PRIVATIZATION AND LIBERALISATION FOR INDUSTRIAL DEVELOPMENT IN INDIA AND OTHER DEVELOPING COUNTRIES

A Dissertation submitted
for the fulfilment of
the requirement for the
Degree of Doctor of
Philosophy

By

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Declaration

I hereby declare that the work embodied in the Dissertation entitled "PRIVATIZATION AND LIBERALISATION FOR INDUSTRIAL DEVELOPMENT IN INDIA AND OTHER DEVELOPING COUNTRIES" carried out by me under the supervision of Professor. V.V.N. Somayajulu, Department of Economics, University of Hyderabad, has not been submitted for any other Degree either in part or in full to this or any other University or Institution.

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June, 1997.

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This is to certify that I, Nagarjuna B, have carried that the research embodied in the present thesis for the full period prescribed under Ph.D ordinances of the University of Hyderabad.

I declare to the best of my knowledge that no part of the thesis was earlier submitted for the award of any research degree to any other University or Institute.

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Dedicated

to

Beloved

Parents.

Contents

CHAPTER - 1

A. MAIN THEME AND NEED FOR THE STUDY :

Over the past fifty years of planned development of many developing economies as in India, public sector assumed greater importance with more emphasis on macro economic planning, policy analysis and use of deterministic and management techniques at micro and macro levels all being incorporated into plan modelling with a strategy or alternative strategies of development as to fulfill ordered set of social and economic goals. Government interventions of states and center interms of direct and indirect planning measures to evolve and assume entrepreneurial and management functions as to form state monopolies in critical strategic, key and basic sectors, particularly in industry (basic and capital goods) and capital intensive, infrastructural sectors as engines of growth and development of nation and states or regions through rapid pace of commanding heights of public investments and nationalisation of industries and of financing and promotional bodies / corporations and of development banking, insurance and many economic and social overheads sectors.

During the latter half of the period of 1970's onwards the states and centre led to evolve joint sector concept in promotion of and financing of many industries in backward regions in India, while management of them is left to private sector entrepreneurs and to distinct specialized managerial skills of private and public limited companies and to cooperatives.

However, since mid-1980s the earlier trends towards raising more of public investments, ownership, management and such other interventions have been seriously questioned, replacing them by liberalization of imports, industrial policy instruments monetary and fiscal instruments too, particularly 1991 onwards strengthening, widening and intensifying many of these economic reforms. This led to a widespread debate about the merits of privatization, public-disinvestment as against public ownership and management of erstwhile activities. Privatization which occurs by way of transfer of assets or service functions from public to private ownership and control attracted greater attention of researchers all over the world.

Privatization, in general is practised in different activities with the following objectives.

a) to improve the economic performance of the assets or service functions,
b) to depolitize economic decisions,
c) to generate public budget revenues through sale receipts of public assets,
d) to reduce public outlays, taxes and borrowing requirements,
e) to reduce the power of public sector unions, and
f) to promote popular capitalism through the wider ownership of assets.

Developing economies have been embracing and practicing economic reforms of varied kind of realizing the cited objectives of privatization which is the central issue or the main theme focussed in this study. While liberalization of industry trade, monetary and financial rigidities are also examined to the extent relevant to the issue of privatization specific and reference to its major objective i.e, to contribute for the improvement in economic performance of enterprises. Hence, privatization and liberalization have been mutually reinforcing and exhibit a complementary role to play in developing countries. Development of capitalistic institutions in privatization and liberalization process would bring in improvements in economic performance. privatization is drawn for implementation by statutes of public authorities and by interplay of market forces. Privatization and liberalization are expected to easeout bottlenecks and shortages. Further, privatization and liberalization are expected to facilitate and promote the trade with bearing on industrial activities directly or indirectly as lubricants and have a function of catalytic agents for industrial development that further provokes for privatization in all other activities / services.

B. OBJECTIVES OF THE STUDY :

Thus the study examined the issues of privatization and the commitment of liberalization schemes in the development process of developing countries and India with the following sequence of objectives of the study,

a) To trace, the role of dependency school of thought and of institutions such as Bretton woods. International Monetary Fund (IMF), World Bank (IBRD) for development of developing economies.

b) To examine, the commanding heights and role of public sector for rapid pace of development of developing economies and to present a case for privatization with the relevant theoretical explanations and to lead for different forms of privatization in developing countries.

c) to trace, the All India govt. initiative of economic reforms and to examine their impact that brings forth privatization successfully for development in India.

d) to trace, the requisite economic structures, structural adjustments and stabilization policies for privatization programmes, and

e) to examine the sale proceeds of public assets and other forms of dis-investments in public sector with the growth of other forms of privatization and their inter linkages in selected developing economies, as outcomes and evaluation of privatization.

C) HYPOTHESES :

1) Privatization in developing economies is expected to resolve their economic problems caused by the commanding heights of public sector.

2) Relevant and requisite economic structures, institutions structural adjustments and stabilization policies to the individual developing countries concerned are a pre-requisite for the success of privatization in developing countries.

3) Privatization can best be regarded as a medium-term supply side economic-policy, a logical complement to a broad strategy of private sector development rather than a "Panacea" - for the

multitude of ills endured by the developing countries.

D) DESIGN OF THE STUDY :

This study involves the critical survey of literature covering the concepts, historical development and pattern of development of the privatization and liberalization in developing economies namely Jamaica, Trinidad & Tobago, Kenya, Malawi, Papua, New Guinea, Sri Lanka, Malaysia and India.

It takes into consideration of the theoretical background and empirical content for a comparative verification and analysis of development, trend and pattern leading policy implications for development in general and industrial development in particular of developing economies with emphasis on India too. This study is classified according to themes as demonstrated and analyzed in the respective chapters with a contribution to evolve an overall synthesis of inter-relationships and role of privatization and liberalization in selected developing economies. The analysis and synthesis as supported by empirical evidences in practice will be relevant and fruitful for future development programmes of developing economies, is a comprehensive and critical review (survey) based research study with a empirical data tabulated and analyzed wherever is needed for an relevant much reliance is placed on the availability of literature and data from secondary sources, which are authentic and reliable from the accessible libraries and research organizations and their reports published or unpublished, but authentic and reliable as they are suited to the present study.

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E. CHAPTERISATION SCHEME :

This thesis is based on the following ten chapters.

The first chapter is an introduction dealing with main theme, focus, need for the study, objectives, hypotheses and design of the study.

The chapter two probes into the "Dependency school of thought" in terms of the development of dependency, reasons for under development and irrelevance or relevance of dependency for development in developing economies.

Chapter three explains the role of Brettonwoods Institutions for developing countries and the I.M.F and World Bank in the development of developing economies.

Chapter four gives an overview of public sector development in the selected economies viz., India, Malaysia, Sri Lanka, Kenya, Malawi, Jamaica, Trinidad & Tobago and Papua New Guinea.

Chapter five presents and examines theoretical explanations for privatization in developing economies.

Chapter six draws insights regarding privatization outcomes and evaluations in selected countries (excluding India) of developing world form earlier reports.

The Seventh chapter continues to examine the privatization outcomes and evaluation further.

Chapter eighth traces the requisite economic structures of those selected countries and spells out specifically the structural adjustments and stabilization needed in those economies as to pursue privatization and liberalization packages.

The ninth chapter traces the initiatives and impact of economic reforms in India particularly about privatization and liberalizations.

The last chapter provides findings and policy implications, suggestions of the study.

CHAPTER -

DEPENDENCE AND DEVELOPING COUNTRIES DEVELOPMENT
A CRITICAL SURVEY

INTRODUCTION :

In the light of Trade Liberaliszation and Privatization packages under the auspices of World Bank and International Monetary Fund (IMF) and of the previous experiences of developing countries as to undergo matured theories regarding development and under-development in developing economies, the relevant areas to be probed for a critical analysis is the theory of dependency and development of under-development. The chapter 2 exclusively deals with it in details.

1.1 INCOMES CLASSIFICATION OF ECONOMIES AND EMERGENCE OF DEVELOPMENT THEORIES AND PARADIGMS :

On the average, China, India and the people of Africa have lower incomes than the people of Latin America, while the Latin Americans have incomes lower level than the people of East Europe relatively to Western Europe, New Zealand, Australia, North America and Japan. The ranges of individual country incomes overlap, average incomes of individual countries give a snapshot impression of the geographical distribution of incomes in the world. Within each country, family incomes differ greatly. The incomes of the lower incomes group in developing country are shared by the peasants cultivating by peasant farmers will be the largest sector.

In a developed economy the income generating sector is large scale manufacturing (larger share in G.D.P) while services will be the largest employment generating sector.

How does the economy move from a primitive technology of agriculture to modern technology based agriculture and services for enormously increased incomes ? is the basic problem of economic development of the developing world. Development theory has undergone a sea-change during last five decades. The change is by no means total, nor is there universal agreement on what it takes for a country to develop, but the early faith in the ability of the state to direct development seems to be given way to a greater reliance on markets. Inward oriented strategies are more and more replaced by outward oriented strategies.

In the recent past, many developing economies implemented market oriented reforms. With these changes has come a growing recognition that development is amulti-dimentional process, within which, price reforms, investment and institutional building are complementary. It is also true with India too, welcoming foreign direct investment and opening economy via liberalization and privatization as part of globalizing the economy. The nature extent and efficacy of the state's role and involvement in planned economies failed and now they are (Erstwhile USSR and other East European economies are centrally planned economies) in transformation towards market economies. We also have another set of economies from third world i.e., economies from Africa, i.e, Zimbabwe and Kenya in 1980's adopted the pro-market policies devised by the World Bank and IMF. Especially in Zimbabwe these radical reforms could not sustain as well in Ethiopia the same experience took place.

1.2 DEPENDENCY - A SCHOOL OF THOUGHT :

The problem of development and conditions of development forever is a passionate subject for the development economists. At the first out set, the problem of development and under-development in Latin America, within the perspective of dependence on foreign sector/factors appeared very interestiangly in the first half of 1960s. The formal beginning of the dependency school (D'School) is usually traced to A.G. Frank's article of 1966 illustrating the essentials of the new approach.

A few years later his book appeared under the title "Capitalism and under-development in Latin America." It was viewed initially as the finest and comprehensive exposition of the underemployment. On the other hand, Frank himself was considered as the originator of the D'School. One can classify the D'School into Frankian and Post-Frankian periods. In fact the initial stream of most radical dependency studies was mainly authored by Carribean and Latin American economists such as F.H.Cordoso, T.Dos Santos, A.Quijano, R.M.Marini, O.Sunkel, C.Thopmas, J.Nun, V.Bambirra and others.

In the 1970s the research methods of the D'School were taken up by scholars from other continents and of other nationalities Africans: S.Amin, G.Amin, A.Emmanuel: Asians : Sen.R., S.B.De Silva, S.Lal as well as European the British and French in

A.G.Frank, the Development of under development. Monthly Review, 1966.

particular whose contribution to the development of the D'School centered around numerous critical articles. Tracing the dependent nature of development of Third World is difficult but one can locate the contributors. New works based on theoretical and methodological achievements of the D'School have been incorporated into many conceptions of development of the third world capitalist economy. They indeed inspired the new ways in the evolution of economic thought. They encouraged as well political action on the international level, forming the theoretical basis for the concept of the New Economic Order. Nevertheless, their work has contributed to our understanding of the third world dependence and development.[2]

1.3 THE VIEW OF DEPENDENCY :

Any attempt to put into precise words regarding D'School meets with difficulties. There are several reasons for such a state of affairs. First, the sheer volume of output of D'School is a barrier of considerable magnitude for historians and critics of economic, social and political thought. Reading the works of individual even the most well known authors is, unfortunately, no substitute for more through acquiantance and can not ensure a correct appraisal of the whole body of work. The contributions of

[2] The approach of Soviet and Polish economists to the problem of dependence and its implications is more throughly treated by A.W. Kubiak in "Studies on the Development theory", Research Institute for the Developing Economies, Warsaw School of Economics, 1986, Warsaw, Poland.

various dependence writers diverge widely in respect of their subject matter, point of view and conclusions. The views of individual authors evolve, under the impact of discussions, their research objective.[3]

The D'School is a user of more or less diverging views but unanimous, however, as far as the subject matter is concerned Dependence and development or under development of the third world) as well as methods of analysis (historical, inter-disciplinary, dialectical, globally oriented approach). The long term perspective adopted by the dependency writers in their investigations allows to identify changes in economic and social structures. Analyses are carriedout on the basis of historical information encompassing the period of expanding mercantilism which spread overseas (chiefly to Latin America) the formation of the export oriented colonial economy (1600 - 1850) that underwent some modifications retain, however its export orientation (1850 - 1930) the period of development characterized by import substituting industrialization as well as the present time marked by the expansion of transnational corporations in to the backward areas.

Investigations of economic phenomena are usually set against the complex background of social and political matters seen in the

This is particularly true of A.G.Frank. He rejected in late seventies the theses he had propounded in the 1960s. A.G.Frank, Dependent Accumulation and underdevelopment, The Macmillan Press, Londo n, 1978.

perspective of class relations and in an institutional environment. The extent to which the socio-political phenomena are actually incorporated into the analyses can vary, however, from fairly small in the works of Frank to avery large in Cordoso's. The dependency writers are primarily interested in the participation of various classes in the generation of income in relation to production or social costs of production, and above all in the distribution of income or benefits that various classes derive from particular models of production and distribution.'

The D'School writers accept gladly some form of dialectics, look at various phenomena in their movement and mutual interaction. They encompass to a greater extent global phenomena. It should be stressed that the periphery is analysed either as constantly interaction with the centre or as an element of the world economy.

Surprisingly, the D'School yields many categories which diverge widely from their standard economic interpretations. The traditional economic structure is changed, with the production relations. Karl Marx, Engels, Lenin focussed their interest on the relations of production in different social formations and on different levels of advancement within one formation. The focus on the relations of distribution was taken from Rosa Luxumberg. The spotlight on the distribution is precisely what differentiaties the dependency writers from contemporary marxists who carry on only the approach of Marx. For this reason, the

D'School is some times called the "Neo-marxist" paradigm.

Among the numerous descriptions and classifications of the current, the analysis of G.Palma stands out as a particularly interesting and precise:

1. The works of G.Frank, Dos Santos, Marini and Pizzario as well as F.Hinkelmert constitute an attempt to construct a theory of under-development of the Latin America.

2. The approach of Sunkel and Furtado is an effort to reformulate Economic Commission for Latin America (ECLA)'s analyses of dependent development.

3. The remaining contributions started by Cardoso and Paleto give analyses of concrete form in which dependence appears and develops. The typology referred to above does not consider numerous researchers 'applying methodology of dependence such as, S.Amin, Emmanuel, Wallerstein. The Carribean dependency authors (Thomas, Levitt) or Indian Economists (S.Lal, R.Sen and S.B., De Silva). Neither does Palma examine the evolution of the dependency school as a whole nor the modifications in view of particular authors belonging to S.G.Palma. Dependency a formal theory of under-development or a methodology for the analysis of concrete situations of under-development ? [5]

[4] A.Foster & Carter from Rostow to G. Frank-conflicting paradigms in the analysis of underdevelopment, in "World Development" Vol.4, 1976.

[5] World Development, Vol6, 1978.

It would be a mistake to think the systematization of the multifaceted dependency thinking as an easy task. The characteristic features of this body of knowledge (and at the same time its weak points) are precisely the multiple formulation of fundamental problems and the multidirectional evolution of views held by its proponents. As much as we agree H.Bermestein that it is possible to discern certain common features as well as difference in the views of the dependency economists.

Generally the subject matter of the dependency theory is constituted by the state and dynamics of the economy in the developing countries (of the periphery) beginning with the medieval period to right now.

All the D'School writers negate western linear evolutionism with assumptions of permanently traditional and backward character of peripheral economies vis-a-vis the developed countries (Centre) and thus invalidate the principle of development imitating the path of the rich countries. According to them the periphery was not always poor, there was a time when its level of development was equal or even surpassed the achievements of the western countries. It is stressed that exploitation of other parts of the

H.Bernstein, "Sociology of underdevelopment Vs. Sociology of Development" in D.Lehmann (ed) Development Theory. Four Critical Studies, London, 1979.

This assumption is typical of Western Economic theories of under development, e.g. of Leibenstein, Nurkse, Rostow, Lerner etc.

world was one of the important factors in the success of the early coiners in capitalists development. In other words, the drain of surplus from the periphery was and still is the most important source of the primitive accumulation of capital. The dependency authors have come to the conclusion that historical development of capitalism on the world scale leads to the emergence of different forms of inequality (in terms of class and space) which underlines the complementarity of the two parts of the world. The countries which were drawn later into the world capitalist economy. The development of the centre and of the periphery -this interdependence was from the beginning qualitatively different - it was just dependence.[9]

Initially they assumed that dependence based on inequality between the centre and the periphery was the fundamental characteristics of functioning and development under capitalism on the world scale and hence stress was laid upon specific features and mechanism of peripheral development. D'School writers claimed that development of the periphery is dependent and dependence

T.Dos Santos, "The crisis of Development. Theory and the problems of dependence in Latin America" in H.Bernstein (ed) Under development and Development. The Third World Today. Harmondsworth Press, Middlesex, 1978.

[9]R.Duvall, Dependence and Dependence theory. Notes towards precision of concept and argument in International Organization, Winter, 1978 No.32.P.60-68.

itself is the reason for differentiation of development prospects in the centre vis-a-vis periphery. It is because dependence reflects the differentiating and asymmetrical process of capitalist production and reproduction on the world scale; its analysis is a key to the explanation of under-development and advancement of the periphery.

1.4 WHAT IS DEPENDENCY ? WHAT ARE THE MECHANISMS OFITS EMERGENCE AND REPRODUCTION ? WHAT FORMS IT DOES ASSUME ?

Apart from the category of dependence and its impact upon the development of the periphery, the dependence economists devoted attention to the manifestations and consequences of dependent development as well as to explain the various forms of dependence.

Dependencies emphasized the lack of autonomy in the development of the periphery (S.Amin), its totally external conditioning development of under-development and exploitation of the periphery by the centre, (Frank, Dos Santos, Hinkel, Marini, Caputo, Pizzaro, Emmanuel), inability of the state to effectively steer the capitalist development and its subordination to the world system (Frank, Cardoso), lack of interdependence between the development of key dunamic sectors in the economy, gaps in the process of capital reproduction (Cardoso),social marginalisation of the exploited classes etc.

A number of publications concerning various aspects and manifestations of dependence had to face the challenge of processes that have proved to be a severe test for a variety of propositions advanced by the dependence writers. Numerous controversies were stirred by such descriptions of dependency.

Since the D'School writers failed to provide a full and generally accepted definition of dependence in relation to the developing countries and analysis of a developmental effort not actually defined.[10]

Historical studies as well as real economic processes occured in the 1970's demonstrated that the periphery is not only a heterogeneous part of the world, but it is also rapidly changing. Some countries of the periphery, developing in the conditions of dependence, made considerable head away on the path of development. For instance Australia and United States of America were indeed a dependent part of the capitalist economy, but managed to transform themselves into the countries of the Centre. Thus, the central thesis about the decisive or determining influence of dependence upon the development of the periphery was threatened. It was also claimed that, now a days interdependence replaced the relation of dependence. As a result, new conceptions of interdependence have been advanced as a substitute for the theory of dependence.

Criticism in relation to the D'School implies greater need for more precise definitions as well as more thorough research into the relationships between dependence and (under) development. The D'School itself concentrated its efforts on analysis of processes taking place within the periphery and did not explain

[10] A.E.Karm. "The meaning of Dependence", in the Developing Economies, 1976, pp.202-206.

unequal development of its various parts, nor the reasons for rapid growth and structural change in the group of the dozen or so countries of the third would and their external expansion. Therefore a number of researchers turned to the analysis of the world system, seeking there more convincing solution to the persistent and growing doubts.

