, thereby empowering the previously marginalised class.

Privatisation, however, cannot be effective unless there is a viable implementing strategy. Such a strategy would have to start with privatising government functions at the provincial level, after the boundaries between localities have been dermacated. The second step is to move to easy projects such as refuse collection, cleaning services, catering services, building maintenance, etc., that are more likely to succeed so that these can have a positive demonstration effect to encourage entrepreneurs to support further privatisation and overcome the likely opposition from interest groups. The third step is to privatise larger national projects such as Telkom, Escom, South African Airways, etc., after a careful cost-benefit study involving the participation of the government, employees, employers, trade unions and the public at large, to create a bargaining situation and produce outcome that is acceptable to all.

There are also other issues of concern. First, whatever the reason for partial rather than full privatisation - political constraints, income distribution, economic circumstances - the gains can be substantial if the process is carefully planned. Some sort of central administrative unit is usually needed to promote or oversee the privatisation process and keep decision makers informed. This will require special skills, and often experts, to assist in the detailed work of process.

The experience of other countries is that if the domestic capital market is not sufficiently developed other alternatives will have to be explored. For example, a privatisation 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. Alternatively, workers could give up their termination benefits or part of their accrued pension rights for shares in the privatised enterprises. The experience of other countries also shows that the best method of sale is to fully privatise the enterprise and to avoid a direct share market sale. The partial sale of shares in Petrocorp in New Zealand, for example, illustrates some of the difficulties. In the case of Petrocorp, it was found that the private sector minority shareholders were in a good position to influence management and thus influence future share sales in a direction contrary to the public sector goals at the time. Private interests thus led the business to take higher risks than the government would take on its own. The partial privatisation also made it difficult to change the regulatory environment due to conflicting private and public interests. To get the best value for the taxpayer, therefore, it is necessary to ensure that foreign bidders are attracted into the sales process. This will remove the pricing of individual blocks of shares from the pressure of the political process and eliminate underwriting problems for the government (Jones, 1991).

Shirley (1988) points out that the immediate visible social costs of privatisation, such as unemployment, closure of plants, and cutbacks in services can be severe in the short run, while the growth of benefits and increases in employment and investment do not appear until the medium term. Preparation for the negative consequences includes, among other things, severance packages for redundant employees, retraining and redeployment programmes, and special lines of credit to assist laid - off workers to start their own businesses. The need for a careful redrawing

of boundaries between public and private ownership within the context of a carefully designed sectoral policy framework is required before privatisation is commenced. Otherwise policies of unrestrained privatisation could end up being counterproductive, often leading to the transfer of a public monopoly to private sector. Designing a strategy for privatisation and classifying state enterprises according to the type of action that should be implemented to liquidate or privatise them, have been a useful step in clarifying the government's objective and approach. Government must be aware that their attempts to rationalize and regulate privatisation can and often do bring the process to a halt.

Another important issue of concern is related to openness and public confidence. Experience shows that the merits of privatisation will be debated regardless of whether information is hoarded or released. The challenge is to make the process transparent and the debate an informed one. The public should know more, for example, about how much implicit and explicit subsidizing goes on with state ownership and about costs, including forgone activities of such ownership. The fact that transition costs will be paid regardless of ownership should be clarified, and if excess labour has to be laid off that too should be made known. In general, the privatisation debate is more about costs. Unemployment, increased imports, liquidation of seemingly modern enterprises are some of the major issues of the public's concern.

To boost the momentum of privatisation process it is important that both the private and public sector develop greater understanding for the process and its problems and attempt to offer collective solutions to them. In this way, the suspicion of the government's ability to undertake a bold and transparent privatisation program can be removed. The privatisation goals must be clearly formulated and their association with economic growth and development spelled out. These

goals should be quantified in terms of results to be achieved in the short term and in the long term.

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