# Privatisation & Public Private Partnerships

PRODUCT: 4343 | COURSE CODE: C211 | C311

**Privatisation and Public Private Partnerships**



SOAS, University of London

First Published 2005, revised 2009, revised 2013

# Privatisation and Public-Private Partnerships

# Course Introduction and Overview

## Contents

# 1 Introduction and Learning Objectives

Welcome to the course *Privatisation and Public-Private Partnerships*. We hope that you will find the course stimulating and useful.

When you have completed this course, you will be able to

- discuss the variety of experiences of privatisation in a wide range of sectors and countries
- discuss the reasons for the emergence, decline, and resurgence of interest towards privatisation over the course of the last decades
- judge the desirability of privatisation in different circumstances
- advise on appropriate methods of privatisation for different policy objectives
- evaluate the results of privatisation
- advise on contractual arrangements between governments and private and voluntary sector service providers
- explain public-private partnerships (PPPs), how they can be organised to produce value for money and the potential pitfalls
- make a judgement on the future of the relationship between the public and private sectors.

The course covers a very contentious area of public policy and management. There are technical arguments about the effects of privatization policy but also beliefs that are strongly held by politicians, managers, workers, consumers and citizens about the policy and about the details of its implementation.

# 2 Course Content — Alternative Narratives

### First narrative: conspiracy theory

There are at least three alternative narratives about privatisation and PPPs. One starts in Chile with the overthrow of the elected government by a military regime led by General Pinochet in 1973. Pinochet's government was strongly influenced by the 'Chicago school of economics', associated with Milton Friedman at Chicago University and supported by US foreign policy. The overall policy was that the state should be as small as possible and the market sector should dominate all aspects of life. Public finances should be run in such a way as to minimise taxation. The state should withdraw from all productive sectors in primary and secondary industries and services that can be provided in the market. It should use the private sector as much as possible to provide whatever residual collective services remain, including pensions provision.

Where the policy was implemented, industries and services were sold off, often to the supporters of the regime, providing new opportunities to make profits. This approach was taken up wherever right-wing governments came to power whose politicians shared the Chicago view. The United Kingdom, under Margaret Thatcher and John Major's Conservative governments, was an early adopter of the new polices, selling off publicly owned industries. A right-leaning Labour government in New Zealand was soon to follow suit. The idea was readily adopted by the Bretton Woods Institutions: the World Bank and International Monetary Fund. Conditionality attached to loans from the World Bank and the IMF included not only restrictive macro-economic policies but also instructions to divest state-owned enterprises.

When the Communist system collapsed in Russia and Eastern Europe, a similar policy path was followed, partly voluntarily adopted by the new governments and partly promoted by the European Bank for Reconstruction and Development. The resulting transfers of ownership benefited either multi-national corporations that came in to buy up the industries or local buyers who managed quickly to accumulate large holdings of previously state-owned assets and who were often linked to the new political leaderships.

Once the process spread from privatisation of primary and secondary industry to infrastructure and public utilities, a similar pattern emerged. National telecommunications companies became vulnerable to take-over from multinational corporations. Electricity generation and water and electricity distribution were also privatised, especially in Latin America, and those companies became dominated by a few multi-national corporations in a position to bid at privatisation time or later acquire the successful bidders.

This narrative sees the whole process as a conspiracy, underpinned by ideological academic work, especially by economists, resulting in the accumulation of fortunes by a small number of world players. A version of this narrative, by Naomi Klein[1], further argues that proponents of privatisation stay vigilant in their search for opportunities to pursue their policies after wars and natural disasters. For example, the control of schools in New Orleans after their destruction by hurricane Katrina was transferred from School Boars to private institutions.

### Second narrative: liberalisation

A second version takes an opposite view. The post-war world in Europe and the post-independence world in Africa were dominated by a statist ideology, much of which also applied in Latin America. The state was seen as the best umbrella institution to carry out post-war reconstruction on the one hand and economic development on the other. Communist rule was just an extreme version of this ideology. Failed state-owned enterprises were unable to turn themselves into profitable, responsive organisations because of the vested interests that had built up within and around them: workers had secure employment, management could provide a solid base of political support for ruling politicians, company cash-flow could provide a range of benefits for politicians and their clients.

Because of the rigidity and inertia in the companies, nothing could be done to improve their performance other than sale to the private sector. Their continued existence drained public resources where losses were made and

1 Naomi Klein (2008) *Shock Doctrine*, New York: Picador.

led to a distortion of resource allocation in the economy as a whole as tax and profits were diverted from their best use. The same applied to public utilities and other public services, including, where applicable, education, health care, transport etc.

Once politicians realised that the statist ideology had been perhaps appropriate briefly following war or independence, but then a brake on development and economic growth, there was no alternative but to privatise and liberalise, releasing the power of market forces and restoring the allocation of investment to where it could make its highest return. Linked to this ideology was the train of thought from Hayek[2] and others that political freedom was inextricably bound up with free markets: once the state allocates resources through a political process, the politicians in control of the state take power away from citizens – the market is the only way for people to take that power back.

Hence privatisation becomes more than a way of improving economic performance: it becomes central to the spread of 'freedom'. According to this narrative, the speed of the spread of privatisation was simply a matter of people realising what a good idea it was. They may have started with small and easy-to-manage sales, but once they realised what a good idea it was, everything would eventually be privately owned, markets taking care of an increasing proportion of resource allocation. Any resistance to the idea resulted only from vested interests.

### Third narrative: pragmatic adjustment

A third narrative is more pragmatic. Leaving aside the few cases of extreme ideology by right-wing demagogues, governments at various periods have been faced with some difficult choices. The fiscal problems that many governments faced following the first oil shock resulted in a desperate search for sources of revenue other than taxation. Asset sales enabled governments to get closer to balancing their budgets without such large increases in either taxation or borrowing as would otherwise be necessary. Selling to the public assets that they already owned through the state seemed like a very good way to raise funds. It had the extra benefit of reducing the fiscal drain if the asset was loss-making. State-owned car companies requiring heavy subsidies were justifiable only on short-term grounds of avoiding job losses. Loss-making airlines could be justified on grounds of national prestige and 'flag-carrying' only to a certain extent when states faced fiscal crisis.