These new endeavours have partially abandoned the initial subject matter of the dependents i.e. , the relationship between dependence was included into the analysis of the mechanism of the world capitalist economy. A.G.Frank in his reassessment of the dependency thinking, its genesis and achievements brought into relief entitled "Dependence is Dead. Long live / Dependence and the Class Struggle'.[11]

1.5 THE CONCEPT OF DEPENDENCY :

One can discern two types of approach in descriptions and attempts at a definition of dependence. The first one creates dependence as economic and social category and seeks its roots in the relations between the classes of the Centre and of the periphery. Such relations determine the mechanisms of functioning of the peripheral economies. The second approach develops certain propositions of the early structuralists. The essence of dependence is sought among the economic factors (productive forces) which exert impact upon the social aspects of development.

[11]A.G.Frank, Dependence is dead, Long live dependence and the class struggle - an Answer to critics, in "World Development" Vol.5, pp.355 to 370, 1970.

The notion of dependence itself gradually widened and acquired greater depth. A.G.Frank who is reputed to have founded the whole approach, did not infact, explain the nature of dependence. He did not show its sources and premises and merely drew attention to its manifestations (the surplus drain, creation of the capitalist structure), the greatest merit in the study and identification of economic dependence of the peripheral counbtries upon the centre should go to the Latin American Economists in particular Dos Santos, Cardoso, Faletto as well as to the Canadian economist C.Leys.

According to Dos Santos, dependence is a situation of conditioning in which the economies of one group of countries are conditioned by the development and expansion of others. If one is to comprehend the nature of dependence one has to say that Dos Santos investigated the economic relations generated within the periphery as well as inter relationships between different international and national elements which create the dependence situation.[12] In this and other works, Ds Santos emphasis that the interlinked elements he refers to are to be found not only among the forces of production, but above all, in social groups and class forces.

Thus the conception of dependence can not be understood without turning towards analyses of the inter-relationships between dominant interests in the hegemonic centres and the

12 T.DosSantos, the crisis of Development theory and the problems of Dependence, op.cit. p.79.

dependent economies. All this suggests that, if the actions of dominant forces in the centre did not find the basis and support in the actions of the dominant classes of the periphery, it would have to be dependent. Thus,, dependence has social nature. Hence, through class alliances, dependence is a set of relationships in which the external factors are reflected at numerous levels of internal changes, which in themselves, can reinforce the model of external relationships. Economic alliances explain why the world capitalist system is reflected in the development of the periphery.[13]

Dependence is no longer an external matter. "The national situation says Dos Santas, is determined by its own specific movement. The international situation within which this movement is accomplished constitutes a general condition and not the cause of national processes, since this situation is an element constituent of the inside of nation that determines the impact of the international situation upon the national reality.[14]

13 G.P.Palma, Dependency and Development. A critical overview in D.Seers (ed) Dependency theory. A critical reassessment, op. cit. p.61 R.duvall - Dependence and Dependencial theory, notes towards precision of concept and argument in "International Organization" 1978. No.32.

14 T.Dos Santos. The crisis of development theory, op.cit. p.72

The most significant contribution to the understanding of the class nature of dependence is authored by Cordoso. According to him, the economic process is as social process whereby different social groups and classes attempt at the creation of an economic system which allows for the attainment of their goals and interests.[15]. As a result, analyses is focussed on characterizing a common and conflicting interests of various classes, inside the periphery and in the world scale. Cordoso and Faletti conclude that common interests i.e., the economic prerequisites, between the various classes of the centre and of the periphery and the relevant states lead to class and state alliance. In a manner the economic processes occuring in the periphery are seen as originally linked to social and political processes. They require to the investigated jointly and not merely analyses side by side and then put together. Cordoso and Faletto understand dependence as a part of social relations between various classes as well as between those classes and state. Thus Cardoso finds contradictions inherent in the state which created the nation without itself being sovereign, are at the heart of all dependency issues.[16]

15 Cardoso, the Industrial Elite in Latin America, in Bernstein (ed) Underdevelopment and Development, op.cit. pp.193-194.

16 Markowska.E. 'Dependency debate on the concept of the State, in Economic papers, Warsaw School of Economics, Warsaw.'

The relations between the dominant classes of the periphery and of the centre are not only based on and limited to external forms of exploitation and coersion. Such ties are deeply rooted in the conformity of interests between these classes, Economic alliances of classes of the Centre and the particular class in the periphery which realized the central bourgeoisie interests and reflects the organization of international capitalism constitute the origin of the classes formation processes in the periphery.

Collaborating with the central bourgeoisie in the process of exploitation of the toiling masses of the periphery, certain peripheral classes not only foster the objectives and interests of the bourgeoisie in the centre, but also reinforce their own position in the social hierarchy becoming thus the ruling classes. The remaining classes and social groups and this yields the specificity of development in different countries of the periphery.

According to Cordoso, these economic alliances are not lasting [18]. The choice of the collaborating class in the periphery is determined by current and long term interests of the bourgeoisie of the centre. At the same time, as the dependent

17 Cardoso. Associated Dependent development, theoretical and practical implications in Stephen (ed) Authoritarian Brazil-origins, Politics and Future" New Heaven Press, London, 1977.

18 Cardoso, Associated Development, op.cit.

capitalist advances, the spectrum of social forces allied to the collaborating class widens. In this manner the incorporation of the periphery into the world capitalist economy leads to the emergence of a peculiar social system in which profits are distributed among the small section of the local economic interest groups and international bourgeoisie. In Cordoso view the system is not static, it reacts to the changes securing in the centre.[19]

In relation to the problem of measurement of dependence, Cordoso stresses that such a measurement of dependence or independence of Sovereign states and its scope does not explain key problems:

a) the dependence of which socio-economic classes or groups has diminished ?

b) which classes have become more independent ?

c) what alliances and interests within each individual country and at the international level provide the direction to the historical process of development.[20]

The problem of economic alliance as the fundamental cause of dependence and under-development of the peripheral countries belongs to the most widely discussed issue with-in the dependency thought.

19 Cardoso and Faletto. Dependency in Latin America, Berkely press, London, 1977.

20 Cardoso, Capitalist Development and the State bases and alternatives in "Ibro-Americana", 1978,. Vol.7.

Cordoso's views were upheld by G.Frank who thereby revised substantially his earlier propositions. In his book "Lumpen Bourgeoisie, Lumpen development, Dependence, Class and Politics in Latin America", Frank stresses that the most important thing is to understand under development in terms of social / economic classes. According to him, bourgeoisie generates the policy of under development in the economic, social and political life of Latin American nations through the use of Government as well as other state instruments.

Later C.Leys in his study of Kenyan society and economy arrives at the conclusions similar to Cordoso's that peripheral bourgeoisie collaborated with the bourgeoisie of the centre, and it is its natural ally in the exploitation of the peripheral.[22]

The outflow of surplus is in view of Leys secondary importancein so far as it is a natural phenomenon in the capitalist development of the periphery. He also says 'under development of the periphery is not caused by the transfer of surplus which is appropriated by the metropolis capital, and this is irrespective of its dimensions. Such transfer should be considered as an effect of peripheral structure which discourage production investment that would rely in the surplus generated in

[21] A.G.Frank, Lumpenbourgeiosie, Lumpen development Dependence, class and Politics in Latin America, New York, MR Press, 1972.

[22] C.Leys, under development in Kenya - The Political Economy of Neo-colonialism, London, Heineunon, 1975.

the periphery.[23]

The second thesis was not confirmed by the Canadian economist Ms.Nicola Swainson, in her detailed study of capital structure in local and expatriate corporations in Kenyan industries, she maintains that local capital extended its pattern of accumulation into manufacturing industries. This has led to cooperation as well as competition with foreign capital.[24]

This is a compromise between the two extreme formulations of Leys. It is possible to affirm, therefore, that at early stages of development the peripheral economy is dependent upon the internal social structures while at some later stages it is dependent upon the internal and external structures.

Economic and class alliances are clearly relevant to the problem of the state activity to its role in the transmission of dependence as well as to the nature of peripheral development.

The state policy as resultant from the class struggles and the fundamental relations of dependence in the periphery is, according to the D'School subordinated to the mechanism of operation of the world capitalist economy. The state under peripheral capitalism developed and strengthens as a resultant policies pursue by the dominant classes which are favourable to

[3]C.Leys, Capital Accumulation, class formation, Dependence. Socialist Register, London, 1978.

[24]N.S.Wakinson. The Development of Corporate Capitalism in Kenya, 1918-1977, London, Heiman, 1983.

the development of the corporate system as well as due to links between entrepreneurs are conducive to the emergence of a specific market, for the peripheral capitalism. In its operation it relied on income concentration and marginalisation of the society. In consequence the state is being separated from the nation and state policy does not serve the national interests.[25]

As the D'School development and its influence various studies appeared which were focussed on specific types of symptoms of dependence (in trade, finance and technology). The scope of these studies was usually restricted to the indication of various forms and manifestations of dependence and of its impact upon selected sectors of the peripheral economy. Such studies were aptly described by T.Billick as "Dependence worries" and were treated as a separate strand. Killick as well as Caporaso, Zare and Gobalet (all African Economists) introduced the distinction between dependence and dependency. The former is assumed to be result of trade capital or technological ties with other countries. It does not lead to lasting negative economic effects and economy, in question, is able to operate without such ties. But dependency on the other hand springs from the integration of

25 T.Santos 'Dependence Relations and Political Development in Latin America. some considerations' in Ibero-American, 1977, vol.8, pp.12-18.

26 T.Killick 'Trends in Development Economies and their Relevance to Africa, in Journal of Modern African Studies, 1980, Book No.3.

the periphery into the world economy and as such generates durable transformations in economic and social structures of the peripheral countries. Therefore dependency can justifiably be seen as a wider concept than dependence.

1.6 DEPENDENCY AND UNDER DEVELOPMENT :

The relationships between dependency and under-development constitute the central problem as well as the main point of contention of the D'School. However, this is not to say that the dependence writers devoted most of their effort to its study. The reverse is true, most of their attention was directed to the problems of functioning of the peripheral economy.

In the multifaceted opinions of the dependence writers one can discern three approaches to the problem of dependence and under development of the periphery.

1. Dependency generates growing under-development of the peripheral countries in relation to the countries of the centre.

2. Dependency leads to a specific, distorted pattern of development ie., to the so-called peripheral or dependent capitalism.

3. Dependency leads to a specific, distorted pattern of development, in other words, dependence promotes growth and development in some peripheral countries, while gives rise to under-development in some other areas.

27

S.Lall "Is dependence a useful concept in analysing underdevelopment ? - in World Development, 1975, Book No. 11/12, pp.No.807-809.

1.7 DEVELOPMENT OF UNDER DEVELOPMENT :

For a long time the D'School was being identified with the under development and as such attracted the attention of both marxist and development economists. The diagnosis of under development which was contrary to the western theory of the identification of causes of under development in the external factors ie., the links with the capitalist countries and not in natural and economic conditions prevailing in the backward areas as well as the promotion of the idea of disassociation from the world capitalism as a necessary path of development in the periphery have made the D'School world renown.

The works of dependence writers of 1960s were fairly uniform in their conviction that capitalist development in the periphery was impossible both in case when it is imported from outside or generated in an autonomous fashion. It is quite surprising to note that in spite of the initial relative unanimity as regards the consequences of dependence there have always been quite diverging news among dependence writers as to what the dependency itself was. The difference were also particularly notable in respect of manner and mechanisms through which dependency influenced the under development in the periphery.

A.G.Frank indicates the existence of internal and external monopolies in the economies of the peripheral countries. These monopolies saturate the satellite economy with capitalist structures and generate the phenomenon of exploitation of satellites by metropolis. Its most visible manifestation is the appropriation and transfer of economic surplus.[28] A.G.Frank defined capitalism and feudalism are not modes of production but as a socio-economic system characterised by specific types of exchange relationship. He thus neglected their connections with class structures and relations of production and built what is rightly emphasized by e.Laclau static and mechanistic model of under-development incapable of fully explaining the social transformation brought about by capitalism in the peripheral countries. [29] Similar drawbacks are shared by mechanisms of social and economic under development sketched in the works of Dos Santos and S.Amin. Dos Santos view is that capitalism was transferred from the centre to the periphery along with the mercantilist expansion of Western Europe into the vast areas of Latin America.[30]

S.Amin in turn claims that dependent capitalism (which sub-ordinated pre capitalist modes of production existing in Latin America) originated as a result of the domination of unequal

28 A.G.Frank "Capitalism and Underdevelopment, op.cit.

29 E.Laclau : Feudalism and Capitalism in Latain America is New Left Reviw, 1971

30 T.Dos Santos "The Crises of Development Theory and the Problems of Dependence in Latin America in H.Benstein (ed) Underdevelopment, the Third World to-day - Harmonds Worth Publication, 1973.

exchange and asymmetric international co-operation. [31]

All the dependence writers subscribing to the development of under development thesis do not mention the loss of the economic surplus. A..G.Frank devoted to this pehnomenon in his analysis of the exploitation of Chile, but hardly mentions it in the case of Brazil. Moreover, the proofs of large scale transfers of surplus which are supplied by dependentists suffer from significant methodological drawbacks. Dos Santos in his calculation leftout indirect contribution of foreign capital to the growth of production exports and imports which has led to the exaggeration of losses. Besides, he did not consider the time lag between the moment of investment outlays and the moment of repatriation of profits generated by it so that the calculations were very in-accurate. In Emmanuel's theory of unequal exchange [32], we can also find shortcomings those can partly be summed up as the limitation of his argument to the supply side only, the neglect of demand in the price mechanism for both means of production and exchange of commodities. Profits that the developing countries obtain from the production and sale of numerous goods are determined not only by this mechanism described by Emmanuel, but also by some other factors, such as monopolistic regulation qualifications and labour intensity in both groups of countries. The structure of resource allocation, state interventionist, which

[31] S.Amin "Unequal Development, London, 1974".

[32] A.Emmanuel "Unequal Exchange" O U P , New York, 1972.

are all left out of consideration. In consequence, Emmanuel's theory is neither a sufficient proof for the existence of the inequality of exchange nor does it yield sufficient evidence to lack the thesis that dependence is at the root of progressive under-development of the peripheral countries. A.G.Frank says "even a nationalit Govt. can't successfully promote capitalist development because of the constraints imposed by the international environment". In his opinion the state remains an entirely sub- ordinated element of global system irrespective of its political sovereignty.[33] None of the dependence writers presented a full and convincing picture of all the mechanisms that could lead to the reproduction of under development in the countries of the periphery. Their explanation raise numerous doubts and leave many questions unanswered. It was fairly difficult to provide practical verification of Frank's contention about the development of under-development. In spite of the fact that Frank was fully conscious of the economic situation in Latin America which has resulted from the colonial and imperialist expansion, his definition of under-development is not quantitative and measurable but qualitative and non-measurable. Frank concludes that "Underemployment is not simply lack of development or non-development, but it constitutes a unique social economic structure generated by the integration of a given economy into the realm of developed capitalist countries.

33 E.Markowska, Dependency debate on the concept of the state in Economic Papaers, W.S.E, 1985, Warsaw.

The interests of foreign and local business class are clearly manifested in the creation of export oriented enclaves in agriculture and mining. The indigenous business class fostered [34] establishment of industries production of luxury consumer goods. In this manner, the pattern of growth of demand, which, by the way, does not reflect the needs of the people. The emergence of dependent and distorted structure favoured the transplantation of new order. Monopolistic sectors which were not integrated into the domestic economic structure, such as altered organizational structure has effectively shifted the growth of demand for labour and excluded large portions of labour force from the market. Additionally, this was the fundamental method where dependent capitalism disseminated against masses. Thus, the dependency writers analyzed the structure of the periphery from the point of view of economic mechanism that created it.

The criteria followed by the dependence writer to the evaluation of under development are very general, quite imprecise. They do not provide the basis for easy comparisons between individual peripheral economies. The dependency theory is capable of giving a clear and precise typology of peripheral countries as regards the level and character of underdevelopment, except different studies specified the individual regions (Latin America, The Caribbean , Africa and Asia). It is not all straight forward to say that the poor suffers from exploitation and if year

34 S.Amin - Accumulation Development : A Theoretical Model in Review of African Political Economy, 1974, Vol.1

to what extent ? A number of D'School writers assume that poor classes are indeed exploited and oppressed but did not explain how this takes place ?

Hence, lack of conceptual clarity affects to an equal degree the categories of under-development and exploitation.

The radical writers in D'School have given scope to numerous criticisms. The subsequent evolution of the D'School was greatly influenced by E.Laclaw whose critique had given rise to new way looking at dependence problems, and as well as the arguments of Warren and Weisskopf. The arguments of Warren and Weisskopf based on the comparison of growth rates in the countries of the periphery and those of the centre in 1970's. By taking the four South East Asian countries as examples, Warren has demonstrated that peripheral economies are capable of sustained growth through the development of the industrial manufacturing sector.[35] While Weisskoof showed that a number of peripheral economies increased their national income at a faster rate than the centre.

CONCLUSION

So the growing development of under-development thesis was no longer relevant for atleast three groups of countries (i.e New Industrializing, Second generation of Industrializing and OPEC

[35] B.Warren, Imperialism Capitalist Industrialisation in Left Review, 1978.

[36] Y E Weisskepf "Dependence as an exploration of under development. A Critique - Michigan, 1976.

countries). It looks Palms is right in stressing that D'School writers are all too eager to jump from the analysis of specific economic, political and social contradictions generated by dependent capitalism to the conclusion that, in the situation of dependence, capitalism has lost its progressive character.

CHAPTER - III

BRETTON WOOD INSTITUTIONS AND DEVELOPING ECONOMIES

INTRODUCTION:

Historically 'Economic Liberalism' was of Western thought where economic institutions like International Monetary Fund (IMF) and World Bank were infact the front institutions of the western economic systems comprising of the early western colonisers who subjugated the colonies of third world during last three centuries. In other words, western economies adopted subtle packages for their imperialistic tendencies to be imposed upon less fortunate countries. Such a mission had been extended universally that the western missionary zeal have now been changed into a international model of economic development through the vehicle of its preachings, a model that has yielded such wealth in the west that has now become a source of hope and emulation to the whole world. One consequence of this success is that economic affairs of a growing number of countries in the third world have been totally subjugated to the western financial institutions, General Agreement on Trade and Tariff (GATT) negotiations, Multinational companies (MNCs),experts and specialists,-all those creators of wealth. . *i*

The manpower and natural resources of the developing countries were arrogated to serve the interests of western economic and industrial systems. When discussing the terms and procedures of international trade treaties and agreements concerning GATT and intellectual rights and negotiating the terms of servicing our debts obligation to the west,historicity of developing countries debts playing an adverse role with unequal treaties and open door trade agreements, imposed by the invasion of western companies. The developing countries can not retaliate the invasion of the west nor can quantify the western debt to them. International trade with unequal though apparently to be mutually advantageous but the combative cost advantage in the historical experience of trade has been one of domination by the strong and deprivation of the weak as an instrument of exploitation of the developing economies.

According to the world bank and IMF, the crisis of the country would undergo certain stabilization programmes in order to overcome the problems. This chapter 3 divided into four sections 1) Bretton woods institutions and Role of lndia, 2) Stabilization policies and Economic reasons, 3) IMF packages - some case studies and results, 4) Development Assistance and MNCs.

1.1 BRETTON WOOD INSTITUTIONS AND INDIA :

The Bretton Woods conference held in 1944, designed an institutional infrastructure that embodied the principles of liberal international economic order, while adherence to the rules of the IMF would provide macro-economic equilibrium, without which the maintenance of a liberal trading system was economically less compelling and politically more difficult. The GATT provided rules reflecting multilateralism and non-discrimination that would enable the contracting parties to reap gains from trade according to the principles of the theory of comparative advantage.

India did not take an active role in the past rounds of multilateral trade negotiations (MTNs). An outside view is that by taking a back seat, India took advantage of a free rider position. Its own trade restrictions were safeguarded by the special and differential treatment (S&DT) accorded to developing countries in GATT while India got the benefit of tariff reductions negotiated in the successive rounds owing to the principle of the most favoured nation (MFN) status.