According to this version of events, the origins of privatisation were pragmatic and the more elaborate justifications came later. The spread of the idea to utilities and public services was also pragmatic: efforts to improve management of public services were sometimes more successful than others and there had been a long history of examples of contractual, concession or

2 Friedrich Hayek's book, *The Road to Serfdom*, published by Chicago University Press in 1944, linked totalitarianism with state control of the economy and proposed small states and free markets. The book was influential on governments and the school of economics, centred on Milton Friedman, which became known as the Chicago School.

private provision. French water distribution, United States prisons, Danish emergency services, private telecommunications companies all provided examples of how companies could run services that were directly provided by the state in other places. They also provided people willing to make the case for privatisation.

The financial crisis of 2008–09 required more pragmatism from governments. The US government resorted to subsidies for banks and the renationalisation of the two largest mortgage lenders as responses to the collapse of the credit system. The United Kingdom government bought a large bank, Northern Rock, and majority shares in others for similar reasons. Whether these extraordinary reverses will be seen by historians as a turning point in government attitudes to public ownership or a temporary pragmatic response to a crisis remains to be seen.

### Your interpretation

Students of privatisation have to bear these different narratives in mind when studying the topic. Studies commissioned by institutions in favour of privatisation are susceptible to selective sampling to pick more examples of successful privatised companies than failures. Opponents will find examples of poor people being denied access to water and electricity after privatisation to oppose the whole process. As you work through the course you will read examples of both, as well as some attempts to be 'objective'. It is not the purpose of the course to press one or other of the narratives, rather to engage you in a range of arguments, evidence and case studies to help you to form your own view.

Of course, that is only one purpose of the course. Few students will be heads of state or governments, asked to make the choice of whether to privatise or not. For those working or intending to work in advisory and executive positions, or act as politicians, there are many second-order questions and choices. The processes of privatisation, contracting out and PPPs can have a variety of consequences. The way sales are carried out and contracts written, the regulatory environment created and the institutional arrangements in general can have profound influences on the efficiency of the industries and services, the distribution of benefits, the impact on the workforce and on the users of public services.

While it is impossible to offer comprehensive coverage of the whole planet's experience of privatisation in one course, we will draw on examples from a variety of places, to show the importance of the economic social and political context to the choice of whether or not to privatise, the choice of methods and the consequences of the decisions. You will be exposed to a variety of examples, including how the Mozambique government reversed its policy towards state enterprises, how oligarchs in Russia managed to privatise profit streams before accumulating assets, how the British government privatised the railways and the consequences of that, how the Kenyan government successfully created a private airline in Kenya Airways, how private companies make money from Public-Private Partnerships, how the Rwanda government sold its state-owned enterprises.

# 3 The Structure of the Course

The course is structured in the following way. Units 1-4 are concerned with privatisation, in the sense of the sale of state-owned assets to private buyers. The first two units include a survey of the scale and scope and methods of privatisation used, in the OECD countries, Africa and Latin America. As well as being descriptive, these units also raise fundamental issues about the policy objectives of privatisation and the methods used. Unit 3 turns to the impact of privatisation, on enterprise efficiency, on economic performance and on the welfare of the populations, including the workforces of the privatised organisations. Unit 4 allows you to apply your own analysis to three case studies: British Railways, Kenya Airlines and the mass privatisation in Russia. It also introduces the attempts by the Tanzanian government to privatise water supply in Dar Es Salaam.

Units 5–8 are concerned with procurement, contracting out and Public-Private Partnerships. They deal with two sets of ideas about how to manage the relationship between governments and service providers and look at case examples of how these ideas work in practice. The course ends with some questions about the future of privatisation.

## The Units

## 4 Course Author

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Programmes at CeFIMS. He has also been Chair Professor of Public Sector Management at City University of Hong Kong and has held academic posts at London School of Economics, London Business School and the University of Birmingham.

He has written about public sector management in the United Kingdom, Europe and Asia, public sector reform in developing countries and about the relationship between business government and society in Asia. Recent books include *Public Sector Management; The Market and Social Policy in China* (edited with Linda Wong); *Miracle to Meltdown in Asia: Business, Government and Society*, and (with Franz Strehl) *Public Sector Management in Europe*.

Further publications are listed on his website: www.normanflynn.me.uk

The revision of the course has been updated by **Alberto Asquer**, the Academic Director of the Public Policy and Management Programme. After a degree in Economics at the University of Cagliari and a Research Doctorate at the University of Salerno in Italy, he did a MSc Management and obtained a PhD (with a thesis on the implementation of regulatory reform in multi-level governance systems) at the London School of Economics. Before joining SOAS, he taught financial accounting and management control in public sector organisations at the University of Cagliari, Italy. His studies on regulatory reform of infrastructure, privatisation and liberalisation of utilities, and organisational change in public sector organisations, have been published in *Governance, International Public Management Journal, International Journal of Public Administration, Utilities Policy, Water Policy, and Competition and Regulation in Network Industries.* He is also chartered accountant and accounting auditor in Italy.

The authors would also like to acknowledge the work done by **Colin Barnes,** a development economist with Masters' degrees in agricultural and development economics from the Universities of Reading and East Anglia (UEA) and a PhD from the University of Manchester. His thesis analyses the macroeconomic and social impacts of privatisation with special reference to Portugal. He is an associate fellow in economics at Leeds University Business School.

# 5 Course Materials

## Readings

The Organisation for Economic Co-operation and Development and the World Bank (and Inter-American Development Bank and Asian Development Bank) have commissioned and carried out a lot of work on privatisation. While this work comes from a perspective of general support for privatisation, it is a major source of both information about scale and scope and ideas about processes. Two booklets from the OECD, on the OECD countries and on Sub-Saharan Africa, are included in the course. World Bank studies on impact are also included, as are other readings, some of which come from different points of view. Case studies come from various sources, including one commissioned for this course.