But India view is very different on GATT, India was placed at a disadvantage in terms of negotiations and the net outcome of the negotiations was that the tariff reductions on export products. Besides the beneficial effect of tariff reductions was offset to a certain extent by non-tariff barriers set up by the developed economies on which the rounds of negotiation have had little effect. It is a process in which countries trade power they command by virtue of their imports and exports in huge numbers for trade concessions. India whose share in world trade is 0.7% does not have any leverage to obtain concessions.[1] United States (US) used to obtain significant concessions from the EEC in Kennedy round. India which probably suffered more in relative terms from Britain's entry into the community, tried hard but got no compensation from EEC. In the recent round US sought compensation from EEC for losses it has suffered through the entry of Greece and Spain into EEC, and has threatened punitive tarriffs on a

[1]A.V.Desai-Uruguay Round and India in "Dpmestic Trade Politics and Uruguay Round" Colombia University Press, New York, 1989.

number of EEC products. India's textile products have suffered too. The low levels of India's perceived economic interest in the Uruguay round made its position there particularly vulnerable to India's over all foreign policy. This has a positive and negative aspects.

The net advantages to India from GATT until the Kennedy round were two fold.

1) India received the benefit of the opening up to developed countries. It did not have to abandon its quantitative restrictions or bind its tariffs owing by Special and Differential Treatment (S&DT) for developing countries for joining.

2) If the structural adjustment programme aims to help and assist the third world in their advancement and economic betterment, then poverty alleviation must be integral to the adjustment packages.

Since the basic objective of a poor country is to over-come poverty and to improve economic betterment of the poor classes,India's efforts to promote exports manifest a number of contradictions. Thus, the export of certain products puts them beyond the reach of low income consumers. The consumption gap between the rich and poor therefore widens, with a consequent receding of the goal of a reduction in economic inequalities.[2]

The present day interdependence is one which combines

[2]Samuel Parmer - Self Reliant Development in an interdependent world in "Beyond - Dependency" edited by G F Erb and V.Kallab, Overseas Development Council, 1975, New York.

sophistication comes from enhanced technological capabilities and expanded social intellectual awareness, the symmetry emerges out of a new egalitarian morality combined with a more balanced capacity for mutual harm. The combination of an egalitarian ethic and reciprocal vulnerability within a framework of wider technological and intellectual frontiers provides the essence of mature interdependence.[3]

II. STABILIZATION POLICIES AND ECONOMIC REASONS :

Stabilization program consists of five kinds of policies they are :

a) 'Austerity' in the sense that the public sector is expected to contract its fiscal deficit (in real and even in nominal terms) and to borrow less from the Central Bank, and include cuts in state spending for public investment and social service programmes resulting into higher prices for products supplied by public enterprises and increased taxes.

b) Revision of the exchange rates in most cases directed towards weakening or devaluation of the host country. Appreciation is occasionally recommended as a anti-inflationary measure.

c) Monetary restrictions, involving not only restriction on credit to the public sector, but also reduced private credit limits, interest rate increases, and similar manoeuvres as applicable in the institutional context.

d) Policies aimed at improving economic performance in the medium

[3]A.G.Mazrun - The New Interdependence in "Beyond Dependency" edited by G.F.Erb & Kallab op.cit.

term. Since the IMF and Bank are market oriented their suggestions usually include 'liberalizing and privatization' if the system by removing state interventions in domestic r.arkets. Lowering trade barriers and easing off on exchange controls. More specific recommendations may include interest rate increases consistent with tight money aimed at raising saving cuts in the real wage. Price incentives for exports and usually non price supply policies such as directed planning and public investment are given short shift.

e) Income policies consistent with the manoeuvres just enumerated are used to redirect specific payments flow, wage restraint, revision of subsidy and transfer payments programmes and stimulate for import-substitution or export promotion which favour certain economic groups are frequently observed. Thus all these are called as stabilization measures of the fund and bank.[4]

II.A. URUGUARY ROUND OF GATT AND INDIA :

Though, initially India opposed to active participation in GATT rounds and earlier plagued by the bitter disputes e.g. on Agriculture, as well as between the developed and developing countries, the Uruguay round was successfully concluded in April, 1994. A key feature of the agreement was the carefully balanced set of concessions between the developing and developed countries that covered the three main sets of negotiating issues.

[4] Wider Studies in Development Economies. Lance Taylor Varieties of Stabilization Experience, Oxford, Calarendox.

In brief they are as follows:

X) The issues not previously covered by GATT and involving forms of deep liberalization previously mentioned, specifically a) trade in service, b) trade based aspects of investment measures.

2) Issues covering areas that had initially been subject to standard GATT rules but were later excluded from GATT discipline for special reasons namely, Agriculture and Textiles / apparels ; and

3) Those related to traditional GATT issues such as tariff Liberalization, subsidies, dumping, Govt.procurement, technical barriers of trade, dispute settlements and institutional reforms. [5]

India earlier to mid-1991 twice tried stabilization policies, the first programme involved a devaluation in 1966. The other one the process of trade liberalization was supplemented by some easing of industrial licensing and fiscal reform in Sri.Rajiv Gandhi's early administration. It was not until the macro economic crisis of 1991 forced into the arms of World Bank and IMF

[5] Robert Baldwin - Development prospects under increasing Globalization - a paper presented in International Conference on India's Economic Reforms, 12h February, 1996 at ICRIER, New Delhi * ICEG, Sanfransico, USA.

so that a more serious attempt at Liberalization.[6]

It is argued that growth in Indian Economy constrained by one or more of three factors.[7]

1. Potential Savings
2. Food Supply, and
3. Available Foreign Exchange.

During the last 3 decades trends in Agriculture output growth accelerated due to new technology, public investment in irrigation and supportive price policy, although the economy remained vulnerable to adverse food supply shocks from bad monsoons. At the same time, the rural incomes of agriculture origin, and income distribution shifted towards the urban middle class and upper middle class and rich class for several reasons (worsening terms of trade and falling wage share) making the aggregated consumption basket more towards non-food intensive items drawn from imports and less of food intensive items due to demonstrative effects of change in imports and consumer preferences. With the rise in oil prices of 1973 onwards the above trends drained off foreign exchange causing binding restriction on growth.

III. IMF PACKAGES- CASE STUDIES:

Trade liberalization may stimulate output (at least in medium

[6]Deepak Lal : India & China Contrasts in Economic Liberalization? World Development Vol.23. Great Britain-

[7]Abjit Sen - Stabilization - Indian Experience - in Wider Studies in Development Economics. op. cit.

term) by creating neo-classical economic efficiency gains. It may also hold down inflation rate, if the law of one price broadly applies, such views are typically Brettonwoods institutions. By contrast the wider studies[8] suggests that liberalization may force de-industrialization if it draws in imports and not have much effect on inflation, if the laws of one price is not enforced by a visible presence of price, competitive traded goods in the system. Anti-liberal policies such as import quotas and export subsidies have positive effects under these circumstances. Colombia and Kenya provide successful test cases.

Exchange liberalization may facilitate capital inflows and create financial depth in the downside it can permit flight and precipitate examples of the latter events as well as situations like Colombia's and Brazil's where exchange restrictions held down capital flight. The World Bank and Fund (IMF) feel that, because it removes distortions exchange liberalization should be pursued.

Interest rate hikes typically reduce aggregate demand in the short run, will they also be inflationary by driving up working capital finance costs ? several wider studies reports that stagnation after interest rate hike in their economies is observed IMF says that such outcome never occur.

In the short-run devaluation tends to be inflationary by driving up intermediary import costs and there by final goods prices through markups. The higher prices cut real wages while

[8]Lance Taylor - Varieties of Stabilization Experience - in Wider Studies - op. cit.

devaluation itself reduces national purchasing power when imports initially exceed exports. At the same time real depreciation may stimulate import-substitution and an export response through the first two channels devaluation will make output contract especially in a stagnant economy. Better trade performance may make GDP to go up.

Devaluation has economy wide repurcussions dependenting on institutional circumstances, in primary exporting countries. It is a tool of fiscal policy, the cash flow of state marketing boards and depends on the difference between producer prices and the exchange rate determined by broader price of export crops. Else-where Wealth effects may be important, aggregate demand probably feel no further, that happened in Mexico after 1982 due to devaluation which increased the value of capital that has flown across the border in Peso (Mexican Currency) terms, stimulating tp spend on the part of rentiers. The country studies emphasize such linkages ; but Brettonwoods approach is to turn them down in favour of price induced substitution effects.

One may ask whether devaluation and other price policies will improve readability (reducing import co-efficients and increase export market penetration) by themselves ? Alternatively is devaluation effective only in connection with other policies such as direct credit, import tariffs, holidays for exporters and commodity targeting along South Korean lines of 1960s and 1970s and so on.

The Brettonwoods institutions view is that devaluation and other price signals do not require complementary interventions to work.[g] The authors studies are opposed to it.

Latin America caught in Debt-trap by raising interest payments on foreign debt and falling exports proceeds due to recession-structural adjustment became the order of the day replacing basic needs of growth with equity in developing economies. Govt.s have to take Draconian measures to cut public investment programmes and imports, workers have to accept reduced levels of purchasing power and employers had to adjust to protectionism abroad and lack of foreign exchange at home.

IV. DEVELOPMENT ASSISTANCE - MNCs

As the result of World Bank and IMF packages into developing economies the liberalization and privatization takes place as a result of multinational enterprises / companies (MNCs) comes into the picture.[10]

IV. 1 MNCs pursue their foreign investments for three main reasons.

a) To take advantage of sales potential or to avoid barriers t imports in the host countries.

b) To take advantages of cost-opportunities (particularly

[9] International Labour Organisation (ILO) - Structural Adjustment by whom ?, for whom ? - Asian Employment Program (ARTEP) New Delhi.

[10] Constantino, V.Vaisots-Foreign Investment & Productive Knowledge-in Beyond Dependency, op.cit.

low-wage / cheap labour) in the host countries that are critical to the competitive position of their products in world markets, and

c) To secure access to foreign sources of critical inputs, such as mineral resources.

IV. 2A study by United States of America (USA) Senate indicated that the late 1960s the USA obtained significant overall benefits from the World-Wide operations of US based MNCs.

There are atleast two different perspectives from which the economic effects of foreign investment on developing countries can be evaluated, the first involves analysis of different economic indicators of the impact of foreign investment (eg. income effects, BOP effects and employment etc) on host country alone.

The second requires analysis of the total benefits obtained from such investment and the way they are distributed among all participants.

CONCLUSION

Some of the negative effects could have been reduced or even avoided by correcting certain Govt, policies such as the high level of protection of foreign affiliates although, such policies

U.S.A. - Senate Committee on finance "Implications of MNCs for World Trade and Investment and for US Trade and Labour Washington D.C.
- US Govt. Printing office, 1973.

are not independent of the terms set by such firms as conditions for their entry into the country. Not all investments are in the interest of host-countries, in such cases developing economies need to have an evaluating and regulatory capability and the political will to refuse the entry of such investments in the first place. After coming across all these facts and results of studies of different economies, it is clear that IMF and the World Bank could and influence the developing countries development.

CHAPTER - IV

PUBLIC SECTOR - ORIGINS AND GROWTH IN DEVELOPING ECONOMIES

INTRODUCTION:

Most of the developing countries has been shifting from massive investment in the public sector. Much of the output of the public sector plants was in the production of capital and basic goods (the former includes machinery, while the latter includes basic intermediate products as fertilizers, heavy chemicals, cement, iron and steel, and non-ferrous metals). The larger private firms which came under the licensing and other control procedures of the Government were largely concentrated in the production of a few agro-based intermediate goods (non-capital and non-basic inputs) and final consumer goods. The results of earlier industrial policies in the developing countries were mixed. Despite public sector achievements of commanding heights and capital intensive diversified products of growth in the developing countries there were problems of structural retrogression and stagnation in the industrial sphere since mid sixties.

Apart from the statutory which were applicable to the public sector was subjected to additional controls, the expenditure of foreign exchange by the public sector enterprises was subjected to far greater scrutiny by govt. departments, than was the case with the private sector, the matter of pricing and distribution and even in respect of what it produced, the public sector was subjected to far greater control than the private sector. The results in the public sector have been long delayed in decision-making, all too often very weak management, inability to reduce results in the public sector have been long delayed in decision- making, all too often very weak management, inability to produce labour costs, and a frequent high-cost, low-return operation. In addition, while originally, govt.-ownership was meant for capital goods and basic industries, public ownership has served as a last resort for manufacturing Formerly private firms that would have other wise gone bankrupt are closed, adding to the local unemployment. In this chapter we are going to prove public sector in developing countries and how that would lead to present situation in the light of liberalization era.

1.1 ROLE OF PUBLIC SECTOR VS PRIVATIZATION :

There have been the rapid strides attaining commanding heights unchecked for growth in public sector investments in state owned enterprises (SOEs) in many developing countries like Malaysia, Malawi, Trinidad Tobago, Papua New Guinea, Kenya and India, during their post-independence period. This common feature to all was/is on account of some of those developing countries ad-oping socialistic systems, some adopted mixed and others even if they adopt capitalistic system; Wherein the role of public investments in critical and strategic sectors was / is not ruled out but more often found obligatory atleast to serve as contra cyclical measure and to regulate and assist if not to control the role of public sector. Particularly in mixed economy like India both the experience and policy have been that the public sector, in addition to its role of state-owned public enterprises to grow in command heights, served to assist, incentive, help-regulate re-invigorate, channelize and control, as per development plan priorities the private sector investments; and administering the supplies at reasonable control prices of public goods to the advantage of private sectors activities, i.e, stimulating effects rather than crowding-out effects to function both as complements but not as competitive substitutes irrespective of the above features of public vs private economic system and / or institutional setup and changes in the institutions and in their systems both the sectors are mutually reinforcing for their growth, both employ public investments can set for growth of private sector or coporate sector.

There have been rapid strides attaining commanding heights unchecked for growth in the public sector investments in SOEs in developing countries in the past. For many developing countries including those covered in the study the dominant feature of their post-independence economic history has been the rapid growth of the public sector. Public intervention in the economy was a since quanon of policy thought the 1960s and 1970s, and the SOE sector has been one of the most common instruments used to effect such intervention. The SOE sector has traditionally been a major consumer of resources and credit is responsible for a major share of fixed capital formation is one of the largest employers in many economies and accounts in many cases for a large share of the public sector deficit.

Measurements relating to growth of public sector depends on data reliability and differences in definition and biased due to inter-agency transfers and other off-budget resource flows. Estimates vary widely but some strong trends emerge. Nellis [1] conservatively estimated that for a sample of sub-saharan African countries, the contribution of the SOE sector to total GDP was 17%. He noted elsewhere [2] that this might blow with a high variance, having many cases (even outside centrally planned economies) where the SOEs accounted for over 50% of total GDP. The public sector generally accounts for a similar proportion of gross investment, although in the smaller economies especially in Africa, the share is higher. The considerable presence of the SOE sector is offset, however, by the flow of funds to it from other sectors of the economy. The SOE sector is rarely a generator of surplus funds, and on average is a net debtor with respect to central government (and through the Govt. budget to the domestic and foreign private sector). A recent evaluation by the World Bank shows that, for a sample of 25 developing countries [3] the

[1] Nellis, J.R. - Public Enterprises is Sub-Saharan Africa World Bank Discussion paper 1. Washington D.C. 1986.

[2] Nellis and Kikeri - Public Enterprises in Sub-Saharan Africa. World Bank Discussion papers 4 Washington, D.C. 1989.

The World Bank World Development Report, Chapter 8, World Bank, Oxford University Press, New York, 1989.

median SOE contribution to the overall public sector deficit was 48%. Its share of domestic credit has been estimated at around 30% with a similar share of total external debt.[4] The SOE sector is however, frequently highly skewed and in general a small number of SOEs account for a large share of output, total employment and new profits or losses. For example, the aggregate total performance for the SOE Sector in Malaysia (which as a whole is profitable) is highly distorted by the size and profitability of the Nationak Oil Company (PETAONAS) whose turnover alone accounts for almost 30% of the total turnover of the 100 SOEs in the country. [5] Behind this aggregate lies a large number of poorly performing companies. A similar example comes from Jamaica where the combined budget of the 21 largest SOEs were equivalent to the total Central Govt. Budget. The sector is similarly skewed in terms of its areas of involvement, especially in Africa. SOEs generally are dominant in the utilities sector for example 86% of utilities in Africa and 6% in Asia are publicly owned.

In Africa, however public ownership also tends to dominate in the transport (41%) and Mining (55%) and is also a major player in the Manufacturing sector (21%). Exposure in the manufacturing sector is significantly lower in Asia and the Caribbean where the

[4] The World Bank World Development Repot, Chapter 8, World Bank, Oxford University Press, New York, 1989.

[5] Peoples National Bank - Economic Report of Treasury - Malaysia - PNB, EPE and KLSE, Annual reports, Malaysia, 1990.

indigenous private sector is generally buoyant[6] the dominant presence of the SOE sector across many sectors serves to underline the fact that SOE performance is as much a matter of macro economic management as it is of micro economic efficiency.

l.2 GROWTH PATH OF SOEs Vs PRIVATIZATION :

The state owned enterprise sector in the countries broadly followed similar paths of specific experiences through different countries experience varying stages in development of each. The common experience reflects the main political and economic concerns facing all developing countries over the last 30 years or so. To some extent the various responses to the crisis of the SOE sector, especially privatization incentives, follow the same pattern in which divergence of approach mainly reflects underlying circumstances rather than fundamentally different objectives. Thus the privatization debate in developing countries is significantly motivated by the search for new instruments through which these same objectives can be pursued.

The facts of the growth of the SOE sector in the countries and its subsequent declining viability are presented as follows. The initial period following independence and lasting until the late 1960s saw only gradual growth in the sector, with the state taking an active role in the provision of naturally monopolistic services and, to some extent, in the purchase and marketing of

[6]John H Dunning - Multinational Enterprises, Economic Structures and International competitiveness. Chichester United Kingdom, John Wiley Sons, London, 1988.

primary sector outputs. The pervading strategy in other sectors was one of Lessaiz-faire in which foreign capital and management played a dominant role what was known as industrialization by government invitation and participation outside its core areas being driven principally by reaction and political expediency rather than by an active policy of interventionist. By the late 1960s and the early 1970s, political thinking, often in response to measurably worsening income distribution and rising unemployment in these new economies, shifted towards more careful economic management, in which public sector investment and employment decisions were grounded in a more exlicit welfare measures and in which the interests of the indigenous population were strongly represented. Particularly favorable economic circumstances of the early 1970s assisted in the promotion of a rapid (and ultimately unsustainable) growth in SOEs sector. Based on these ideas, strongly Govt, intervention, based on a mixture of Govt. investment in commercial activities and to a much lesser extent, outright nationalization, was financed through the combination of favourable shifts in the terms of trade facing developing countries in the mid-70s and a high inflow of official and commercial foreign capital by the end of 70s the SOE sector was the dominant player in many of these countries.

It was found that ownership, whether public or private, is not our evaluation but the key determinant of enterprise performance and the efficiency of resource allocation. As such the growth of the SOE sector need not be viewed strictly as a problem. however, as is widely and broadly seen, the growth of the SOE sector during the 1970s has been matched by a decline in its level of financial viability and a concomitant rise in the net flow of resources to the sector. Its drain on public finances and the inefficiency of this large sector remained as one of the the problems facing Govt.s in sustaining the SOE sector were not merely concerns about micro-economic efficiency but rather had macro economic effects on both the demand and supply sides of the economy. Consequently the sectors poor performance was seen as a major contributory factor to the alarming economic crisis.

By the end of the 1970s the SOE sector in many developing countries was performing very badly indeed. The problems of the sector is well known[7] viz.,

1. Political interference
2. Political appointments were widespread
3. Public accountability was nominal
4. Control of management was weak and
5. Administrative functions overwhelmed commercial activities :contradictory objectives dominated. Investments were excessively capital intensive and often suboptimal responsiveness to market conditions was often non-existent.

Many of the firms that had been taken over by Govt. on the argument that a) they were being run badly by the private sector had no corporate plans for recovery, and b) often performed even worse under state ownership than under the private ownership from

[7]Shirley - Managing State owned Enterprises, World Bank Staff

which they were supposedly rescued, c) on the top of this, it was not unusual for the sector to face chronic organizational deficiencies in its relationship with central govt., involving multiple controlling agencies, overlapping of functions, and an absence of performance criteria.