You also have a Course Reader with several articles and reports on different countries' experience of privatisation, and different participants and scholars' views on the matter.

In Unit 7 of the course, you will read some chapters from *Public-Private Partnerships*, by Darrin Grimsey and Mervyn K Lewis, and in Unit 8 you will study IMF guidance on PPPs and work through some case studies.

In several of the exercises in the units you are invited to submit summaries of your answers to the Online Study Centre, and you are urged to do this, to start a dialogue with fellow students and to share your ideas and experiences of the topics studied here.

## 6 Assessment

Your performance on each course is assessed through two written assignments and one examination. The assignments are written after week four and eight of the course session and the examination is written at a local examination centre in October.

The assignment questions contain fairly detailed guidance about what is required. All assignment answers are limited to 2,500 words and are marked using marking guidelines. When you receive your grade it is accompanied by comments on your paper, including advice about how you might improve, and any clarifications about matters you may not have understood. These comments are designed to help you master the subject and to improve your skills as you progress through your programme.

The written examinations are 'unseen' (you will only see the paper in the exam centre) and written by hand, over a three hour period. We advise that you practise writing exams in these conditions as part of your examination preparation, as it is not something you would normally do.

You are not allowed to take in books or notes to the exam room. This means that you need to revise thoroughly in preparation for each exam. This is especially important if you have completed the course in the early part of the year, or in a previous year.

### Preparing for Assignments and Exams

There is good advice on preparing for assignments and exams and writing them in Sections 8.2 and 8.3 of *Studying at a Distance* by Talbot. We recommend that you follow this advice.

The examinations you will sit are designed to evaluate your knowledge and skills in the subjects you have studied: they are not designed to trick you. If you have studied the course thoroughly, you will pass the exam.

### Understanding assessment questions

Examination and assignment questions are set to test different knowledge and skills. Sometimes a question will contain more than one part, each part testing a different aspect of your skills and knowledge. You need to spot the key words to know what is being asked of you. Here we categorise the types of things that are asked for in assignments and exams, and the words used. All the examples are from CeFiMS examination papers and assignment questions.

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### Definitions

Some questions mainly require you to show that you have learned some concepts, by setting out their precise meaning. Such questions are likely to be preliminary and be supplemented by more analytical questions. Generally 'Pass marks' are awarded if the answer only contains definitions. They will contain words such as:

- Describe
- Define
- Examine
- Distinguish between
- Compare
- Contrast
- Write notes on
- Outline
- What is meant by
- List

### Reasoning

Other questions are designed to test your reasoning, by explaining cause and effect. Convincing explanations generally carry additional marks to basic definitions. They will include words such as:

- Interpret
- Explain
- What conditions influence
- What are the consequences of
- What are the implications of

### Judgment

Others ask you to make a judgment, perhaps of a policy or of a course of action. They will include words like:

- Evaluate
- Critically examine
- Assess
- Do you agree that
- To what extent does

### Calculation

Sometimes, you are asked to make a calculation, using a specified technique, where the question begins:

- Use indifference curve analysis to
- Using any economic model you know
- Calculate the standard deviation
- Test whether

It is most likely that questions that ask you to make a calculation will also ask for an application of the result, or an interpretation.

### Advice

Other questions ask you to provide advice in a particular situation. This applies to law questions and to policy papers where advice is asked in relation to a policy problem. Your advice should be based on relevant law, principles, evidence of what actions are likely to be effective.

- Advise
- Provide advice on
- Explain how you would advise

**Critique**

In many cases the question will include the word 'critically'. This means that you are expected to look at the question from at least two points of view, offering a critique of each view and your judgment. You are expected to be critical of what you have read.

The questions may begin

- Critically analyse
- Critically consider
- Critically assess
- Critically discuss the argument that

**Examine by argument**

Questions that begin with 'discuss' are similar – they ask you to examine by argument, to debate and give reasons for and against a variety of options, for example

- Discuss the advantages and disadvantages of
- Discuss this statement
- Discuss the view that
- Discuss the arguments and debates concerning

## The grading scheme

Details of the general definitions of what is expected in order to obtain a particular grade are shown below. Remember: examiners will take account of the fact that examination conditions are less conducive to polished work than the conditions in which you write your assignments. These criteria are used in grading all assignments and examinations. Note that as the criteria of each grade rises, it accumulates the elements of the grade below. Assignments awarded better marks will therefore have become comprehensive in both their depth of core skills and advanced skills.

**70% and above: Distinction As for the (60-69%) below plus:**

- shows clear evidence of wide and relevant reading and an engagement with the conceptual issues
- develops a sophisticated and intelligent argument
- shows a rigorous use and a sophisticated understanding of relevant source materials, balancing appropriately between factual detail and key theoretical issues. Materials are evaluated directly and their assumptions and arguments challenged and/or appraised
- shows original thinking and a willingness to take risks

**60-69%: Merit As for the (50-59%) below plus:**

- shows strong evidence of critical insight and critical thinking
- shows a detailed understanding of the major factual and/or theoretical issues and directly engages with the relevant literature on the topic
- develops a focussed and clear argument and articulates clearly and convincingly a sustained train of logical thought

- shows clear evidence of planning and appropriate choice of sources and methodology

**50-59%: Pass below Merit (50% = pass mark)**

- shows a reasonable understanding of the major factual and / or theoretical issues involved
- shows evidence of planning and selection from appropriate sources,
- demonstrates some knowledge of the literature
- the text shows, in places, examples of a clear train of thought or argument
- the text is introduced and concludes appropriately

**45-49%: Marginal Failure**

- shows some awareness and understanding of the factual or theoretical issues, but with little development
- misunderstandings are evident
- shows some evidence of planning, although irrelevant / unrelated material or arguments are included

**0-44%: Clear Failure**

- fails to answer the question or to develop an argument that relates to the question set
- does not engage with the relevant literature or demonstrate a knowledge of the key issues
- contains clear conceptual or factual errors or misunderstandings

*[approved by Faculty Learning and Teaching Committee November 2006]*

## Specimen exam papers

Your final examination will be very similar to the Specimen Exam Paper that follow below. It will have the same structure and style and the range of question will be comparable.

CeFiMS does not provide past papers or model answers to papers. Our courses are continuously updated and past papers will not be a reliable guide to current and future examinations. The specimen exam paper is designed to be relevant to reflect the exam that will be set on the current edition of the course.

## Further information

The OSC will have documentation and information on each year's examination registration and administration process. If you still have questions, both academics and administrators are available to answer queries.

The Regulations are available at www.cefims.ac.uk / regulations.shtml, setting out the rules by which exams are governed.

*UNIVERSITY OF LONDON*

*CENTRE FOR FINANCIAL AND MANAGEMENT STUDIES*

## MSc Examination

## Postgraduate Diploma Examination

**for External Students** **91DFM C211**
**91DFM C311**

# *PUBLIC POLICY AND MANAGEMENT*

POLICY STUDIES

PUBLIC FINANCIAL MANAGEMENT

## *Privatisation & Public-Private Partnerships*

### Specimen Examination

*This is a specimen examination paper designed to show you the type of examination you will have at the end of the year for* **Privatisation & Public-Private Partnerships**. *The number of questions and the structure of the examination will be the same but the wording and the requirements of each question will be different. Best wishes for success in your final examination.*

The examination must be completed in THREE hours.

Answer **THREE** questions, answering **at least ONE question from EACH section**. The examiners give equal weight to each question; therefore, you are advised to distribute your time approximately equally between three questions.

You should where possible illustrate your answers with references and practical examples from the course especially from the selected research which forms part of your course materials.

**Do not remove this Paper from the Examination Room.**
**It must be attached to your answer book at the end of the examin-ation.**

 **PLEASE TURN OVER**

## Section A

***(Answer at least ONE question from this Section)***

**1.** Why has privatisation been adopted more enthusiastically by some governments than others?

**2.** Can privatisation produce optimal results when there are multiple objectives?

**3.** Why are multi-national rather than local companies so prominent in water and electricity supply after privatisation? Is this situation sustainable?

**4.** How would you evaluate the success of a privatisation programme?

## Section B

***(Answer at least ONE question from this Section)***

**5.** What are the main differences between contracting for the purchase of stationery and contracting for large computer systems?

**6.** What are the conditions under which contracting is likely to produce a satisfactory outcome? Using examples, discuss the likelihood of these conditions being in place.

**7.** How does market structure affect the nature of the relationship between governments and private and not for profit suppliers of public services? Illustrate your answer with examples.

**8.** How would you evaluate the success of a public-private partnership, from the point of view of the government entering the partnership?

**[END OF EXAMINATION]**

# Privatisation and Public-Private Partnerships

# Unit 1 Introduction to Privatisation in the OECD Countries

## Contents

## Unit Content

The first two units of the course contain a survey of privatisation, an analysis of the various reasons for which governments privatise and a review of the different methods used in privatisation.

Unit 1 starts by looking at what was available for privatisation at the end of the 1970s, after the various processes of nationalisation and new-starts had resulted in a pattern of public ownership in a wide range of sectors, in the West. Then, we will look at how, after privatisation looked to be going out of fashion in early 2000's, this policy regained attention at the end of the decade.

The Unit then contains a general discussion of the twelve main reasons for privatisation. After that, it looks at the reasons for and methods of privatisation in the OECD countries (the industrialised world). A quiz is provided on the main reading that should help consolidate what you have read. We conclude with a case study — reasons for privatisation in Mozambique — forming a link to the next unit which is about the world outside the OECD.

## Learning Outcomes

When you have completed your study of this unit and its readings, you will be able to

- discuss the scale of privatisation in the 1980's and 1990's, where it took place and in which sectors
- discuss the resurgence of interest towards privatisation in the late 2000's
- outline the range of options for privatisation processes
- list and discuss some of the objections to privatisation, from a consumer perspective
- explain why governments have privatised state owned industries, and make a preliminary judgement about the relative merits of privatisation.

### Reading for Unit 1

#### OECD Report

OECD (2003) Sections 1.1, 1.2 and Part 2 of *Privatising State-owned Enterprises: An overview of policies and practices in OECD countries*, Paris: Organisation for Economic Co-operation and Development.

#### Reader

Chris Cramer (2001) 'Privatisation and Adjustment in Mozambique: A "Hospital Pass"?', *Journal of Southern African Studies*, Volume 27, Number 1, March.

## 1.1 Introduction

Privatisation, in its various forms, represents a reversal of an earlier process of state involvement in a variety of extractive, productive and distributive activities. If you have completed *Public Policy & Management: Perspectives & Issues*, you will remember that the activities in which the state is involved shows a great variety around the world.

The reasons for state involvement in mining, agriculture, manufacturing, transport and energy are different in different parts of the world. In Western Europe the governments dealing with reconstruction after World War II accepted responsibility for the development of industries that had either been destroyed during the war or were diverted to arms production. Different governments chose to support the development of different sectors, so some governments ended up running automobile industries, coal mining, steel production, shipbuilding, chemical plants, gas and electricity production and distribution, airlines, railways and banks in addition to the sectors that had had a longer history of state ownership such as the postal service, telecommunications, law enforcement, and the military.

Communist countries had an even bigger public sector, almost all but the most petty of economic activities being controlled by the state and the Party under systems of national economic planning. There are still remnants of these state owned industries and enterprises in China, Vietnam and Cuba, for example.

While privatisation, in the form of selling enterprises to private companies or through share issues, has probably peaked in volume worldwide, there are still governments struggling with the question of how to manage their state-owned enterprises and whether to change their ownership.

At the same time, governments are struggling with alternative ways of funding and managing those activities that are more obviously the business of government — such as the provision of infrastructure, maintaining the rule of law, external defence, maintaining a healthcare system. What is the best way to implement policy in these areas? To what extent should private or non-profit organisations be involved in service provision, capital financing and the employment of staff?