1.3 SPECIFIC COUNTRY EXPERIENCES*- DISTINCT PHASES OF DEVELOPMENT IN SOE SECTOR :

A) JAMAICA :

three distinct phases of development in the SOE sector can be differentiated for Jamaica. The first occured up-to independence in 1962. During which the Government's role in the Economy focussed on the creation of regulatory regime and the development of the key infrastructural sectors. The main areas of operation at the eve of independence were in regulation and promotion, social and community services, and manufacturing sector was restricted to intervention through two development finance corporations, while all the public utilities, except the railways, water and the post office, were still foreign owned.

The second phase coincided with the era of the first post independence government (the Jamaican Labour Party's)[8] and the creation of an explicit commitment to greater state participation in the economy. Although there was some growth in the fixe of the SOE sector during this period, the major growth did not occur

[8]J.L.P. - The Jamaican Labour Party

* Tables I, II and III presented at the end of allchapters (PP. 241-243) give the sources of quantitative information to make inferences of this section.

until the third phase following the election of the first PNP (Peoples National Party) Government in 1972.

The PNP Government committed to a socialistic economic strategy and adopted an aggressive industrial program aimed at direct control of the economy, and the achievement of income distribution goals. The growth of public sector during the late 70s was both precipitate and chaotic, and by 1980 accounted for around 20% GDP. Loss making SOEs abounded, accountability structures became amazingly diverse, while the financial control and monitoring system was moribund. Over staffing and the intricate weave of price controls to which the sector was subject rational resource allocation virtually impossible.

b) TRINIDAD & TOBAGO :

A Similar three phase development occured in Trinidad and Tobago, the first phase from 1956 (the date of independence) to 1970, embraced an identitital non-interventionist stance which combined the active promotion of private sector led industrialization with the creation of a regulatory framework, although a small number through bail outs. Following the Black Power Riots in response to increasing unemployment and worsening income distribution, the early 1970s saw a revaluation of the role of state intervention in the economy.

The second phase witnessed the shift to effective Government intervention through SOE sector development, this change in policy coincided with a rapid expansion of state revenue following the

[9] P.N.P.- Peoples National Party, Jamaica.

1973 increase in the Oil Price and the discovery of the Natural Gas Offshore.

The Government was able to finance the expansion of the SOE sector throughout the 1970s and 1980s through a policy of both nationalization and Government, backed creation of new industries. By 1986, the Government was the majority shareholder in 46 firms, in 35 of which it had 100% ownership. By 1985, the total value added of the SOEs was 16% of GDP, SOE sector employment accounted for 13% of total formal sector and capital investment for 26% of the total. [10]

c) MALAYSIA :

In Malaysian economy the origins of the SOE sector are initially tied up with the new Economic Policy (NEP) developed in 1970 following riots in Kuala Lumpur in the previous year. The NEP is an affirmative action program designed to reduce and eventually eradicate poverty by raising income levels and increase in employment opportunities for all Malaysians, and to correct economic imbalances so as to reduce and eventually eliminate the identification of race with economic function. Prior to 1970s Government participation in the economy was limited to regulatory infrastructural and marketing operations.

The 1970s witnessed an unparalleled growth in equity acquisition by the Government and its holding companies. As a

[10]International Finance Corporation (IFC) - Various Annual Reports and Facts Books of Emerging Stock markets, Oxford University Press, New York, 1990.

result through viewed as being fundamentally a market oriented economy by 1980s the SOE sector in Malaysia consisted of approximately 1150 enterprises, comprising the traditional core sectors i.e, transport, communications, water and energy. Additional importance was given to services sector, finance sector, construction and manufacturing sectors. As a result of overall resources of the SOE sectors were hidden by the early 1980s the sector accounted for 25% of GDP.[11]

d) . SRI LANKA :

Economic policy in Sri Lanka since 1940s has been directed towards the reduction of unemployment and the alleviation of poverty. In the first 30 years after independence in 1947, the problem was addressed by expanding the agriculture sector, and by expanding the agriculture sector, and by promoting an import-substituting industrialization strategy built around a core SOEs. SOE sector grew from the late 1950s through nationalization in the plantation sector, transport and financial sectors.

In the 1970 Government business undertakings act came into effect, and in 1971 land reforms act paved the way for the creation a large number of Government owned business undertaking and accelerated the process of nationalization in the plantation sector. By 1977 there were 250 SOEs covering all areas of economic activity in the economy, accounting 20% of GDP and 35% of Gross Investment and 40% employment. However the growth in the

[11] Ministry of Finance - Economic Report 1990 - Kaulalampur, Malaysia, 1990.

sector had slumped and employment creation had stagnated. In the 1977 liberalization of Sri Lankan economy contained the seeds for the latter attempts to rehabilitate SOE sector and to proceed towards privatization.[12]

e) KENYA :

The origins of the SOE sector in Kenya extended back to the early 1900s, with the creation of the East African Railway System, linking Mombasa on the Coast with the inland cities of Nairobi and Kampala. After independence in 1963, public ownership was widespread in infrastructure, agriculture marketing and also in finance sector. Until the late 1970s attention shifted towards the role of the state in resource management, under the 'African Socialism'. This combined with the goal of Kenyanization i.e, rapid acceleration of the transfer of economic control/power from the hands of foreigners and Kenyan Asians to Kenyan Africans. By the 1980s the SOE sector in Kenya consisted of 150 SOEs accounting 15% of GDP in the late 1970s and similar proportion of Gross capital formation, 30% of employment and 50% of public sector capital formation but later 1970s the SOE sector revealed the critical state and gave way for liberalization reforms.[13]

12

Central Bank of Sri Lanka - Review of the Economy, Colombo Press, Colombo, 1989.

13

I.M.F. Staff papers . The Kenya Govt. Fiancial Statistics - Flow of funds - State Owned Enterprises Sector - Kenya, Oxford Press, New York, 1990.

f) MALAWI :

In Malawi SOE sector is small in number of enterprises (it consists of 24 enterprises only) it accounts for a major share of GDP (25% in 1984) . Malawi's SOE sector has evolved in a manner almost identitical to that of Kenya. After independence of Malawi too got into public investments in infrastructure sector and development finance sector, in the early 1970s practical more interventionist stance pursued in the early 1970s and implemented through the operations of three large holding companies, the Malawi Development Corporation (MDC), the Agricultural Development and Marketing Corporation (ADMARC) and the Press Corporation [14], which were rapidly involved in the promotion of the manufacturing and service sectors. As with Kenya the 1970s were relatively favourable terms of trade which combined with low producer prices to generate large cash balances in the hands of ADMARC. These were invested in the non-traditional sectors. These investments were not self sustaining and the terms of trade reversal in early 1980s exposed weakness in the SOE sector, these weaknesses transmitted themselves in to problems of macro-economic management.

g) PAPUA NEW GUINEA :

The SOE sector in PnG is the smallest in the countries we covered in study, both in absolute and terms to GDP. The SOE sector accounts for approximately 10% of GDP and 8% of total

[14] The World Bank - Economic Statistics on Malawi - Oxford University Press, New York, 1989.

capital formation and a similar proportion of employment. It consists of 40 enterprises, covering commodity marketing, commercial statutory authorities (CSAs) which cover the main utility sectors and finance and a number of smaller commercial enterprises. The SOE sector is profitable. In the 1980s the SOE sectors problems were dissimilar to that other countries. PNG is a mineral based economy and stands to enjoy a substantial boom in that sector. The challenge for the non-mineral sector is how to manage the consequence of a mineral boom so as to avoid the problems of non-mineral sector, and latterly in respect of privatization, it has been more an issue of optimal management for the future an issue of optimal management for the future than response to failures in the past.

h) INDIA :

Prior to 1947 there was virtually no public sector in the Indian economy. As on March 31, 1992 there were 246 Central Government organized enterprises, excluding banks, financial institutions and departmental understandings like the Railways, Posts etc. Out of the total investment of Rs.135,871 crores at the end of March, 1992 the share of enterprises producing goods amounted top Rs.102,713 crores (75%) and that of service enterprises was Rs.32,085 crores (23%). The balance of Rs.1,073 crores was accounted for by companies under construction.[15]

15 Y.K.Alagh - Policy Growth and Structural Change in Indian Industry - E.P.W., Vol.22, pp.19-21, Bombay, May, 1987.

i) PUBLIC ENTERPRISES UNDER STATE GOVERNMENTS :

As on March 31, 1992 there were 636 state level public enterprises functioning in 24 states. the investment in State Enterprises as on March, 1986 was of Rs.10,000 crores. The 1956 industrial policy resolution adopted the socialist pattern of society as national goal led to a enlargement of the role of public sector.[16]

From the table III it may be noted that 48% of total employment (i.e. 88 lakhs) in the public sector is in government administration and the balance is spread in other economic enterprises run by the Centre, State and Local Government, the share of public in total employment in the organised sector reveals that in transport and communication, electricity, gas and water and construction the share of public sector is in the range of 9-98 percent, a situation of total dominance with the nationalization of Coal sector and takeover of 20 major commercial banks these has been a significant improvement in the position of the public sector.

During the last three decades, the share of public sector in Net Domestic product (NDP) ha shown a steady improvement. Public sector accounted for 10.5 percent of NDP in 1960-61 its share in 1987-88 has risen to 25%. The increase is significant one. The share of public enterprises, however, rose from 6.6.% in 1960-61 to 15.3% in 1987-88.

[16] I.G.Patel- On taking India into 21 st Century - Modern Asian Studies, Vol.21, pp.2, 1987.

Public enterprises survey (1992-93) has estimated the net profits earned by the profit making enterprises along with the looses suffered by loss incurring enterprises, during 1980-81 and 1989-90 there is a trend of decline in the ratio of losses and a serious reversal of trend has occured during 1991-92 and this ratio has again jumped to 59.3%.

1.4 SHORT COMINGS OF THE PUBLIC SECTOR :

The main points which merit consideration are :

a) MOUNTING LOSSES : A review of working of public sector enterprises in India reveals that either the profits in them have been deplorably low or that they have been making losses. Consequently, the losses are mounting year after year. Data given in table VI for the public sector enterprises both by the Central and State Governments enterprises reveal that as compared with performance of the Central Government, the State Governments are having perennial loss-makers like irrigation works, state electricity boards and state road transport etc.

b) Political factors influence decision making in location.

c) Delays in completion and increase in costs of construction

d) In efficient management.

e) Higher capital intensive ness leading to lower employment generation.

1.5 FUTURE DIRECTION OF POLICY :

Standard conference of public enterprises (scope) expressed opinion on the white paper of the Government of India on public enterprises (published in the Economic Times dated No.v.'1989).

The principal problems facing the public sector in India are :

1) Excessive Bureaucratization and lack of autonomy and no accountability,

2) Political interferences and suggested,

a) Privatization of loss making units and reduction of controls,

b) Changing work ethos in public sector undertaking.

CONCLUSION

The performance of SOEs are becoming bad and leading to the inefficient economies in most of the developing countries. There have been adopting to Privatization programs as a panacea to the public sector's vices.

Experience of Industrially Developed countries in the context of SOEs is same, but the privatization context is not. Privatization experience over a decade in developing countries is not simple. Privatization and liberalisation have been mutually reinforcing and exhibit a complementary role to perform in developing economies. Privatization is strongly suggested for SOEs ills in coming chapters will dealt with privatization exclusively.

CHAPTER - V

PRIVATISATION AND LIBERALISATION ISSUES : THEORETICAL OVER VIEW

INTRODUCTION :

Two major inter-related issues become relevant and important when examining privatisation in developing countries. First, an economic perspective firmly locates the key objective of privatization as that of efficiency improvement, in the theory of ownership transfer, which provides a coherent framework for analyzing the design and implementation of privatization to become an integral part of structural adjustment or part of a programme which aims at an economic restructuring in order to improve the efficiency of resource allocation. As one of the fundamental goals, efficiency improvement must be the yardstick against which privatization initiatives are judged.

Second, when theoretical arguments for privatisation are grounded primarily in the economic conditions of developed countries, and are applied to the developing countries, the situation becomes much more complex. Competitive goods, capital markets, high and efficient savings mobilization and effective regulation are exception to developing countries. Their absence requires an adjustment of the way in which the theoretical arguments for privatisation are applied in developing countries.

In particular, it is necessary to focus attention on

Marshall Goldman - "Economic Reform" in the age of High Technology ", New York, W.W. Norton, 1987.

limitations to competition, correspondingly more extensive role for monopoly regulation and competition policy and on constraints to privatization imposed by narrowly based capital markets. In other words, market structure, savings mobilization and regulatory capacity in developing countries, lead us to conclude that an adjustment is required in the role of privatisation in developing countries.

DEFINING PRIVATIZATION :

The term Privatization has been used to describe an array of functions designed to broaden the scope of private sector activity, or the assimilation of efficiency enhancing techniques generally employed by the private sector. Essentially privatization is only a process, and therefore the privatization implies the transfer from the public to the private sector of ownership and / or control of productive assets, their allocation and pricing, [2] and the entitlement to the residual profit flows generated by them. Another form of privatisation is by clarifying the nature and extent of the relationship between privatization and the wider issue of economic deregulation. Many aspects of deregulation, such as price-liberalization, abolition of import controls and the deregulation of factor markets, will affect the performance of public enterprises, either indirectly through the effect of deregulation on the competitive environment in which the firm operates. In principle, the distinction between the nature

[2] Pirie, M - Privatization in Theory and Practice. Adam smith Institute, London, 1986.

and effects of the two concepts is clear, and indeed en-ante, there is no logical reason why they should be connected. In practice, however, the identification of the separate effects of privatisation and deregulation on performance is often very difficult.

No identification of privatisation is ever likely to be water tight, and in many cases the extent to which 'Privatization' has occured is a matter of degree and interpretation.

POLICY OBJECTIVES OF PRIVATIZATION :

Privatization and liberalization emerged as policy issues amidst the debt crisis and worsening fiscal performances of the early 1980s. Many Governments have embraced privatization and it has quickly found a position at the heart of programmes of economic reform of development. It has been viewed as an instrument geared towards both short-term stabilization through expenditure reduction and also medium-term supply side improvements by promoting more-efficient resource allocation :

1) The first foremost objective is that of 'Public Finance Rationalization' . In the face of significant resource flows privatization is seen as away of reducing net-budgetary transfers and of eliminating confinement external debt-liabilities. Moreover, with Govts. under pressure to meet short-term budget deficit targets, privatization proceeds can generate valuable capital revenue, easing the pressure for expenditure cuts in other areas, and also reducing the adverse effects, which deficit

financing can have on domestic investment. [3]

2) The second set of objectives are the economic efficiency or supply side objectives. These, as noted, are closely related to the broader issues of liberalization, and are particularly relevant given the history of Government intervention in enterprise management. Attend to these two fundamental objectives are a host of other, somewhat broader, aims associated with a programme of privatization, and which themselves are also central to current thinking on structural adjustment debate. Amongst this is the use of public sector divestiture to 'crowd-in' a private sector. The direct relationship between privatisation and the pursuit of each objective is often clouded by the nature of the overall policy environment into which privatization fits.[4]

This chapter deals with these inter-related policy objectives of privatisation initiatives in the following sequence of subsection heads.

1.0 PRIVATIZATION AND PUBLIC FINANCE :

In terms of financial impact, the proceeds from privatisation represent the capitalization of future net resource flows achieved by the sale of the asset. Privatisation is a simple liquidity

[3]Glade - State Shrinking - A comparative enquiry into privatization, univ. of Texas, Austen, Texas, 1986.

[4]Pine - op.cit.

transformation of the Government's net worth.[5] Sale of state assets to the Private sector in an economy characterized by fully efficient capital and money markets full and cost less information and neutral tax structures. The price at which the asset is sold will be the sum of the discounted future profits generated by the asset. Thus the sale will result in the public and private sectors adjusting their relative liquidity positions, but leaving their respective networth unaltered. In particular whilst the immediate effect of an asset sale is indeed a reduction in the current budget deficit, this must be offset against compensatingly higher defects in the future caused by the loss of future earnings - stream from the asset sold. However if government were to invest the proceeds in income earning assets, and in capital markets are efficient, then the net earnings from investing the proceeds from the asset sale is say bonds will generate a profit stream of equal net present value.

The Private sector thus reduces its holdings of money (or other financial assets) and acquires equity in privatized enterprises, while the government reduces its equity and increases its holding of money. Here the physical impact is neutral.[6]

[5]The World Bank - World Development Report, Oxford Univ. Press, New York, 1988.

[6]The initial cash payment can be thought of in terms of subsidies - Debt write offs, etc., rather than cash payments.

CASH EFFECTS :

There are number of ways in which the public sector seller and the private sector buyer may have different valuations of the proceeds from a asset and hence bring about a real effect from privatization.

OTHER METHODS :

There are other methods in which the sale of assets can be non-neutral many of which are more likely to be pertinent in developing economies. An obvious example occurs when the government is credit constrained either domestically through controls being imposed on domestic credit expansion, or in international capital markets because of a loss of credit worthiness. such constraints increase the government's discount rate (reflecting its preference for current revenue) relative to the purchasers. The purchaser can consequently pay less than the value of the future profit stream - discounted at its (the purchaser's) rate of discount.

a) TAX DISTORTIONS AND VALUE OF PUBLIC FUNDS :

One recent contribution argues that real fiscal effects from privatization are determined by the value of public funds in the hands of government (Jones et al, 1990) The Jones, Tandon & Vogelsang (JTV) model starts from a similar basis to that of neutrality result.[7] They argue that if, because of tax distribution and incentive effects the value of cash from the

[7] P.Kregmann - Dutch Tulips and Emerging Markets, Foreign Affairs, July- August, 1995.

asset sale is greater in public rather than private hands, then there is a net fiscal gain to privatization. They also assume that this reduction in the dead weight cost of taxation will generally occur and hence that there is fiscal, if ultimately neo-liberal rationale for privatization.

Vernon (1988) in commenting on JTV model raises a number of questions about its assumptions referring in particular to the positive crowding-out effects that such large scale transfers may have.[8] Needless to say the argument acquires a greater degree of complexity when the purchaser comes from the foreign private sector, where the transfer of funds will affect the fiscus not only directly but also indirectly through the stabilisation requirements of changes in the balance of payments.

The same arguments applies, perhaps more strongly. Where the purchaser is foreign and the government faces significant foreign exchange constraints. Here, because of consequent constraints on import levels the Governments valuation of current foreign exchange will be higher than that of Private Sector.[9]

Similar non-neutralities will occur in the presence of a narrow tax-base or in any situation where an increase in the marginal rate of taxation would decrease Govt. revenue, as a

[8] Vernon - A technical approach to privatization (EOI Working Papers, World Bank, Washington, D.C., 1988.

[9] J.K.Galbraith 'Economics in the 21st Century - The Economic Journal, Vol.101.

result of 'Laffer-curve' effects. If there are differing degrees of risk aversion between the public and private sectors we may expert the same non-neutralities. Normally it would be assumed that, because of its size the Government is able to spread risk and will have a lower degree of risk-aversion. In such circumstances the value of the asset would be higher in the hands of Government and centers paribus, there would be no sale. Since the transfer of assets will in general alter the distribution of wealth in the private sector, this will generate second-order effects throughout the economy brought about by changes in the propensities to consume, to invest, to import and so on.[10]

GOVERNMENT CREDIBILITY EFFECTS :

The credibility of the Government in the eyes of private sector also plays a major role in determing the public finance effect of privatization. In this case, the problem facing the Government is how to convince the purchaser that it (the Government) will uphold the conditions of the sale and there-by maintain the future value of the asset. This problem arises typically because in a privatisation programme, the seller, i.e, the Government, has superior knowledge of the quality of the asset, and more importantly, has the capacity to alter its post-sale value in the hands of the buyer through policy and other interventions conditional on its sovereign authority.

[10]Jones - Benefits from Privatization - Boston University, Press, Boston, U.S.A., 1988.

This problem is of particular relevance in those developing countries which have a history of extensive state intervention in the economy, a record which has not been conducive to the maintenance of asset values in the hands of the private sector. If the private sector fears future re-nationalisation or other types of default, this will depress the price it is prepared to offer, and therefore generate a structural non-neutrality in the model. Creating a positive reputation thus enables the Government to signal a change in regime and commit itself against future nationalisation or other forms of punitive intervention.

This form of policy credibility creation also carries over to external relationship with the donor and foreign investor community. Both private and official foreign capital flows will be determined not only by perceptions of the viability of specific projects but also Government for not interfering with the terms and conditions of foreign investment. An important aspect of this is the credibility of Governments in meeting the conditions of adjustment lending. Official funds often tied explicitly to market oriented reforms with private capital flows being similarly but implicitly tied to the same reforms. In this respect the credibility of Government will determine the inflow of capital, but correspondingly it is a Government's commitment to privatisation that is viewed as a bench-mark signal in the development of a less interventionist, more market friendly policy stance.

Enhanced official aid flows and improved access to international capital markets thus represent important positive externalities flowing from the successful implementation of a privatisation programme.

2.1 ECONOMIC EFFICIENCY EFFECTS :

Privatisation is aimed at improving economic efficiency and is undertaken on the assumption that the production of goods and services is achieved more efficiently under the direction of private rather than public owners.

Privatisation, it is argued, will enhance productive efficiency (i.e. it leads to lower-cost production) and allocative efficiency (i.e. it forces down consumer prices so that they are closer to the marginal cost of production).

a) INCENTIVES AND OWNERSHIP : THEIR EFFECT ON PRODUCTIVE EFFICIENCY :

Supervising management and monitoring its productivity is a costly task facing enterprise owners, costly in terms of time and human resources, especially when the objectives of an enterprise are diverse. Moreover, the information on performance is hard to acquire and the link between inputs and effort on the one hand and outputs on the other are complex, the more diverse the objective of the enterprise the less effective the monitoring of performance will be, and the lower will be the level of managerial efficiency. Under public-ownership, enterprises are often used by the Governments to pursue non-commercial objectives which are inconsistent with efficiency and financially viable performance, for example, employment maximization objectives, non-commercial price setting aimed at keeping input prices low for other sectors, uneconomic investments and limited product innovation often dominate decision making at the expense of a more commercial orientation. Concomitant to the pursuit of these non-economic objectives by the owners of the enterprise is the inefficient monitoring and control of management.

On the other hand, private ownership, it is argued, is equated with a higher level of managerial supervision resulting in more commercial and more timely financial decisions (in terms of pricing, investment, R & D levels, innovation, product marketing etc). This results directly from the more single-minded profit maximization objective of private ownership which leads to a higher level of monitoring management performance, and the institution of more effective forms of incentives thus it will have more efficiency.

This is the crucial assumption of the privatisation debate, that the switch from public to private ownership should result in more precise and more measurable objectives on the part of the owners, which in-turn should create the environment and incentives to monitor and control management more efficiently. This improvement derives from the concentration of property rights over the asset.

Under public ownership, property rights are by definition, dispersed and no individual owner (i.e, the elector as share holder) has an incentive to bear the costs of gathering costly information and thus to exercise control over the management of the enterprise, principally because the benefits accruing to this effort can not be captured by the individual alone.. The dissipation of property rights under public-ownership thus serves the link between asset ownership and its ultimate control and management.[11]

In that context, the re-concentration of ownership in private hands allows the benefits of control to be internalized by the owners of the asset and there by creates incentives to bear the costs of information gathering and management monitoring. While the tradability of these property rights (i.e. equity) allows the forces of competition to drive this level of performance monitoring to an optimal level. This albeit powerful argument over simplifies the relationship between forms of ownership and nature of control of management in a number of respects.

First, while the creation of property rights is a necessary condition for control to be exerted over management, it is not a sufficient condition.

Second, notions of the public sector as a homogeneous social welfare maximizer and the private sector as a pure profit maximizer are some what naive. In reality, neither sector conforms to these types. While these assumptions are often convenient simplifications, maintaining then in the context of privatization serves to obscure rather than clarify the links

[11]W.R.Thirsk 'Recent Experience with reform in Developing countries. Richerche Economiche, Vol.44, No.2-3.

between ownership and efficiency.

There are two elements to the ownership argument. First, those who argue that differences between public and private ownership are necessarily 'intrinsic'. Rather the argument is such differences are grounded in the disparity between the objective functions of public and private sector owners and different forms of agency relationships of the ownership structures.

The differences between public and private owners are instrinsic claims that public sector owners will always pursue non-commercial goals for political ends. While there is plenty of evidence that this often occurs, there is no intrinsic reason why it is always the case. The fact that there are many examples of SOES (such as those operated in Singapore) which are not used in pursuit of non-commercial is an adequate reputation.[12] The presence of non-commercial objectives is more indicative of poor-management rather than an intrinsic future of all public ownership. the removal of such objectives may be necessary condition for altering the objective function of public owners, but it is not sufficient one.

The second element of the argument is that to compare the 'general equilibrium' objective function of public ownership with the partial equiibrium' of private ownership is generally an inappropriate comparison. To explain, the attraction of the shift from public to private ownership is that it replaces a complex,

[12]Glade - Op.Cit

'general equilibrium' objective function of the **Government which** includes not only static and dynamic considerations **but** also second-order effects in the economy (for example, the impact **the** actions will have on employment, trade and fiscal balances) with a tighter 'partial equilibrium' objective function of **the** private sector as principal. Because of these differences it is argued that **the** information requirement of the public objective function is much heavier than for the private sector, **and that it is** simplicity and lower informational demands of the private maximum and that foster the efficiency gains. Here this question arises what becomes of the additional general equilibrium elements of the public sector objective function ? In answering this, we encounter here the link between public and private ownership and the issue of regulation. In an ideal world where the social costs and benefits coincide with private costs and benefits then, concomitantly, the objective functions will be equivalent and their information requirements congruent in this case of transfer of ownership will not result in simplification of the objective function. In cases where social and private sectors and benefits diverge then further policy in the form of regulatory practice may be necessary to achieve social welfare objectives, consequently, the simple case of the general versus partial equilibrium comparison is inappropriate. Rather, the relevant comparison is between public ownership and private ownership with regulation, and with of the two can most efficiently acquire the necessary information and put in place the incentives necessary to extract efficient performance by managers (the agents).

Once we introduce the regulation, then, and acknowledge the necessary informational demands that it begets, the comparison becomes more complex.

PEOPLE AND SOEs :

The public sector characteristically the extended relationship linking the electorate, legislature, executive and bureaucracy in the public sector provides for complex agency chains. the first link is that between the electorate as principal agents and the legislature and executive agents.

While political success (i.e. continuation in office) may depend inter alia on meeting the concerns of the electorate about SOE performance, pursuit of economic efficiency in public enterprises is actually more likely to be subordinated to meeting the concerns of specific interest groups. This is the strongest when the benefits of efficiency gains to the electorate are dissipated widely, and the adjustment costs fall principally on an active political group. for example in a situation of chronic over staffing, the costs of adjustment will fall primarily on organized labour, the political power of such interest groups will determine how far the electorates concerns are transmitted into political action to reform the SOEs. It is straight forward, and historically accurate, to imagine situations in which the electorate is dissatisfied with the performance of the sector, but the power of those to whom the rents from inefficient SOEs are accruing will ensure that the general concern is not addressed.

However, as popular support for privatization has increased, so the electorate costs of ignoring the pressure for reform from the electorate, consumers has grown so as to ensure that reform and privatization emerge at least as covert objectives of government. The problems are similar to standard agency problems in industrial economics namely those of a Semitic information on the effort level of the enterprise management, and of the consequent ability of the management to extract rent from their control of information.

Public sector organizations face three particular problems. The first is that traditionally there are many links in the agency chain, and agents are often responsible to more than one principal. Second, the links between inputs (i.e. effort and efficiency) and output (profitability) are frequently weak. This arises both from the complexity of the 'general equilibrium' objective function and also from the fact that price setting is frequently controlled. Finally, prescriptions on the use of performance-related pay often deprive public sector organizations of one of the most important instruments available to private sector principles to influence the actions of the agent.[13]

3. a) PEOPLE AND PRIVATE SECTOR :

How, then will a change in the objective function of the principal, brought about by the transfer of asset ownership to the private sector, alter the performance of management ?

[13]Rees, R. - The Theory of Principal and Agent - Bulletin of Economic Research, Vol.37

The direct effect of curtailing some of the interventions is that Government's can make in an enterprise by strengthening the barriers between politicians and managers. [14] [15] The arguments for private ownership are based on simplification and streamlining of the agency chain, the greater flexibility in the design of incentive efficient contracts. At the extreme, if the owners are also the managers of the enterprise, or if the owners have complete information on the effects of manager's actions on enterprise performance, then it would be possible for share holder to monitor management and sanction its actions accordingly. However, as with incomplete information and / or multiple share holders (as with public share issue). The situation is less simple. Specifically there is a free rider problem, leading to sub-optionally low monitoring of management.

No individual has the incentive to incur the cost of monitoring except by the Board of Directors, who act for the shareholders as a whole to enforce behaviour from management consistent with profit maximization. The creation of executive management structures produces further principal agent relationships, hence the continual process of innovation in management structures in the private sector can be seen as an attempt to find the most efficient inventive contracts in the face

[14] Galal - Public Enterprise Reforms - A challenge for the World Bank - World Banks - Policy Planning Division Papers, 1990.

[15] Galal - Op. cit.

of inherent principal agent problems.

A second method by which shareholders can, in theory, ensure that management performs in a manner consistent with profit maximization is through the threat of takeovers. In an efficient capital market, share prices automatically reflect performance so that management inefficiency results in share values lower than profit maximizing level. A hostile-bidder could then but the shares at this level and earn a profit on the takeover by enforcing appropriate management behaviour.

Failure to perform renders the company liable to a hostile bid hence the threat of takeover creates a self regulating incentive scheme.[16] Thus, the effectiveness of the capital market in imposing managerial discipline requires first, that the share prices accurately reflect current asset values and, second that the number of players in the market is sufficient for takeover threat to be credible. The larger are privatization sales relative to average market size, the weaker the takeover threat will be in automatically regulating post-privatization performance.[17]

4. MARKETS. COMPETITION AND PERFORMANCE :

Though market liberalization and the promotion of competition are neither necessary nor sufficient conditions for privatization,

[16] Glade, op.cit.

[17] W.R.Thirsk.

they are often closely linked. The link occurs because a chief determinant of information costs is the degree of competitiveness in the market, competition generates information and lowers its cost for the owners of firms in the market (regardless of ownership), and it is the lower information costs which enhance efficiency as monitoring of management improves. Thus, changes enterprise performance have more to do with the nature of competition on performance.

First, the extent to which the existence of a competitive market environment facilitates greater control of management through the reduction in information costs and, second they way in which competition drives prices towards their welfare-maximizing level by eliminating monopoly profits.

Competition between firms in the same market means that prices and profits reveal information about the cost of an enterprise, and in particular about the efficiency of input use. Competition can have direct effects on the interval efficiency of the firm. Its main effect is the elimination of monopoly profits. A useful starting point for an analysis of this aspect of competition is the theory of contestable market's which identifies the conditions required to ensure that firms operate efficiently both intervals of managerial or cost-reducing efficiency, and also interms of welfare-improving pricing and investment (see Baumol et. al 1982) . In essence of contestable market is one in which any firm is continuously exposed to actual or threatened competition from efficiency producers who can enter the market at low-cost, under-cut the incumbents price and acquire market share. The threat of this profit reducing competition is thus the spur to efficient operations by all firms in the market.

Though con testability is evidently not a realistic description of markets in developed countries, it serves as a useful benchmark, against which to assess barriers to competition existing in most markets, and provides a guideline to assess the likely outcome of programme of privatization.

5. BARRIERS TO ENTRY AND MAINTENANCE OF MONOPOLY POWERS :

Contestability relies on the threat of market entry being the catalyst for competition. Its anti-thesis, entry-deterrence, is thus clearly central to the maintenance of monopoly or oligopolistic profits, and to the efficiency arguments for privatization. Traditionally many areas of SOE operation have been regarded as natural monopolies, we can estimate in particular of the utilities, transport and communications networks and some highly capital intensive production activities such as steel making and cement[18]. The important point is that given the economics of the industry, competition will be absent regardless of the type of ownership thus privatization per se may not alter performance instantaneously, such a possibility leads to the issue of regulation. Barriers to entry and the maintenance of monopolistic profits can occur even when at the industry is not a natural monopoly. This form of entry deterrence - known

18 Glade - op.cit

generally as strategic entry - deterrence - allows an incumbent firm (or firms) in a market (regardless of the nature of the ownership) to maintain its (their) dominant market position in a number of ways. Patenting, advertising, brand proliferation, technology choice, capital intensity, product dumpting, loss-leading and predatory pricing are all used as means of determining entry to the market. The scope for entry deterrence depends on four key factors, the elasticity of demand for the product, the scope for technological substitution and cost reduction, the access to credit to allow the firm to survive through periods of intense (but unsustainable) price competition, and the enforeceability of collusive behaviour. In general, the more elastic the demand for the product, and the greater the choice of production technologies the less vulnerable is a market to strategy entry-deterrence and thus the more open it is to competition. Similarly the larger the incumbent and the greater its access to financial resources, the more able it is to indulge in 'Painful'' strategic behaviour to maintain its monopoly position, while the breader the range of instruments available, the more sustainable is entry deterring collusion.

In the light of those theoretical results a number of features concerning the likely effects of competition emerge as salient to an analysis of privatization in developing countries. First, there are a significant number of sectors where SOEs dominate. Many of these are natural monopolies and they are therefore unlikely to feel the effects of competition. [19]

Second, those which are not natural monopolies dominate by virtue of their size, and often their access to technology and credit. Thus while there are a number of sectors, where the scope for effective competition is high (for eg. in the industrial), manufacturing and service sectors), significant barriers to **entry** either natural or strategic, are likely to prevail.

Third, the number of sectors within the economy where the extent of competition is sufficient to generate efficient outcomes is small, especially in lower income developing economies, finally, one of the common features of small economies is the prevalence of inter logging directors . Often senior official, financiers and eminent business people sit on the boards of many different public and private enterprises and are thus in a position to promote collusive behaviour.

6. REGULATION :

Markets are competitive and if there are no externalities then there will be no difference in the information costs to public and private principals and internal efficiency will be unaffected by the form of ownership, assuming, of course that the public owners are not pursuing commercial objectives. The question of regulation is concerned with the problem of ensuring that a firm (whether public or private) acts in a manner consistent with social welfare.

[19] Paul S - Emerging issues of Privatization and the Public Sector - World Bank - Working paper # 400, 1988.

Regulation of public firms is traditionally (and often suboptionally) undertaken by fiat, through public (non-market) determination of pricing and output decisions. The regulation of private companies, in contrast, generally operates through public fiscal or legislative interventions operating within broad market determined parameters. the essential feature of the regulatory problem is that in general the regulator (i.e. the Govt.) does not have the same degree of information about the market as the firm itself has.[20]

6 A) REGULATION VERSUS PUBLIC OWNERSHIP OF MONOPOLISTIC ENTERPRISE

This model shows how the regulation decision is based on an estimation of the relative magnitude of two principal-agent effects namely the extent to which Govt. can control public sector managers versus the extent to which the private sector manager can capture rents from the regulatory process.

Here the three groups are called information sets viz:- the Govt., public sector officials and private owners. There are three types of private information. [21]

1) The externalities and political objectives attached to the enterprises activities (eg. consumer surplus, environmental consideration, national security etc.)

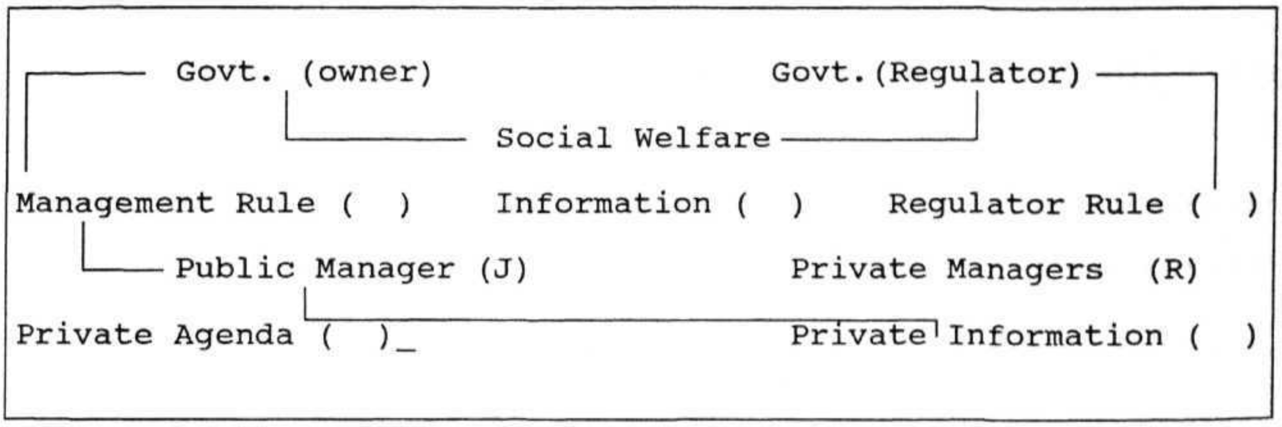
[20] Waterson - Economic Theory of Industry, Cambridge Univ. Press, Cambridge, 1984.

[21] Marshall Gold Man - op.cit.

2) The efficiency reducing private agenda of the public officials and

3) The firms cost demand and other market conditions.

The model is based on the following diagram:



The profitability of the firm is a function of actions, X, and the nature of the cost and demand, conditions) , thoughtout we assure the profits, II are increasing in X and X, IIo, IIx >0

We can assess the two forms of ownership being considered by the Govt, in the decision to privatage.

6 a) (i) <u>THE ENTERPRISE DIRECTLY MANAGED</u> BY <u>PUBLIC OFFICIALS</u> :

By didn't of their role as managers of the firm, public officials have information 0 on demand conditions, and under ownership the total profits accrue directly to the treasury (X,O). As employees of the state owned enterprise, the managers pursue the public objectives ψ the benefits accruing from which are S S(X, ψ) over all (W^G) govt. welfare is thus $W^G = S(X, \psi) + \Pi_G(X,0)$ However the public officials also pursue their own private goals defined as J (X, E) , where. $J_\chi < 0$.

Total welfare under public ownership determined by the outcome of the principal agent game between govt. and the public sector managers.

Total welfare under public onwership determined by the outcome of the principal agent game between govt. and the public sector managers. Thus $V^G = W^G - \alpha J (X,E)$

Where is measure of the extent to which public officials **can** pursue their own agenda.

$W - V^G = \alpha J (X, E)$ is simply the measure of enteprise efficiency arising from the rent that public officials can extract because Govt. can not observe.

ii) <u>REGULATED PRIVATE ENTERPRISE</u> :

In view of the loss Govt. may consider the alternative option, namely the privatization of the enterprise and the introduction of a regulatory procedure to ensure that the social objectives, are met. Here, for simplicity, we assume that the Govt. directly fulfills the role of regulator.[22] Now the Govt. is no longer directly run by the public officials only the private owners observe

The regulator must therefore establish a policy which meets the welfare objectives. But still allows the firm to cover its costs in the worst case demand environment (so that the output actually produced.) This necessarily yields the firm more profit than is optional (i.e. if Govt. had access to) in all cases

22

In general, this will not be the case and the regulatory function will be carried out by the public officials who will reain their own private agenda.

where demand is higher or costs lower than in the worst case. In this institution the firm choices its optional response to the regulatory rule and as a result the privatized enterprise will earn informational rents (R X, P) which are always greater than or equal to zero.

As a result of regulated private ownership, the welfare function is

$$W^P = S(x, \Psi) + \Pi^P(x, \emptyset) - R(x, P)$$

If we assume, cateris paribus, that the neutrality result holds so that the divided yield from the asset under public ownership Π^G(X,E) is equal to Π (X,E) the capitalized value of the sale proceeds, then the difference between the two ownership regimes can be expressed simply as

$$W^P - W^G = \lambda J(X,E) - R(X,P)$$

Thus the privatization decision is between two completing second best options, namely the welfare loss of public sector managerial inefficiency on the one side, and the welfare loss of monopoly profits accruing through information rents on the other. The simple result underlines the central point that, in assessing the benefits of privatization when enterprises are capable of earning monopoly or oligopoly profits, the factors determing the decision will be

a) The extent to which the public sector officials actions deviate from the objectives of the Govt.

b) The capacity of the public sector to design cost effective and efficient regulatory schemes, and

c) The extent to which private managers can extract and maintain informational rents.