Newly independent countries emerging from colonial rule also followed the path of state involvement in many economic sectors. State-owned industries were considered a reliable vehicle for economic development as they had been in Europe in the rapid post-war growth period. In some cases the development path was informed by socialist ideology – a belief in the superiority of public ownership over private profit – and in others by more pragmatic reasoning. In many ex-colonial countries, governments were privatising state enterprises and public services, including water supply, agricultural production and distribution, mining, manufacturing, public transport and electricity generation and distribution.

Up to the late 1970s, in many countries, including the industrialised countries of the OECD, key sectors of the economy were dominated by state-owned public enterprises. This is shown in Table 1.1, which shows the dominance of public ownership particularly in fields such as postal services, telecommunications, gas, electricity and railways. The importance of state ownership was much less in the United States which had a liberal laissez–faire tradition. In contrast, for example, Austria, France, India and Portugal, corporatism and socialist / social democratic governments had played an important economic role in post World War II development.

It was against this background of significant state ownership of key sectors of the economy, that the major privatisation programmes were undertaken. Privatisation and the different approaches and options for privatisation have formed an important component in the reform and restructuring of the public sector in high-income countries, such as those of the OECD where the United Kingdom, France, Germany, Italy, Australia and New Zealand have included privatisation as a part of their public sector reform activities.

Table 1.1 The Extent of State Ownership of Business by Economic Sector in 1978

| | Posts | Telecoms | Electricity | Gas | Oil production | Coal | Railways | Airlines | Motor Industry | Steel | Shipbuilding |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Australia | ● | ● | ● | ● | ○ | ○ | ● | ◕ | ○ | ○ | n/a |
| Austria | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | n/a |
| Belgium | ● | ● | ◔ | ◔ | n/a | ○ | ● | ● | ○ | ◑ | ◔ |
| Brazil | ● | ● | ● | ● | ● | ● | ● | ◔ | ○ | ◕ | ○ |
| Canada | ● | ◔ | ● | ○ | ○ | ○ | ◕ | ◕ | ○ | ○ | ○ |
| France | ● | ● | ● | ● | n/a | ● | ● | ● | ◑ | ◕ | ○ |
| Germany | ● | ● | ◕ | ◑ | ◔ | ◑ | ● | ● | ◔ | ○ | ◔ |
| India | ● | ● | ● | ● | ● | ● | ● | ● | ○ | ◕ | ● |
| Italy | ● | ● | ◕ | ◕ | n/a | n/a | ● | ● | ◔ | ◕ | ◕ |
| Japan | ● | ● | ○ | ○ | n/a | ○ | ◕ | ◔ | ○ | ○ | ○ |
| Mexico | ● | ● | ● | ● | ● | ● | ● | ◑ | ◔ | ◕ | ● |
| Netherlands | ● | ● | ◕ | ◕ | n/a | n/a | ● | ◕ | ◑ | ◔ | ○ |
| Portugal | ● | ● | ● | ● | n/a | n/a | ● | ● | n/a | ● | ● |
| S. Korea | ● | ● | ◕ | ○ | n/a | ◔ | ● | ○ | ○ | ◕ | ○ |
| Spain | ● | ◑ | ○ | ◕ | n/a | ◑ | ● | ● | ○ | ◑ | ◕ |
| Sweden | ● | ● | ◑ | ● | n/a | n/a | ● | ◑ | ○ | ◕ | ◕ |
| Switzerland | ● | ● | ● | ● | n/a | n/a | ● | ◔ | ○ | ○ | n/a |
| United Kingdom | ● | ● | ● | ● | ◔ | ● | ● | ◕ | ◑ | ◕ | ● |
| United States | ● | ○ | ◔ | ◔ | ○ | ○ | ◔ | ○ | ○ | ○ | ○ |

n/a not applicable or negligible production
○ privately owned: all or nearly all
◔ 25% publicly owned
◑ 50% publicly owned
◕ 75% publicly owned
● publicly owned: all or nearly all

Source: Adapted from Toninelli (2000)

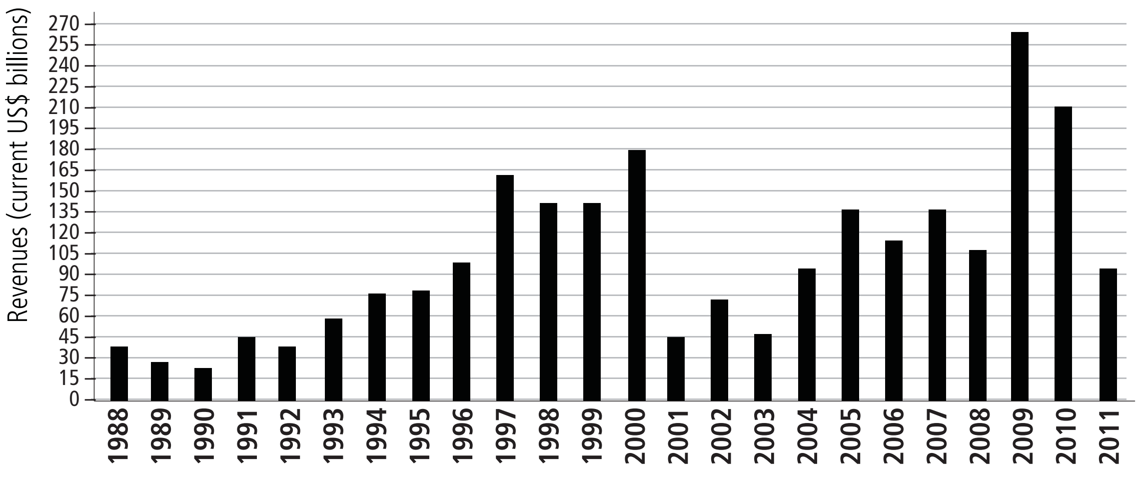
This attempt at public sector reform was subsequently introduced into middle and low income countries, including the transitional economies of the former Soviet Union and other former COMECON centrally planned economies – the Baltic states (Estonia, Latvia and Lithuania) Bulgaria, the

Czech Republic, Hungary, Poland and Slovakia and other Balkan states including those within the former Federal Republic of Yugoslavia. There were two separate sets of privatisations: the transfer of industries, especially extractive and manufacturing industries, through trade sale, flotation or voucher issue and the attempt to privatise public services.