It may instances governments have been faced with this problem but more often than not emphasis has been placed on the first of these factors, occasionally to the complete exclusion of the other two. One of the less benign outcomes of this narrow focus has been the transfer of ownership (and monopoly control) to foreign private companies, who, because of their size, have dominated the regulation game and effectively captured the regulatory process.

6 B) REGULATION IN PRACTICE :

In general regulation has focussed on the rate of return as a strategic variable with which to celebrate the monopoly of profits of an enterprise and to trigger the extent of regulation.

In this scheme firms are allowed to make a maximum rate of return on capital (i.e. profit) over a certain period which will be some mark up over the market rate. The well-established Arerch - Johnson (1962) model demonstrates how under these conditions firms will make decisions affecting their capital base with a view to altering the price they are allowed to change. In particular, rate of return regulation leads to over capitalization, through which the firm obtains higher absolute profit but lower internal efficiency. The regulatory challenge is to design an incentive scheme to exploit this superior information available to the managers. There are two types of result in these models of regulation. The first arises where the regulation can not observe the cost structure of the firm and generally sets an allowable price which exceeds he socially optional price. In this case the firm is earning monopoly profits on its restricted information set.[23]

The second result arises where the regulator is able to use competitive forces to push firms into revealing their information. Thus one role of competition is a world of incomplete information is to generate comparative cost and efficiency information for the regulator which can be used to improve the efficiency of the regulatory process.

7. PRIVATE SECTOR DEVELOPMENT :

While the shrinking of the public sector and containment of fiscal deficits frequently dominate thinking on privatization is seen as an instrument to 'crowd-in' a nascent private sector, and thus reverse the downward trend in aggregate private sector investment which has been such a characteristic of the 1980s. It is viewed therefore as a means not only of enhancing the marginal efficiency of existing investment (by switching its source of supply), but also as a means of increasing the total volume of investment. This 'crowding-in' argument is of course, intrinsically linked to the broader issues of deregulation, state shrinkage, and financial liberalization policies, all of which are aimed at promoting higher domestic savings and improving their

23 Vickers & Yarrow - Privatization - An Economic Analysis. MIT - Press - Cambridge, U.S.A, 1988.

intermediation to productive investment. Part of this impetus for privatization derives from the feeling that 'getting the prices right' in terms of deregulation and financial liberalization may be necessary condition for growth in private sector investment, but alone if may not be sufficient. Thus the creation of an enabling environment may need to be primed, in Keynesian framework, through the privatization of state-owned enterprises. This view is lucidly expressed in the Government of Malayasia's guidelines on privatization which link the two efficiency elements of privatization thus (Government of Malayasia, 1985) :

....Privatization is expected to promote competition, improve efficiency and increase the productivity of the services, (in addition) privatization, by stimulating private enterpreneurship and investment, is expected to accelerate the rate of growth of the economy.

The arguments surround the impact of privatization on efficiency of investment and service delivery discussed in earlier sections are those for 'crowding-in'. Three general arguments can be advanced. First, as a result of extensive cross-subsidization, soft budget constraints, and administrative restrictions conferring preferential market access, state-owned enterprises frequently enjoy high degree of protection. The removal of such barriers as a result of programme of privatization and deregulation will be accompanied by an inflow of private investment seeking to exploit these previously protected opportunities for monopoly profit. the analysis of this process has been dealt with above in relating privatization to market structures. Second, and related, of the expected rate of return to private investment is a negative function of market uncertainly, then a reduction in this uncertainty will boost investment. Frequently, public investment decisions are made by fiat. As a result, price and output levels will diverge from real resource costs, and will be unresponsive to demand conditions. Even if allocation decisions are market-based, product prices may be distorted by the web of cross-subsidization in the goods and factor markets. These non-market decisions distort price signals and consequently increase the degree of uncertainty facing private investors contemplating market entry.[24] A reversion to market price signals through privatization will thus be accompanied by a reduction of uncertainty, thereby raising the expected rate of return to domestic fixed capital investment. The third way in which 'crowding-in' is expected to occur is less precise and relies on the extent to which privatization may after the degree of risk aversion in the economy. Often subsumed in notions 'corporate culture' on 'market orientation, the idea here is simply that y re-establishing the link between economic risk and reward, the private sector will be induced to switch from asset accumulation in the form of precautionary assets (e.g. fixed income deposits) to more risky domestic capital assets. This asset-switching effect is important when governments seek to reverse private capital flight which has occured under earlier

[24] Glade - op.cit

economic control regimes, and a number of countries have, in fact, designed their privatization programmes around attempts to promote the direct repartition of domestic capital which had beer previously exported.

8. CAPITAL MARKET DEVELOPMENT :

Closely related to the previous point is the view that privatization, especially in a number of smaller countries, will serve as a means whereby local capital markets may be either developed or revitalized and domestic savings mobilization enhanced. A commonly perceived problem of many of the smaller emerging capital markets is the shortage of tradable stock, and augmentation of the supply of stock through the sale of government equity has been seen as one way through which the capital market may be effectively 'kick-started' into action. That privatization and capital market development have become fused in the minds of policy-makers is understandable, and, indeed there can be little argument that privatization, especially if it is to occur on a large scale, will be facilitated by the presented of properly functioning capital markets. But privatization can, and often does, occur both in the absence of adequate formal capital markets and / or without the intermediation of capital markets even where[25] such markets exist and function well. Similarly, capital markets can be (and in many countries have been) developed in

25 Impact data suggests that in terms of number and scale of enterprises sold, non-market sales predominate even when capital markets exists.

quite a healthy fashion without privatization programmes. Nevertheless, privatization is often viewed as offering opportunities for linkages with capital market development. However, it can have potentially main effects on capital market development, and can, if mishandles, weaken the capacity of nascent capital markets to intermediate and manage the risks resulting from public to private asset transfers.

9. INCOME DISTRIBUTION :

Privatization will rarely have a neutral effect on the distribution of income. Consequently, the perceived implications of the sale of assets for income and wealth will be a major determinant of the privatization prices. In some instances the issue is made explicit as in the case of Malaysia where one of the main stated objectives of privatization is to promote the attainment of the New Economic Programme income distribution targets. More frequently such discrimination, determining, for example, the relative access of domestic and foreign participants, is implicitly achieved through the design of the programme. For example, if divestiture is affected through private sales there will generally be a concentration of equity wealth. On the other hand, the distribution of shares freely to all electors will initially have a positive effect on wealth distribution. Indeed, one of the most common phenomena is privatization share issues in both developed and developing countries is the 'underpricing' of shares so as to achieve a favourable wealth distribution.

There are other, more complex income-distribution effects at work. One of the dominant forces leading to the creation of large SOE sectors originally was the desire to address concerns over income distribution and to redress the balance of economic power towards the government's political constituency. This was achieved through a number mechanisms, i.e. the expansion of employment, fringe benefits, price subsidies, etc. State-owned enterprises became key instruments for the allocation of rents to favoured groups. The thrust of pro-privatization arguments lies, however, in the efficiency-enhancing removal of such rents, and thus in many cases privatization is seen as antithetical to these earlier forms of government behaviour. The key point here, as the case studies show, is that the evolution of privatization programmes has been determined by the attempts of governments reconcile the twin objectives of maintaining control over the allocation of such rents while achieving the desired efficiency gains.[26] This can in some cases result in the paralysis of the entire programme, or in other cases can manifest itself in the complex nature of sale process.

10. MEETING ADJUSTMENT CONDITIONALITIES :

The emergence of policy-based lending in the 1980s has been privatization being drawn into the intricate relationships between developing countries and their external creditor who rapidly embraced the policy. For example, the decade of 1980's saw the World Bank involved in 143 adjustment loans directed towards SOE

26

Bienen and Waterbury, "The political economy of privatization in Developing countries - World Development, 17 (5).

reform worldwide, of which half included privatization components, put simply, in such cases governments pursue privatization in order to have access to such do non assistance, **and** to ensure that aid disbursements are not jeopardized. However, the relationship is rarely straightforward, and in practice, though progress in implementing privatization policies has rarely matched the expectations of creditor, aid disbursements have not been compromised. More often, the credibility of the donors **(for** example, the World Bank and IMF.

Table 1: World Bank lending for SOE reform and privatization (no. of loans by type of land and region).

	SALs	SECALs	TALs	PELS	PETALS	TOTAL
AFRICA	30	17	21	9	2	79
LATIN AMERICA	i4	4	10	5	1	33
ASIA & PACIFIC	5	3		1		9
MIDDLE EAST & NORTH AMERICA	6	11	3	2		22

	PRIVATISATION COMPONENT	VALUE[c] US $ m
AFRICA	45[a]	1.687.1
LATIN AMERICA	18[b]	1.965.1
ASIA & PACIFIC	7	870.0
MIDDLE EAST & NORTH AMERICA	4	830.0
	74	5,353.2

Source : Country Studies (1990)

a) Includes $ 85m (2SALs) to Malawi

b) Includes $ 191m (3SALs) , 1 PEL, 1 TALO to Jamica

c) Total value of lending with privatization component.

SAL (Structural Adjustment Loan)

SECAL (Sector Adjustment Loan)

TQL (Technical Assistance Loan)

PEL (Public Enterprise Loan)

PETAL (Public Enterprise Technical Assistance Loan)

vis-avis OECD governments and other developing country governments requires that slippage, non-compliance and amendment of privatization conditions are tolerated (see Mosedy, Harrigan and Toye, 1991). The pursuit of privatization within this framework can, and does, create distortions and problems for its implementation.

11. THE IMPACT OF PRIVATIZATION :

Despite the wealth of discussion and theoretical argument relating to the merits of public versus private ownership, actual evidence to date is less the conclusive. In this section we aim briefly to marshal the existing evidence in order to provide a background for the country studies. Moreover, the evidence focuses exclusively on the link between privatization and efficiency. No comprehensive body of evidence exists to assess either the direct and indirect public finance effects of privatization or any of the subsidiary objectives. While country-study analyses provide the detail of individual programmes, they often lack readily generalizable conclusions.

Numerous attempts have been made to draw more rigorous and generalized quantitative conclusions on the issue of public versus private ownership but they have faced a number of difficulties.

The first problem facing any research into privatization is that of data availability and measurement. Primarily the poor financial and technological data of SOEs prior to privatization make evaluating changes consequent on the transfer of ownership difficulty. Furthermore, even if the data are available, it may not be possible to draw any firm conclusions because of the time lags involved in the assessment of changes in performance. The effects of a transfer in ownership may not be felt for a period of months or years, and the translation of these effects into measurable quanta may take loner (especially given the publication lags on company accounts). While this represents a general problem, it is particularly the case in assessing the privatization experience of the 1980s, to a significant extent, we are not yet in a position to evaluate fully the effect of privatization.

Not withstanding the issues of measurement and data availability, we are confronted by a more fundamental problem, namely that, as discussed above, standard economic theory in general has nothing to say on ownership per se. It offers no clearly defined and testable hypotheses, but rather establishes the link is between ownership and performance through a series of related theories and hypotheses concerning the nature of incentives, agency problems, financial constraints and profit-maximizing behaviour. Inference is therefore necessarily complicated, and as killick and Commander,[27] stress:

....While mainstream economic theory does point to the preferability of competition, it is actually silent on the ownership issue... there is, of course no necessary connection between the two.

This problem is underscored by the technical complexity of distinguishing within the data the effects of privatization per se from the host of liberalization and SOE reform measures that have frequently accompanied privatization. One of the most complex relationships to disentangle is the relative effects of the pre-privatization 'clean-up' of the enterprise and privatization itself. For example, Vickers and Yarrow[28] show the extent to which in the UK major improvements in commercial performance occured prior to priatization as the public sector prepared the enterprise for sale.

A third measurement problem arises with the construction of counterfactuals - what would have happened in the absence of privatization. In some cases this is a relatively easy issue. In the situation in which, say, the government chooses to sell on textile firm out of a number of similar firms, then the performance of the remaining public sector textile firms will

[27] Killick, Commander - "Privatization in Developing Countries - A survey of the Issues, CUP, Cambridge, 1988.

[28] Vickers and Yarrow - op.cit.

provide the basis for a counter factual. Matters are more complex in the case of monopolies, and in particular the natural monopolies where there is by definition no counter factual comparator. Further, matters are again complicated by the effect of associated reforms, especially in terms of price deregulation and where the monopoly is a price setter in domestic markets, and thus profit can not easily be used as an indicator of 'welfare'.

Fourth, in any form of comparative analysis, there is a problem of selection bias. For example, if, as is the case, governments embark on their privatization programme by selling the most viable enterprises, the resulting performance effects may be overstated vis-a-vis the impact of privatization on the SOE sector in total.

To get at the effect of ownership on performance two main methods have been employed. The first is to tract an individual enterprise through time in order to assess the impact of its sale on performance. As noted, however, given that many privatization programmes are in their early stages, there are very limited data available to do justice to this method. The second approach is to abstract from the specific question of the effects of privatization as process in order to focus more simply on the relationship between performance and ownership, since ultimately it is this that is of concern to policy-makers. In this type of empirical work researchers generally regress performance variables (financial, technical, etc.) against a measure of ownership, while controlling for a host of characteristics of the firm or industry, or country. the standard model is for the form,

p = $\alpha_0 + \alpha_1 D + \alpha X_2 + \in$

Where F is the measure of performance ; P the ownership variable; and X a vector of relevant characteristics, both the nature of the firm and the macro economic and policy environment in which it operates. The focus of the work, is essentially, to estimate the size and the sign of the coefficient. .α_1 Of the two main approaches, the first uses direct comparisons of identified comparisons of identified companies operating in similar markets (and thus for whom the vector of variables X is similar.) A number of studies further distinguish the ownership variable between fully private companies, SOEs and joint-venture operations.

12. RESULTS :

The number of empirical studies following this latter method is so vast that we can attempt comprehensive surveys, such as Vickers and Yarrow (1988) for developed economies, and Bouin and Michalet (1991) and Millward (1988) for developing countries but a brief summary of the main results, and focus on the problems of drawing inferences from these results for developing countries is presented.

a number of important results come from head-to head studies in industrialized economies, most notably with Caves and Christensen's (1980) study of the two Canadian railroad companies operating a in a relatively deregulated environment, and a number of studies of the (more regulated) air transport sector in

Australia (Davis, 1971, 1977) ; Forsyth and Hocking, 1980 ; Kirby and Alabon 1985) . While the Canadian study suggested that in the presence of a competitive market ownership was not an important determinant of performance, the studies for Australia are less conclusive. Their efficiency seemed higher in the private sector as opposed to the public but, even so the extent of the regulation so greatly reduced the overall efficiency of operations relative to similar efficiency levels overseas that the relative performance differences seemed less significant.

Similar results emerge in studies of monopolies, where the evidence suggests that, regulatory frameworks notwithstanding, there is no clear difference in performance between publicly and privately owned utilities (see Vickers and Yarrow, 1991). One of the a biggest international studies (focusing only on large companies) is less ambiguous, however (see Boardman and Vinning, 1989) . In their study of 500 firms in 1983 (of which 419 were private, 58 public and 23 jointly owned), they found that, in general, state-owned enterprise performance (measured only in terms of financial performance) was worse than that of private companies across a range of financial and productivity measures.

Millward's (1988) review of performance studies in developing country industries draw similar conclusions. Examining differences in technical efficiency, Hill (1982) on the Indonesian textile sector, Tyler (1979) on the Brazilian plastics and Steel industry, Hughes (1990) on the Jamaican aluminium sector, and Kim (1981) on manufacturing in Tanzania, all arrive at similar conclusions : public ownership has a small, negative, but statistically insignificant effect on technical efficiency, with overall performance being principally determined by size. Strong diminishing returns to scale are frequently observed which, since public enterprises have tended to be larger than their private counterparts, becomes a key explanation of the apparently worse performance of SOEs. However, it must be noted that such results may be distorted by a sample selection bias since often enterprises have fallen under public ownership as a result of public rescue following financial crisis under private sector operation.

One relevant result which emerges from the above studies, and in particular from the analysis in Tanzania, concerns the relative efficiency of foreign-owner enterprises. Foreign capital, management and choice of technology tend to be more efficient and more profitable than domestic capital, either public or private. A qualification on this result is provided by Grosh's (1990) study of manufacturing in Kenya. Here the evidence suggests that, while there is very little difference between the performance of private manufacturing enterprises and those in which government has majority control, neither group is as efficient as joint-venture operations in which the government takes a minority equity position with the majority equity and management in the hands of (often foreign) private investors. This latter group (referred to as quasi-public firms) has a much lower rate of effective protection and a lower domestic resource cost than both public and private companies, whilst still retaining a higher rate of **return.** One of the valuable aspects of this study is the way in which is explores many of the problems noted above. For example, in the case of Kenya many of the public companies under examination have become so simply as a result of 'resuce operation' on the part of the state in order to protect employment, etc. As a result the SOE sector is dominated by old-vintage enterprises, operating in economically sub-optimal locations. This will inevitably depress their aggregate performance. In this respect we can note the ongoing work of Bhaskar (1991) in assessing the effects of ownership in the Bangladesh manufacturing sector. Here the sample selection problem is avoided since, following wholesale nationalization in 1972, the choice of which enterprises to privatize has (apparently) been made on relatively random basis thereby providing the researcher with a relatively unbiased sample consisting of both public and private firms. Initial indications, however, fail to alter radically the conclusion from other studies.

Thus, the empirical evidence on the effect of ownership is less than categorical. However a number of conclusions emerge which reinforce the central argument of this book. The first is that, ceteris paribus, in relatively competitive markets the evidence suggests that private enterprise is rarely (f ever) less efficient or less profitable than public enterprise, and more frequently is significantly more efficient or profitable than comparable public enterprise. Beyond this conclusion the results are less clear, although this ambiguity serves to underline the central argument that ownership by itself is rarely the dominant determinant of performance. In particular, the influence of the regulatory and competitive environment (particularly in the utility sectors) greatly overrides the impact of ownership on enterprise performance.

13. CONCLUSION :

This chapter has served to provide the theoretical economic context within which privatization can be assessed. It has outlined the major objectives assigned to privatization as a policy instrument, and has reviewed the key economic relationships which are expected to provide the transmission mechanism from privatization to enhanced performance and efficiency. In some cases this transmission is theoretically clear and precise ; in other, the mechanisms are less quantifiable and turn on the broader issues of policy credibility, government reputation, investor expectations, the management of economic coalitions and the allocation of rents. We have also attempted to reflect some of the empirical evidence which has emerged in a an attempt to quantify the overall efficiency impact of private ownership. The evidence is plagued by often intractable measurement problems but does suggest that there is some discernible positive effect of private ownership on the financial performance of companies. Little evidence has yet been adduced on the broader effects of privatization on macro economic performance. The question which remains unanswered therefore is : why, in the face of such neutral evidence, has the developing world (and its creditors) embraced privatization as such as an article of faith in economic adjustment ? Part of the answer lies in a search for credible alternatives in response to the evidently parlour state of the SOE sector in so many developing countries.

However, we believe that a fuller and more interesting explanation lies in the persistent failure to extract from the evidence of, and theoretical argument for, privatization an understanding of how the key transmission mechanisms relating privatization and enterprise performance are altered when privatization is implemented within the generally thin market structures prevalent in developing countries.

<u>NOTES</u> :

01. The definitions used inter-alias by Pirie (1986), Glade (1986), and Berg and Shirley (1987)
02. Conditional, of course, on the constraints imposed by the economic and regulatory environment faced by the enterprise.
03. It is interesting that in Malaysia even this has been compromised by the existence of comprehensive government underwriting for the largest BOT schemes (Baild Operate Transfer)
04. Pirie (1986) identifies some 22 different forms of privatization, many of which have only a limited relationship with the definition suggested here.
05. World Development Report (1988) notes that for a sample of developing countries the median contribution of the SOE sector to the total public sector deficit was 48%.
06. The initial cash payment can be thought of interms of 'Sweetners' - subsidies, debt write-offs, etc. rather a cash payment.

07. Al thought, as will be discussed later, they do allow for the pure effects of the 'dynamic efficiency' of private ownership.

08. Vernon (1988) suggests that it was this form of crowding out caused by wholesale privatization in Chile which led to the bankruptcy of many of the very enterprises that had been sold to the private sector under the programme.

09. The discounted value of the profit stream in the hand of the government would be higher than in the hands of the private sector, and thus the maximum price the private sector would be prepared to pay would be lower than the minimum the government would sell for.

10. Consider again, for example, how the collapse of much of commercial sector in Chile in 1982-83 was accentuated by the excessive leverage of many privatized assets.

11. This form of argument derives from the work of Alchian and Demesetz (1972) .

12. See, for example, Glade's (1991) discussion of the efficient operation of SOEs in Latin America.

13. For a comprehensive review of the issues of principal agent relationships and incentive design see Rees (1985).

14. Frequent confusion arises between privatization and liberalization. There are many interventions a government can make which effect the running of the firm after privatization, including output price controls, penal taxation, interest - and exchange-rate policies, etc. It is often assumed that these will be removed during the privatization process, but there is no necessary reason why they have to be. Thus, the removal of government interference as a goal of privatization must restrict itself to the removal of more direct, firm-specific interventions.

15. it is sometimes the case that technocratic arms of government have used, or intend to use, privatization as a method of removing SOEs from parts of government (especially line ministries) they consider to be more prone to interference.

X6. There is, however, a free-rider problem here also since a (small) shareholder receiving a bid by a raider has an immediate incentive to hold on to the shares and free-ride the capital gain brought about by the hostile bid (assuming that the share price will rise as a result of the new management is to 'discipline'. However, strategic behaviour, compulsory acquisition orders and limited legal protection of minority shareholder interests can combine, and have combined, to dilute the effect of the free-rider problem, thereby re-establishing in part the link between internal efficiency and takeover threat.

17. This phenomenon has probably been diluted somewhat in recent years by the growth in the leveraged buy-outs and junk-bond dealings.

18. Although technological innovation has shrunk the realm of natural monopolies, especially in the telecommunications sector.

19. See for example Waterson (1984) and the references therein.

20. Clearly, if the regulator had full information and sufficient power's/ he could compel the firm to act in a first-best manner all the time.

21. For simplicity we ignore the possibility of agency problems which may exist between the objectives of the electorate and the actions of the government. This does not alter the essential elements of the result.

22. In general, this will not be the case and the regulatory function will be carried out by the public officials who will retain their own private agenda. As with note 21, this is done to keep the model simple, but as a result side steps the important problem of 'quis custodiet ipsos custodes ? (wqo guards the guardians ?).

23. There are a hot of more complex models which extend the simple case - see Vickers and Yarrow (1988) for a summary.

24. This phenomenon is, of course, exacerbated to the extent the government is able to alter market conditions by fiat. One

of the major elements of uncertainty facing private capital during the 1970s was the risk of government appropriation of assets and their profit stream. Combined with the effects of poor macro economic management and financial liberalization, this contributed to high levels of capital flight.

25. In fact, our evidence would suggest that, in terms of number and scale of enterprise sold, non-market sales predominate, even when capital markets exists and are quite well developed.

26. One of the major elements of many SOE reform/Privatization programmes is an attempt to create a consistent database for the SOE sector. Under public ownership audit requirements are frequently ignored and the compilation of accurate and timely financial data is rarely a priority.

27. It may be noted that only late in 1989 did the World Bank embark on its first major post-privatization performance evaluation exercise. The final results of this study are not expected to emerge until 1992 at the earliest.

28. Note that in these studies there is no systematic attempt to take into consideration the second-order economic effects attendant on the pursuit of employment or other objectives carried by SOEs.

CHAPTER - VI

PRIVATIZATION - OUTCOMES AND EVALUATIONS

6.1 INTRODUCTION :

The purpose of this chapter is to describe and analyze the implementation of and progress of divestiture as part of the liberalization programmes in the countries selected and studied. The details of each programme are covered in the countries, the study the systems in which change is towards in progress, a number of developing countries like Jamaica and Malaysia, where sizeable sales of public assets have occured. Section 1 deals with the way in which privatization and liberalization as policies have been adapted to meet the constraints and characteristics of developing countries; and, second the way in which these adaptations affect the capacity of privatization to fulfil the objectives set out for the policy.

Section 6.2 presents a factual report on the extent and characteristics of privatization across the selected countries, and contrasts with the financial results from State Owned Enterprises (SOE) reform programs. From this analysis we could derive a set of structural economies under discussion. However, a substantial portion of the literature on privatization in developing countries has focussed on these issues, but rather on the narrower debate concerning and getting the process right. We describe some of the salient features of process issues in section 6.3. Hence, this section considers the adoption of privatization programs.

These issues clearly play some part in determining success or failure, but it is the argument that the fundamental determinants of privatization outcomes lie in the structures of economies and the nature of privatization programs as political process. Along with the inherent conflicts between the objectives of privatization, these factors serve to delineate a comparatively small domain for programme issues. Discussion of the structural features of economies - which essentially involves making explicit and the implicit assumptions of the developed country privatization model follows in the remainder of the present chapter.

6.2 PROGRESS OF PRIVATIZATION :

Progress in privatization in the sample countries has been slower than hoped, especially with the India it has been very slow and the privatization not exactly began or it could be said that as partially began recently i.e, in 1991. As noted at the beginning of this chapter, while listing of privatization transactions cannot be totally comprehensive, that it is accurate enough, and certainly captures the most important transactions. In compiling the figures to adhere closely to our own definition of privatization, and have made certain assumptions. First, we have included only sales (public and direct) leases and management contracts. Within these we include sales of equity (either total or partial) owned by the Govt., even when this equity is held through development finance or other institutions, but have, however, chooses to ignore closures of plant as privatization, in many cases we excluded transactions which accord with the relevant government's definition of privatization but not with ours.

In tables 6.1 to 6.8 we identify the pattern of the privatization programs that have occured from the start of the policy upto July, 1991. All proceeds are expressed in US Dollars and as a proportion of GDP so as to facilitate cross-country comparison. Another possibility is to express them as a proportion of the budget deficit, this causes problems because the 1980s for all our developing economies, were a period of considerable fluctuations in public finances. Thanks largely to the impact of the debt crisis, commodity price shocks and intense adjustment measures. Thus, the proceeds from privatization expressed as a proportion of the deficit are uninformative, they generally say more about the movement in the deficit than they do about the proceeds from privatization. Moreover, the gross proceeds from the sales are reported here and no attempt is made to identify the costs of privatization (either the direct costs such as transactions fees, or the indirect costs such as write-offs and other pre-privatization costs). The tables therefore may overstate the short run revenue flows from privatization once again.

For these countries we have identified only 98 enterprises which have been (totally or partially) privatized through sale purchasing out of a total of approximately 2,000 SOEs (table 6.1). In addition the privatization process has tended to be concentrated in the smaller enterprises leaving the large concerns untouched, in short privatization has to date only skimmed the surface of state sector holdings.

As a corollary, the proceeds from privatization have not generally been large (the only exception to this being Jamaica). Privatization proceeds during the period total a mere US $ 537 million, of which US $ 411 million or 77% is accounted for by Jamaica and Malaysia (table 6.2). As a proportion of GDP only in Jamaica and Trinidad and Tobago has the accumulated sum of privatization proceeds reached a proportion of GDP, greater than

1% (table 6.3). It is particularly interesting to note that in Malaysia, a country popularity regarded as being in the vanguard of (developing country) privatization, the volume of privatization revenue remained minuscule during the entire 1980s.

Another common thread is the concentration of transactions in certain types of enterprise. The majority of enterprises, that have been privatized have been commerce, manufacturing and service enterprises and 53 out of 98 with the next largest number being from agricultural sector (through this is dominated by the small tea estates sold by ADMARC in Malawi) (table 6.4). However, proceeds from commerce, manufacturing and service enterprise sales were less than 30% of total proceeds and less than half of those from sales of transport and communication enterprises (table 6.5). further more the average sale value of privatization in this type of enterprise is only US $2.6 million. The great majority of privatizations to date have as noted earlier, been concentrated in the small govt, enterprises, which are generally located in the industrial sector and may be amongst the more competitive companies in the public sector portfolio, the only large enterprises dealt with have tended to be either banks or telecommunications firms, with a small number of sales in the latter category dominating the figures for total proceeds. (the transport and communications sector accounts for US $ 537 millions, with an average sale value of US $ 33 million).

This is similar when it comes to looking at method of sale, the largest number are accounted for by direct sales to domestic buyers, after which direct sales to foreign enterprises and public sales through capital markets are roughly equal in number. However, the value of private sales to domestic enterprises is very low, an average sale value of US $ 1.7 millions per enterprise, versus an average value of US $ 12.4 million for public sales, and an average US $ 9.6 million for sales to foreign enterprises. Importantly, direct foreign involvement (participation countries except in India accounts for almost 40% of total sales value.

Clear links emerge between type of enterprise, method of sale, and source of finance (pages-246 to 253 for tables) direct domestic private sector participation has been concentrated exclusively in the small the commercial, manufacturing and service, and agricultural sectors, where it accounts f 50% of sales. Larger sales, and in particular those in the finance and banking and transport and communications sectors, depend on direct foreign involvement and public share issues. The higher average size of joint-venture sales as a method of sale in the commercial manufacturing and services sector is also notable and their presence in the transport and communication seems a necessary component.

A significant comparison is often made that involves the short term impact on fiscal balances of privatization vis-a-vis SOE befor. Data suggests that, in those countries where serious attempts have been made to deal the problems of the a public sector, the immediate public finance position has been improved to a greater extent by direct SOE reform. It is conceptually difficult to identify the exact magnitude of public finance effects arising from SOE reforms; the figures presented here are therefore indicative. By analyzing public finance accounts we have attempted to identify those changes in the flow of funds between Government and the SOE sector which can be ascribed to SOE reforms. This exercise is notoriously difficult, however, for a number of reasons. First, where SOEs predominate in the tradable goods sectors (e.g. through primary production or marketing of export crops), their financial performance is heavily determined by exogenous factors, and in particular changes in the terms of trade. The 1980s were an era of volatile international price movement, and in such cases identifying changes attributable to reform is difficult. A second, and related, point is the perennial problem of relating profit for surplus to efficiency in situations of imperfect competition. Improved (short-term) chas flow to government from a monopolistic marketing board can be as much the result of a reduction in producer prices as it is of improved efficiency.

These are not withstanding, an attempt made to identify the fiscal effect of SOE reform in the countries studies. As in the earlier section, these changes are expressed in terms of GDP rather than of the budget deficit itself. For example, in Trinidad and Tobago the set of reform measures introduced in the mid-and late - 1980s, reduced government transfers to the SOE sector by a cumulative amount of 10.5% of GDP between 1982 and 1988, as compared with cumulative privatization receipts of 2.3% of GDP. In Sri Lanka, the reduction of Government transfers equals 6.4% of GDP between 1982 and 1988, as against privatization receipts of 0.2% of GDP. IN Papua New Guinea (PNG) the net cash flow from govt., to SOEs was reduced as a proportion of GDP by 1% between 1982 and 1987 as against privatization receipts of 0.04% of GDP. These aggregate figures are substantiated in the case studies by empirical evidence from individual publicly owned companies undergoing reform programs within the public sector, as well as those being cleaned up in advance of privatization. Such firms often show dramatic improvements in their financial positions vis-a-vis govt. This evidence would suggest, then, that govt.s, in developing countries facing (often tough) budgetary targets earn a far higher return to their scarce reform effort when concentrating enterprises.

One further point needs mentioning, the countries experience shows that few SOEs other than the smaller National Investment Bank of Jamaica (NJBJ) sales in Jamaica were brought to market without first undergoing a major financial and managerial reconstruction, if they were not already profitable. Strictly speaking, if we seek to identify only the effects of the change in ownership on performance, then the effect of such clean-ups must be excluded. However, the counter argument is often expressed that such changes can only be initiated and maintained when a commitment to privatization is credible and therefore these cleanups represent an integral part of the privatization process. This argument is motivated by the observation that, in the past, a number of countries have pursued similar reform measures under public ownership with no intention of privatization, although such efforts were frequently successful in the short run, their effects have not been sustained. That it is suggested that only with the credible threat and hence eventual realization of an ownership change can such improvements be locked-in as Shapiro and Willing (1990:4) note:

"In terms of real politique needed reforms of public sector control may be infeasible, and the drama, stock and coalition - creation of privatization may be the only effective route for real change.

This argument is difficult to accept into - to, since we are skeptical of the implicit assumption that the public sector is everywhere and always an intrinsically bad enterprise manager. While privatization programs in developing countries have not yet altered radically the public/private balance, the threat effect of privatization has brought a halt - in some cases dramatic to the rapid expansion of the SOE sector evident in the 1970s. Thus, in Malaysia, where during the 1970s govt., enterprise acquisition and creation was running at almost three per week, the 1980s saw the creation of new SOEs fall to almost to zero. A similar story can be told for Jamaica, Kenya and Sri Lanka. Further more, the widespread acceptance of the 'Philosophy' of privatization, especially amongst populations and electorates dissatisfied with public enterprise performance, has made it easier for govt., to undertake SOE restructuring that would previously have faced broad political opposition. Hence, our threat of privatization into policy making and control processes has imparted a notable degree of flexibility into these economies, and in this sense alone has contributed to the supply-side responsiveness perused under adjustment programmes.

This discussion of short term public finance effects should not, however obscure the cessions of the data on the first decade of privatization. These are that privatization has proceeded slowly, it has raised only marginally reduced the size of the public sector, it has raised comparatively small volumes of funds the majority of sales have been small and concentrate by sector and there has been a pronounced dualism linking sale size, enterprise sector and method of sale whereby small divestitures of commerce/manufacturing/services enterprises are managed through direct sales to the domestic sector, whereas large sales of banks and utilities are carried out through public share sales or direct sales to foreign firms.

6.3. PRIVATIZATION METHODS AND MANAGEMENT :

Privatization and Liberalization began to be promoted as a solution to the ills of the SOE sector in the early 1980s and at that time the expansion of the SOE sector had reached its aopgee and it was increasingly clear that the sector's growth, let alone its overall size, was unsustainable. Thus at a time when many countries not least the United Kingdom were embracing the idea of privatization as apart of a broader reforms aimed at reducing the role of the state sector many developing countries see privatization as a quick and efficient means of averting or solving the impending crisis of the SOE sector. Though in many cases privatization was welcomes principally as a solution to an immediate fiscal crisits, it must also be acknowledged that many countries accepted it as an integral part of a shift towards grater market orientation of economic policy.

6.3.1 PRIVATIZATION STRUCTURES

In all the countries covered here began to move towards liberalization and privatization in the early 1980s with the creation of various institutions (either adhoc or statutory) charged with managing the divestiture process. The main developments were as follows :

PRIVATIZATION LEGISLATION AND STRUCTURES

Jamaica	NIBJ Divestiture Committee	1981
	NIBJ Divestiture Secretariat	1982
	National Hotels and Properties Divestment Unit	na
	Agro 21 Divestment Secretariat	na
	PM's Cabinet submission on Privatization	1986
	Cabinet Sub-Committee on Privatization	1990
Trinidad and Tobago	Bruce Committee	1979
	Bobb Committee	1984
	Rampersad Committee	1984
Malaysia	Malaysia Inc. Policy	1983
	Cabinet Committee on Privati-zation	1985
	Privatization Secretariat -Economic Planning Unit	1985
	Privatization Guidelines	1987
	Privatization Master Plan	1990
Papua New Guinea	National Executive Council - (NEC) Policy Statement on Pri-vatization - I	1987
	NEC Policy statement on Privatization - II	1988
Sri Lanka	Parliamentary Committee on Public Enterplrises	1980
	Presidential Commission On Privatization - I	1987
	Presidential Commission on Privatization - II	1989
	Public Investment Management Board	1989
Kenya	Ndegwa Committee on Statutory Bodies	1979
	Working Committee on government Expenditure	1982
	Task force on Divestiture	1986 & 90
Malawi	Department of Statutory Bodies	1982
	World Bank Structural Adjustment Loans (SAL) I to III	1981 to 86

India	High level committee on Public Sector Commercial Banks World Bank - SAL - Loans	1991 to 95
	Committee on Issue of Dis-investment of shares in Public Sector Enterprises (Sri Ramakrishna - Chairman)	1996

The enthusiasm with which the ideas were adopted differed between countries. For example while in Kenya the Ndegwa committee report on the Statutory Bodies of 1979 and the working committee on Government Expenditure of 1982 took a cautious view of privatization, viewing its primarily as a minor adjunct to the broader aim of imposing greater discipline on the SOE sector, in Malaysia privatization was enshrined as part of the Malaysia Inc policy promoted by the then Prime Minister Dr.Mahathir bin Mohammed in 1983, as a central element in the restructuring of the entire economy, to an extent these differences reflected the nature of the crisis facing the respective economies, and also the relative balance between the political and technocratic impulse for privatization, with higher profile programs being associated with greater political support for the programme. Thus in Kenya privatization enjoys technocratic support but the consistently been regarded with suspicion by politicians, and the work of the Ndegwa committee and the working committee has not received whole hearted support from the executive. In Malaysia, however, privatization emerged as the personal standard of Dr.Mahathir whose enthusiasm ensured that the programme has achieved a profile higher than is perhaps warranted, and has done so against significant opposition from technocrats and other groups.

Similar phenomena exists in Sri Lanka where President. premadasa has formulated a particular brand of privatization policy known as people-ization and in Jamaica where in the mid-1980s privatization was a crucial line of political schism between the government of them Prime Minister Saga and the opposition. the profile of Malawian privatization has been high, especially outside the country. Malawi has frequently been held up by the donor community as the primie example of privatization in action in Africa it is not clear whether this view is held as strongly within the country itself. Finally in Papua New Guinea and Trinidad and Tobago the profile has been more modest also this is same with India. In the case of PNG, privatization was overshadowed by the macro economic management of the incipient mineral boom, while in Trinidad and Tobago the Government of then National Alliance for reconstruction has been distinctly ambivalent about privatization. It has remained committed to it for pragmatic rather than ideological reasons, but still emphasizes the importance of the SOE sector in raising employment and meeting ethnic balance objectives.

6.3.2 A TYPOLOGY OF STRUCTURES :

Three main structures for privatization exist amongst the countries studied. The first is a centralized structures where the privatization/SOE reform process is handled exclusively by a single institution within government, the institution may be either an existing department of government, usually within the Ministry of Finance, or a specifically created institution. This type of structure exists in Malawi, where the co-ordination of SOEs and their privatization is managed entirely by the Department of Statutory Bodes (DSBs) in Trinidad and Tobago, where privatization is managed by a committee within the Ministry of Finance, and, latterly in PnG where privatization is the responsibility of the Commercial Investment Division (CID) of the Ministry of Finance. The polar case, that of complete decentralization, where each relevant holding institution is responsible for the privatization of elements of its portfolio, more clearly characterizes the situation of Kenya. Here each Minister with SOEs in his/her portfolio is responsible for the management of privatization in that sector. Sri Lanka followed a similar path in the early phase of its privatization programme, as did PNG during the first, and ultimately unsuccessful, phase of privatization when a similar structure prevailed.

The third model is the hybrid in which there are a small number of institutions or bodies with a relatively broad scope of functional responsibility. Jamaica most clearly represents this type of model. Although, formally, privatization was supposed to be managed by the Divestment Secretariat of the National Investment Bank, in fact major portions of the programme were carried out by agencies that had previously been responsible for the (mis) management of the asset they were privatizing.