There has also been a trend towards privatisation in many of the countries whose governments developed state industries after independence. The Indian government, for example, included privatisation among its policies of market liberalisation. Ghana, whose government was a leading exponent of development through nationalised industries has been through a programme of privatisation and denationalisation. Other African states have divested themselves of industries acquired soon after independence – for example, Kenya Airlines.

Privatisation of state-owned enterprises (SOEs) expanded rapidly during the 1980's and 1990's. Figure 1.1 (reproduced from the Milan-based Privatisation Barometer), shows that in the early 2000's, the total number and value of sale of SOEs shrank. The reasons for this mainly related to the exhaustion of the easiest opportunities to divest; the growing awareness that the policy may be ineffective if not supported by appropriate institutions and policy framework; and the sell-off in world equity markets after the burst of the technology bubble in September 2000.

Figure 1.1 Worldwide Revenues from Privatisation of State-Owned Enterprises, 1988-2011 (in US$ billions)




Source: Privatisation Barometer (2011)

Privatisation, then, bounced back in late 2000's. The 2008 financial crises, in particular, lead several governments to terminate subsidies to financially non-viable SOEs and to divest themselves of others as a way to partially fix their debt burden (Kikeri and Perault, 2010). In part, however, this 'privatisation wave' was also related to the return to the market of automotive and equity in financial institutions that had been temporarily taken into State hands by the US government during efforts in 2008 to rescue their troubled economy (Nellis, 2012).

The 'new privatisation landscape' (OECD, 2009) that formed in the late 2000's presents some peculiar features, particularly the large number of mixed ownership SOEs (that is partially privatised SOEs). In a number of instances, governments preferred to sell only part of their shares of SOEs, especially in utilities companies (such as EDF of France; ENEL in Italy and so on). The partial opening of SOEs capital to private investors was primarily intended to increase the efficiency of government-controlled companies by subjecting them to the rigour of financial markets and to attract fresh capital. In addition, the retention of stakes in partially privatised companies was related to governments' intention to keep influencing companies' commercial activities. The rise of mixed public-private ownership firms pose special corporate governance issues, primarily because of the conflicting objectives pursued by the public and the private owners of partially privatised firms.

## 1.2 Why Privatise?

The main objectives of privatisation have been a combination of the moral, economic, political and social. They included the following:

1. Reducing the powers of the state. Liberal political and economic thought emphasised the loss of individual freedoms implied by the growth of state power and influence. In part, this motivation was a reaction to the extreme loss of individual liberties in the fascist and communist dictatorships in Europe but the ideas were applied to all states. Writers such as Friedrich Hayek in the UK and, later, Milton Friedman in the USA argued that all reductions in state activities result in an increase in personal freedoms. Hence privatisation was a moral good, rather than an economic benefit.
2. Reducing the power of organised labour (the trade unions). Especially in Western Europe the trades unions that organised the workers in nationalised industries were generally in a strong bargaining position, with high union membership densities and, often, political support. When right-leaning governments attained power they saw that privatisation of these industries could reduce the unions' bargaining power.
3. Better control over public expenditure. Because of their national political importance, state industries often developed financial deficits that were financed from taxation and borrowing by governments. Losses were incurred by motor manufacturers, steel producers, airlines, railways and other industries, in this way. The legal protection of workers' rights would restrain efforts to improve profitability in these industries under private ownership, politicians were often unwilling to accept the political consequences of job losses and the other painful consequences of cost reductions. It was frequently easier simply to apply more public funding to the companies than face the consequences of efficiency improvements.
4. The main motivation for some privatisations was the cash gained from the sale of the assets.
5. The development of popular capitalism in which more of the population had a stake in the economy. Pro-capitalist governments, such as the Conservative governments in the UK from 1979 onwards and the post-communist governments in Eastern Europe attempted to

spread the stock ownership among a larger section of society. Privatisation, especially at prices that represented a discount on market value and therefore a windfall profit for stockholders, represented an attractive way to do this. Voucher privatisation, whereby shares were widely distributed among the populace, had a similar goal.

6. Improving economic efficiency, productivity and innovation in a stagnant public sector. Various diagnoses were made to explain below-standard performance of state enterprises, including: political interference in management decisions; unclear governance arrangements linking managers to the enterprise owners; lack of incentives for managers to perform well; ambiguous or contradictory corporate objectives (such as profitability and numbers of people employed); excessive employment rights for workers; and monopolistic market structures that protected inefficiency.
7. Avoiding ‘crowding out’ – the idea that investment in the public sector leaves less capacity in the private sector, either through the shortage of labour and capital or through increased interest rates as governments borrow to finance investment in state enterprises.
8. A desire to break the link between the state and industry, thus allowing enterprises to respond to the market rather than political decisions.
9. Privatisation increases the capitalisation of local stock exchanges as the new companies are listed.
10. Privatisations attract foreign investors and may improve overall liquidity in local stock markets.
11. When privatisation is a condition of a government receiving a loan, in a sense the objective of the government that is forced to privatise, is to do just enough to ensure that the loan is secured.
12. In addition to the policy goals of governments, other players had their own objectives. Some people were to become rich as a result of the privatisation process. The oil oligarchs in the former Soviet Union are an extreme example of a group of people who managed to acquire wealth by getting hold of assets previously collectively, publicly, owned. Other groups benefited too, whether they be shareholders in Western companies who acquired East European industrial assets, or the small number of merchant bankers who organised the flotation and public sales of public corporations.

As this list demonstrates, privatisation can be used as a means to many different ends. In the academic literature, most of the reasons for privatisation can be summarized in two approaches – the ‘property rights’ and the ‘public choice’ approaches. There follows an extract from an article by an Austrian and a German economist, succinctly summarising the two positions.

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### Reasons for Privatising Public Enterprises

For at least the last century, economists have employed a positive economic theory to explore the implications of profit maximization by private firms operating in private property contexts. Only since the late 1960s have empirical studies been undertaken dealing with the behavior of publicly operated firms. Since then a large number of studies of a variety of activities of public or private enterprises now exists and their main focus is the question of how public firms differ from their private equivalents.

Basically two approaches are employed. The first, explored in section 2.1, is the property rights approach. It concentrates on the differences in the ease of captureability of economic surplus of a resource and the rights to direct an asset's use, alter its from or transfer its claims among existent and potential owners. In short, this approach explores the differences in incentives between public and private agencies caused by variation in the ability of owners to monitor management and the problems that emerge when the goals of 'owners' and their agents, 'managers', diverge. The second one is called 'Public Choice approach' (elaborated in part 2.2) and concentrates on political coalitions and their effect on input usage and reward and/or product characteristics. The Public Choice approach also includes the theory of bureaucracy (Niskanen, 1971, 1975).

### [2.1] The Property Rights Approach

The property rights approach points out one crucial difference between private and public firms. The practical difficulties in transferring ownership rights among individuals in the public sector and the relative ease of such transactions with private assets which includes, of course, the ability of owners (citizens) to monitor their agents (elected officials' and bureaucrats') behavior. Up to now, this approach pioneered by Armen Alchian is well known, but it is useful to recall his predictions: government managers will not organize the inputs under their direction in such a way, as to maximize the wealth of the tentative owners, the general citizenry. Alchian predicts, therefore, that public firms will be less efficient, their management will enjoy 'quieter lives' and because of this the public will give them lower levels of discretion then their colleagues in private firms. To put it in another way, the property rights approach is concerned with any type of cooperation in which ownership and management fall apart. The arising principal–agent problem may be virulent in private enterprises as well, but to a much lesser extent. Numerous studies have been undertaken which have tested this proposition and the result that public enterprises are less efficient then private ones is confirmed in most of them.

To sum up the results gained so far: the property rights approach seems to indicate that
(1) private production is cheaper than production in publicly owned and managed firms and
(2) given sufficient competition between public and private producers (and no discriminative regulations and subsidies) the differences in unit cost turn out to be insignificant. From this, one may conclude that it is not so much the difference in the transferability of ownership but the lack of competition which leads to the often observed and less efficient production in public enterprises.

### [2.2] The Public Choice Approach

The public choice approach appears to provide a broader analysis than the property rights one. The public choice approach assumes that politicians, bureaucrats, managers of public enterprises are selfish utility maximizers subject to constraints. In this approach it is, e.g. for a politician, assumed that he acts selfishly in order to reach his ideological or personal goals under the constraint not to lose the next election. As for a politician to stay in power is the most important constraint (or even sometimes a goal), he will also use public utilities for his own selfish goals. One reason for this is evidently the lack of incentives for politicians and tax-payers to exert effective control of an efficient use of public enterprises or resources in the economy. This argument seems especially valid for the case of public utilities or enterprises. Public utilities offer excellent opportunities to reach the selfish re-election goals of governments like an additional employment and the stabilization of purchasing power of certain regions. If such a 'misuse' of public utilities or enterprises leads to full employment and higher income at least for a certain time span then it is easier for a government to win an election without such a 'misuse' of public utilities. The costs of such popular policies can be made invisible for several years (or even 1 or 2 legislative periods) as the deficits of the public enterprises can be hidden in the general budget deficit.

As the public choice approach is more concerned with micro-economic aspects, De Alessi claims that public managers are growth- and not wealth-orientated. He argues and finds supporting evidence that this leads to larger staffs and higher capital labor ratios since excess capital makes managers and their subordinates' productivity appear higher to their monitoring agents, the legislature. Already Borcherding, Busch and Spann (1977) argue that public employees effectively coalesce through their organizations and 'capture' civil service commissions over time, altering the rules in such a way that private employers competing for labor with public firms face a less wage elastic market than would prevail under a free market. This public employee market power is enhanced, they claim, by the fact that public service employees contribute to the election of the ultimate 'bosses', definitely not an option for a private sector union.

In some sense, then, public employees can alter the position of the derived demand schedule for their services by (a) 'nudging' the final demand schedule for public services to the right and (b) specifying rules which lower both the elasticity of substitution between themselves and rival factors and the elasticity of supply of these close substitutes. Both (a) and (b) will tend to raise wages, but they may raise employment too, since, in effect, the budget and tie-in effects may offset the usual substitution effects one might derive from the neoclassical models of labor demand in the presence of a simple monopoly. De Alessi (1974) in another paper argues that given the relative loose monitoring of public enterprises by the political review authorities, a rational position for the latter given the gain-sharing results of assiduous monitoring, managers will indulge their taste for security rather more than in private firms. He finds evidence consistent with the risk-avoiding hypothesis. Public managers' tenures are more secure, of a longer duration, and their fluctuations in real wages are lower than their private counterparts.

In conclusion, according to the public choice scholars, governmental agencies and firms have distinct biases leading to higher production costs, just as the property rights literature suggests, but excessive outputs as well. The latter obtains because the bureaucracy can affect demand more readily under monopoly public ownership by the strength of its members' votes and/or lobbying efforts. The absence of a civil service and the constraint on strong unions by more competitive types of supply, public or private, is thought to reduce the ability of members of such bureaucracies to offer their services to the legislature on disadvantageous terms compared to potential competitors. On the other hand, the bureaucracy is not likely to have sole 'capture' rights over the bureaus, but share the ownership claims with other interests.

To sum up this part, the public choice approach does not only recognize the differences in behavior between publicly owned and managed firms and private ones due to the limited transferability of ownership. It also considers the likely oversupply of public services due to the lack of competition in their provision and production. This oversupply is then quite often used for selfish re-election goals of politicians and can result in higher employment and higher wages in certain regions for a certain time.

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Source: Schneider and Belke (2004)

It should also be highlighted that privatisation may spread across countries through a 'contagion' effect – or, more precisely, in relation to pressures of institutional isomorphism. The study by Fink (2011), for example, showed that the privatisation of telecommunication companies in 21 OECD countries can be explained by emulation pressures. The analysis suggested that privatisation in the telecommunications sector gained legitimacy as more and more governments emulated privatisation policies that they observed in countries that they perceived as similar. Through a kind of 'snowballing effect', governments of all ideological preferences were pressured by the increasing legitimacy of the liberal economic paradigm to privatise their own SOEs as well.

Those given the task of implementing privatisation have had to balance the different objectives in different circumstances. In some cases, the privatisation process itself, and the volume of transactions, seems to have become a goal rather than a means to a goal. Clarity of objectives is important in the decision whether or not to privatise, the choice of activities to privatise and the method of privatisation.

## 1.3 Scale and Methods of Privatisation in OECD Countries

We now turn to an account of privatisation by the OECD, an organisation that has generally been in favour of privatisation as a way of promoting economic development.

**Reading**

Selected sections of *Privatising State-owned Enterprises*, published (2003) by the Organisation for Economic Co-operation and Development.

You should now read the following sections of the OECD booklet, *Privatising State-owned Enterprises*:

Sections 1.1 and 1.2 (pp.19–34) and then Part 2 (pp. 45–118). Section 1.1 concerns policy objectives, and 1.2 is a descriptive account of the scale of privatisations. Chapter 2 turns to the question of methods and techniques of privatisation. You do not need to read 1.3 or Chapter 3 yet, as we will come back to the evidence on the effects of privatisation and lessons from the experience in Unit 3. When you have read these sections, test your understanding by answering the following questions. While they are based on the reading on the OECD countries' experience, many of the questions apply to the process in general. In the next unit we will look at Africa, Latin America and Asia.

**OECD 'Privatising State-owned Enterprises'**

1 The report says that privatisation has six objectives. Is this an exhaustive list of

reasons for privatisation?

2. What are the main conflicts of objectives that can be resolved by trade-offs or by the prioritisation of one objective over the others?
3. What are the main interests involved in the privatisation process and how do their objectives differ?
4. Is there a trade-off between creating a competitive sector after privatisation and the maximisation of revenue for the selling government?
5. Is shareholder value the only legitimate objective of a privatised company, as implied by the report?
6. Does the end of the natural monopoly in telecommunications for technological reasons necessarily mean that telecommunications should always be privatised?
7. How does privatisation help a government's fiscal position?
8. What elements of the privatisation process contribute to making companies more efficient?
9. Which OECD country raised the most money, proportionately to GDP, from privatisation?
10. In which countries has foreign direct investment been a major component of privatisation?
11. When is a centralised approach to privatisation appropriate and when is a decentralised approach better?
12. What kinds of conflict of interest can arise for privatisation advisers?
13. What are the main conflicts of interest involved in the whole privatisation process?
14. Why do companies need to be restructured before they are privatised?
15. Why is bank privatisation an important part of the privatisation process?
16. In what circumstances is there a danger of 'moral hazard' after privatisation?
17. What are the advantages of a staged sell-of of an individual company?
18. What are the arguments for and against foreign ownership of privatised companies?
19. What are the elements of a labour strategy as part of a privatisation programme?
20. What are the alternative uses of privatisation proceeds?
21. What are the advantages and disadvantages of
    a. Initial Public Offering
    b. Trade sale by negotiation
    c. Trade sale by open tender?
22. Which methods of privatisation lead to wider share ownership?
23. Who gains and who loses as a result of an under-valued public offering?
24. Why would a government offer discounts to buyers of shares at privatisation?
25. Why have some governments given free shares to employees of privatised companies?
26. Why does the report recommend caution in the use of controlling interests by governments, including 'golden shares'?

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In the next unit we turn to other parts of the world, including Asia, Africa and Latin America. In preparation for this and to consolidate your thoughts on the reasons for privatisation, look at Mozambique as an example of a developing country's privatisation programme.

## 1.4 Privatisation in Mozambique

Let us take Mozambique as an example[1]. After independence from a collapsed colonial power, Portugal, in 1975 the Frelimo government followed a policy of establishing state enterprises in all sectors including agriculture and industry. Due to a combination of lack of success of many of these enterprises and the economic effects of the civil war against the Renamo insurgents during the 1980s, the government gradually adopted a policy of encouraging the private sector and then of privatisation of state enterprises. The country has been used by the World Bank as an example of widespread and successful privatisation.

**Reading**

Now turn to the Course Reader and study an extract (pp. 82–89) from Chris Cramer's article on privatisation in Mozambique, 'Privatisation and Adjustment in Mozambique: A "Hospital Pass"?[2]. Cramer, a development economist at SOAS, argues that there were many objectives for privatisation in Mozambique and all were being pursued at the same time.

Chris Cramer (2001) 'Privatisation and Adjustment in Mozambique: A "Hospital Pass"?', reprinted in the Course Reader from the *Journal of Southern African Studies.*

As you read this article, please list the many objectives and answer the question:

- Are there conflicts between these multiple objectives?

## 1.5 Conclusions

You have now been exposed to the scale of privatisation in the industrialised world and a little of Africa, as well as the alternative privatisation methods. Before drawing any general conclusions, wait until you have been exposed to the process in other, different environments.

It does appear already, though, that privatisation is a means and not an end: that different governments have used privatisation for many different reasons. For public servants designing and managing privatisation the problem is one of being clear exactly what the purpose is before making decisions about how to implement the process.

1 If you want to follow up the Mozambique example in detail, you could read M Anne Pitcher (2002) *Transforming Mozambique: the politics of privatization 1975–2000.*

2 'Hospital pass' is a sporting term from soccer or rugby football, meaning a pass that will result in injury to the recipient, because s/he will subsequently be tackled.

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