This 'gamekeeper turned poacher' approach proved surprisingly successful. The hybrid model is also present in Malaysia and where the 'mainstream' privatization programme is managed by the Economic Planning Unit, while the divestiture of smaller industrial sector SOEs come under the am bit of UPSAK, the Ministry of Finance Public Enterprise Monitoring Unit and Sri Lanka, where the Public Investment Management Board (PIMB) and the Commercialization Division have separate spheres of responsibilities. The case of India too belong to the hybrid type of structure the responsibility is lad with the Statutory Bodies but the supervisory role being done by the Ministry of Finance in

Centre as well at the State level also.

Thoguh these three types can be distinguished, they are not static structures, so as programs mature (or at least acquire a higher profile) structures have tended to become more centralized. To an extent this reflects a learning process most countries found that without inter-agency co-ordination (and co-option) the process of privatization became not only extremely protracted but also undermined by significant problems. The developing experiences are replete with examples of weak co-ordination of agencies resulting in poorly implemented programs, consequently over the decade there have been a number of revisions to privatization structures aimed at improving co-ordination. Under the privatization master plan in Malaysia, for eg., the activities of UPSaK and the EPU are gradually being merged. Simiarly in Sri Lanka the previously decentralized structures through which line ministries dominated the process have been replaced by fiasco of the attempted sale of the Niugini Insurance Company has led to moves to strengthen the structures, with all initiatives being channeled through and co-ordinated by the CID. However it is not invariably the case tht centralization will improve the speed of programs, even if it is improves efficiency. For eg., in Jamaica the current Peoples Nationalist Party Govt., has moved to centralize the structures it inherited from the previous Jamaica Labour Party administration. Some Jamaicans close to the privatization programme fear, however, that this will slow progress, since it will result in greater power to a bureaucracy that still ambivalent about divestiture.

India's privatization in Public Sect6or Enterprises as part of PSE reforms has been taking place but at the slow pace, the fear of privatization in the workers group making them to work more efficiently and the losses are coming down in the Central Public Enterprises but that came with the State level Public Enterprises has no change in losses but the losses amount became less significant. In 1993 and 1994 there were many partial privatizations taken place (after committee submitted the report in April, 1993 i.e. The committee on the Issue of Shares in Public Sector Enterprises). The PSEs are Steel Authority of India (SAIL) Limited, Bharat Petroleum Corporation limited (BPCL), Hindustan Petroleum Corporation of Limited (HPCL), Rashtriya Chemicals and Fertilizers Limited (RCFL), National Aluminium Company Limited (NACL), Neyveli Lignite Corporation of India Limited etc.

One of the more ramifications of these various organizational structures concerns the way in which programs are developed. what has tended to happen throughout the decade and across countries is that the more clearly a 'Privatization Pipeline' emerges by which government clearly announces its intentions, the companies identified, the method and proposed timetable for sale. This approach stands in contrast to a more reactive approach to privatization whereby government, having endorsed the principle of privatization, has proceeded on a relatively adhoc basic with candidates being selected sequentially and often in response to immediate financial crises. Exemplifying this latter approach is the Kenyan situation where the notion of 'Privatization by default' has gained currency, here the catalyst has been the financial collapse of the SOE (generally one in which government has a minority stake held through a development finance institution), which was forced the official receiver to identify a private sector purchaser to take over the company.

Thus the latter 1980s witnessed the disclosure of comprehensive arrays of privatization presented as a 'shopping list' to the domestic and foreign private sector. The most comprehend so far has been the Malaysian Privatization Master plan which, unveiled in 1990, provides a 5 year plan of action aimed at divesting approximately 430 enterprises, similar pipelines have been developed by the governments of Sri Lank, Jamaica, Malwai and PNG, of course the development of these ambitious plans does not ensure that sales occur on target.

6.3.3. METHODS OF SALE :

There is virtually no limit to this different methods of sale open to governments, and experience worldwide has shown that privatization has spawned a considerable number of innovative selling techniques. However, most of the countries have inextricably linked the privatization of state assets to public share issues through a formal stock exchange. Indeed, in each of the five countries in which a formal capital market/stock exchange exists sales through the stock exchange have occured and have often been used to raise the profile of the programme. This is particularly the case in Jamaica and Malaysia where the National Commercial Bank (NCB) and Malaysian Airline System (MAS) sales respectively were central to establishing the credibility of the privatization programme. Moreover, this method of sale has been used to effect (part of) the largest sales under taken across all the countries, namely the M$ 136.3 million (US $ 54 million) sale of MISC in Malaysia and the K$ 110.0 million (US $ 20 million) sale of Telecommunications of Jamaica (TOJ) in Jamaica.

The single most common method has involved the direct sale of the enterprise (or part of it) to a domestic or foreign, purchase, to a joint venture consortium of both. In general, the purchasers have been either third parties, or (in the case of the sale of Govt., equity in Joint Ventures) the existing incumbent shareholders. One of the dominant, if not particularly surprising, features of the findings in this study has been the limited extent to which the domestic private sector has emerged as a major player in this process. This more so in the smaller economics, tends to question the assumption of a private sector hither to 'crowding-out' by large scale SOEs, and raises questions about the 'crowding-in' capacity of privatization. This point is reinforced by an analysis of the way in which sales are managed. While there have been some cases where competitive bidding has been possible for enterprises sold to domestic capital (eg., smaller NIBJ and some hotel sales in Jamaica), in most other cases the seller (i.e, the Government) has not been in a position to invite rival bids for the enterprise, usually then, it has been faced with a situation where there is a single buyer, able to exploit this monosony power (this situation was actually institutionalized in the 'first come, first served' early sales of the Malaysian programme). Buyers tend to be existing enterprises and are often competitors in the same domestic, or often export market, frequently they are companies which have had up-or-down stream linkages with the government company and use the purchase to integrate their operations, and in some cases, they are 'fly-by-night' companies able to exploit the unique set of circumstances surrounding the privatization process. furthermore, given the lack competitive auctions and the consequent monopsony rents. It is no surprise that many purchasers of privatized assets in developing countries believe that they have clinched a good deal. What has failed too occur in general through the private sale process has been the introduction of new domestic venture capital into the market.

One ramification of this dormant private sector has been that enterprises have rarely been sold directly to the existing management, or the employees of the firm. A characteristic of most public share sales has been the allocation, often at preferential terms, of shares to employees and managers, but in general this has constituted only a small proportion of total equity (often around 5%) and has been aimed at ensuring managerial and employee co-operation in the sale. In general, however the absence of such buy-outs highlights two of the key questions which will affect not only this form of ownership transfer, but also the privatization process more generally in developing countries. First there is the issue of the risk of ownership, and whether a traditionally risk-loving private sector owner, and secondly, bearing this point in mind there is the concern that the domestic financial sector will be reluctant to absorb the risk of lending to finance this form of new ownership. In view of relatively low levels of personal wealth, employees or management buy-outs will generally be highly leveraged and given the acknowledged risk aversion of the financial sector in developing countries the prospects for obtaining such risk capital are limited.

The foreign Institutions dominant players in the privatization process in developing countries, particularly in Africa, Oceania and the Caribbean, where the domestic private sector has traditionally been thin. Foreign capital has always played a major role in these economies, either in terms of debt financing of public sector investment, or by way of foreign direct investment, and foreign participation in privatization programs is therefore a logical extension of this process. However, such participation has engendered ambivalent attitudes. In some cases, foreign capital has been seen as the only way in which debt-distressed and hence credit-constrained economies may be able to access the capital, technology and managerial expertise adjustment. This consideration has been critical in the Jamaican programme, not only in the privatization of the only two telecommunications firms to Cable and Wireless (UK) but also in planning the divestiture of a number of large, but persistently poorly performing, SOEs (e.g. Aiir Jamaica, the international Airline, JPSCO, the electricity utility, and JRC, the rail company) to other foreign buyers.

In other countries, such transfers of ownership are regarded as implying a loss of sovereignty, and foreign participation has been highly regulated. Nevertheless, foreign participation through direct sales (often as a result of existing share holdings 0 has been an important feature of privatization in all the economics studied. As the tables indicates the foreign sector has accounted for over 40% of all sales, and has predominated in the acquisition of larger assets by direct sale. In PNG, Trinidad and Tobago, and Sri Lanka all direct sales of assets have been to foreign investors, while in malawi the same result has only been attenuated by the sale of a number of small enterprises to local entrepreneurs : buy value foreign capital has dominated in the programme. As a footnote to this point while foreign capital has still dominated in all the programs reviewed its presence has further ramifications, to the extent that it has been the opposition to foreign capital which has so severely retarded many of the programs. In numerous cases (particularly in Kenya, Malawi, PNG) sales have been forestalled as attempts have been made to identify domestic purchasers of assets, rather than having to rely on the actual demand from foreign capital.

To an extent, it has been easier to access of foreign capital through direct sales than through capital market sales. None the less, foreign ownership through equity participation in public share sales has been considered. One of the key instruments for this is the debt-equity swap, which, though developed in Latin America, has not been a major feature in other developing countries. Elsewhere, however, foreign participation have been to alter in response, inter alia, to the demands of the privatization programme. For example, in Sri Lanka the punitive 100% withholding tax on foreign share transactions was waived for Mitsubishi of Japan's equity participation in the 1989 sale of United Motors, and eventually abolished entirely in 1990, similarly a small portion (approximately 3%) of the equity in STM (the Malaysia telecommunications company) has been allocated to foreign investors the first time in Malaysia that foreign participation in privati\ation issues has been countenanced. This sale was expected to occur. Although this takes as its main focus transfer of assets through sale and leases, a number of other methods of transfer of control have occured. The most common has been the relatively widespread use of the contracting out of management, either as a precursor to full divestiture or as an end in itself. this type of reform/restructuring has been particularly prevalent in the airline industry (Air Lanka, Air Malawi and Air Niggini have all entered short-term management contracts with overseas airlines), and also in some of the manufacturing sectors. For example, in Trinidad and Tobago's steel Industry, in the textile industry in Sri Lanka, and in the cement industry in Jamaica, the management contracts have gone on to become eventual owners of the enterprise. A further method of privatization to emerge, as yet only in Malaysia, has been the build-operate transfer method of financing capital projects, used extensively in Malaysia to finance the construction of a toll - road net work and elements of the water treatment and sewage system. The procedure has been plagues by a number of problems, and to a large extent the 'privatization' element of the venture has been compromised by the network of guarantees and underwriting arrangements necessitated.

6.3.4 PROGRAMME MANAGEMENT :

The final technical / institutional issue concerns programme management. Programs have failed where governments have not ensured that the agency 9or agencies) responsible for the implementation of privatization has been given sufficient powers in relation to other agencies in the bureaucracy around them, and where line ministries are well placed to derail sales programs. More importantly, implementing agencies have often been inadequately staffed to carry out the time-intensive process of privatization, and sales have proceeded too rapidly for the capacity of the institutions to manage the sale. This was a feature of the Unit Motors sale in Sri Lanka where the enterprise was sold with the important issues of the transfer of pension rights unresolved. Similarly, the abortive sale of Niugini Insurance Corporation was so rushed that, though the Act establishing the corporation was as an SOE was repealed, its 'successor company legislation was not passed and the corporation was ultra vires for almost 18 months. Finally, the failed transfer of the Uplands Bacon Factory and Kenya Meat Commission to the private sector was in large measure due to the combination of pressure from donors to meet adjustment conditionality and weak domestic management of the sale.

Most of the problems stem from a tendency on the past of government and external donors to underestimate the resource cost of managing the privatization effort : it is one of the ironies that the management of privatization can in fact involve an extensive call on the time and resources of the public sector. This is manifested in a variety of ways, and governments have generally underestimated the extent to which the details of individual privatization transactions have to be dealt with before asset sales can go ahead. For instance, it is often the case that major changes need to be made to the legal standing of SOEs before privatization of enterprises is another issue where handling the details of such transaction is found to take much longer than expected, while the identification and screening of suitable buyers have proved an extensive process. Moreover, Privatizations require a great number of smaller issues to be addressed, especially relating to the contractual terms and conditions of the post-privatization labour force, the transfer of their pension entitlements, and the restructuring and renegotiating of their trade union status and recognition (if any). In some countries, underestimation of these requirements has led to two specific problems. first countries are frequently involved in adjustment programs which have time-specific privatization components. Delays in the completion of privatization transactions sometimes result in countries breaking loan conditions. Secondly, important aspects of the programme are decided either during or after the privatization itself. We have already mentioned problems this may cause for the future successful regulation of monopolies, but in other cases, as with United Motors, adhoc provisions have had to be introduced to cope with the fact that certain procedures had not been promulgated prior to the sale of the enterprise.

Amongst the smaller developing countries, one of the main resource costs associated with privatization has been the lack of experience domestic technical expertise, which has resulted in many of them having to import expensive foreign consultants to held structure and implement the details of each transaction. Only in the case of Kenya has the government not resorted to the use of external consultants in the design and management of the programme. Aside from the direct costs of this form of technical assistance, there is a concern that, though the capacity of the consultants is not questioned, much of their experience has been gained in the management of the UK privatization programme, and there has been a tendency for this to emerge in the form of homogeneous programme across countries, frequently placing a great emphasis on the use of public share sales. Moreover, the use of external consultants often reinforces concerns on the part of anti-privatization coalitions that the exercise is fundamentally about the sale of national assets to foreign investors. Whether correct or not, such concerns have an important affect on the way in which privatization is promoted as an adjustment policy.

a) THE ORIENTATION OF GOVERNMENTS:

As its broadest and most charitable, the government's objective function can be characterized as maximizing the welfare of the greatest number of citizens. In this case, the emergence of privatization can be seen as a response to general dissatisfaction with SOE performance just as in this perspective the creation of SOes was response to concerns about domestic asset distribution and establishing national economic control. In a number of countries, shifting perspectives about the merits of SOEs on the part of the public have made privatization programs politically possible - most notable examples being Jamaica, Malaysia and Sri Lanka. This possibility is reinforced from Government's point of view by the observable popularity of privatization programs in other countries and hence the potential political advantage to be gained from 'successful' privatization. These considerations clearly interact, political support for privatization programs is often a direct function of the 'success' they enjoy. Success this sense usually means the extent to which the domestic constituency enjoys, or expects to enjoy, participation in the privatization process, the most obvious indication of shard success being thorough public share issues where it is clear that the 'riches are being shared. Thus we find that the profile of the programme is higher in Jamaica and Malaysia where the use of public share sales has been a feature while in Sri Lanka the people-ization initiative was attempted to bring a similar degree of popular support by directly linking the programme to wider share participation. In other environments where the potential beneficiaries are less obvious, or not obviously central to the government's domestic constituency (such as Foreign capital), the public level of support is more limited, and the programme of lower profits.

In Malaysia the programme was conformity with the distributional objectives of the New Economic Policy, namely the promotion and protection of the Bumiputra's relative asset holdings. These aims were realized in the sales of MAS and MISC, for eg., through the design of preferential government golden share that retained a substantial degree of control over the companies after their 'privatization' and the pre-placement of substantial amounts of equity with the public sector institutions Indeed the rent-transferring objectives of the Malaysian Government have consistently resulted in a refusal actually to transfer risk and a consequent stymieing of the objectives of improved efficiency and private sector development.

In some cases the government has an even narrower objective function. This is the case in Malawai, where the privatization exercise has largely concentrated on restoring the financial viability of press holdings, the country's largest single company, wholly owned by the President. In other cases, the inability of government to adjust privatization as a new method of achieving old objectives has slowed programs, even where general public support would be forthcoming. In Kenya the failure of the government to institute a distribution scheme that would ensure the allocation of assets to Kenyan Africans rather the Kenyan-Indians and yet simultaneously raise sufficient revenue has retarded the programme. In PNG, the government's inability to seel to the domestic sector and the political sensitivity of selling to the foreign sector following the Bougainville riots has paralyzed the programme, and, in Sri Lanka entrenched bureaucratic opposition to privatization harmed certain transactions. The key point of this discussion though is that in general the adjustments made to privatization programs in order to accommodate or implement these goals are revenue and efficiency reducing. By restricting access (and thereby raising rents) they drive a wedge between the actual and potential revenue yield from the asset, incur the deadweight loss of rent seeking activity, and depart from optimal resource allocation. Despite this, political imperatives appear such that the trade-off is made. This pattern is repeated when we look at the design of individual sales.

b) GOALS AND TRANSACTIONS :

It is often the case that the initial phase of privatization programme is controversial, this is especially so when privatization represents part of the agenda of elected party, or when it is exposed by a recently vicarious wing of a party in power. In these circumstances, when debate over privatization is characterized by conflict, the first transaction with substantial publicity is required by the government to be 'successful' in effect it becomes a bell-wether sale. The importance of privatization leads, however, to the government adopting a risk averse stances, and hence the requirements for political success do not fit easily with that economic rationales for privatization. The example of this type of transaction is the public sale of NCB shares in Jamaica. The intense opposition of the PNP to the sale meant that the JLP had to find a formula that would be politically attractive, this is found in the promotion of wider share of ownership. In order to achieve this aim, the government shaped the transaction so that (1) there was a 7.5% limit on the total share holding to be acquired by any individual, (2) the share allocation mechanism in the event of excess demand would strongly favor the smaller investor and (3) the issue was priced conservatively. While this strategy was successful in attracting a large number of new players into the equity market, for reputational reasons, the government had to specify the ownership restriction extremely tightly. This reduced NCB's potential efficiency by locking in a sub-optimal level of management monitoring (resulting from the free-rider problem in information collection implicit in a widespread share holding). Further more, one of the obvious effects of under pricing the issue was to forgo potential revenue. Thus, two key objectives were compromised by the government's response to the political dynamics of the sale.

Another example arose in the sales of United Motors Limited in Sri Lanka. Here, the sale of the enterprise was speeded upon account of political considerations in spite of the worsening security situation in the country, and the resulting lack of attention to the design of the issue (application forms were not delivered on time, the prospectus was poorly prepared, etc) was a primary cause of the issue's failure. Moreover, in order to ensure that sale of equity would go ahead regardless of public demand, the government arranged for a group of public sector financial institutions to underwrite the issue. In the event, the sale was a disaster, and these underwriters took up 70% of the equity issued. Following privatization, there were only three trades of equity in the following year, and it is clear that the underwriters were colluding in managing the stock so as not to destabilize the share price. It is difficult to see how this outcome is contributing either to improving efficiency within the firm, or to the development of the stock exchange.

The fact that governments' aim to raise capital from privatization gives leverage to groups able adversely to affect the sale. In public share sales in particular, such leverage accrues to the managers and labor force of the enterprise to be power over government to extract rent-creating concessions. such behaviour on the part of managements to explains the frequency of efficiency-reducing measures incorporated in the terms of sale (post - privatization preferential market access and tax exemptions, the retention of unprofitable parts of a portfolio within the public sector) suppliers of labor have at times extracted extreme concessions an interesting case is the Malaysian railways, which the government has offered to sell for M$ 1 million if the purchasers commit themselves to forgo any retrenchment of the labor force. More frequently in public share sales, Employee Share Scheme (ESS) are established which offer equity at a discount. ESSs are often justified on the economic grounds that they extract higher effort levels from labor by tying reward to profitability via dividends. However , the quantitative importance of these links is dubious, and they are in any case strongly attenuated by free-rider problems and high monitoring costs. Rather, the main function of ESSs in privatizations seems to be transfer rents to employees principally to reward loyalty or to avert their opposition, especially in cases where retrenchment is expected. If under pricing exists, then ESSs which give employees secure access in the allocation system, will guarantee against employee 'missing out' in any windfall profits made as a result of undervaluing the net worth of their past and future laborers. In some cases, the transfer process can become somewhat extreme. In the case of Seprod, a Jamaican company privatized in 1985, 33% of the total share issue was reserved for employees at a price of J $ 1.50 against a market issue of price of J $ 2.50. The option to purchase these shares was exercisable at any time for five years given that the share price of the firm never dropped beneath its issue price and at one point reached J $ 8.50 per share, substantial opportunities existed for capital gains. Not surprisingly, nearly all the Seprod ESS shares were taken up.

Another feature of making a success of privatization involves attracting buyers, at times, risk aversion on the part of governments means that they prefer to compromise revenue objectives rather than lose sales. Most SOEs brought for sale have been involved in pre-privatization clean-ups, with often substantial capital restructuring and / or loss write off being under taken at the government's expense. The pre sale debt write offs in the textile mills in Sri Lanka the substantial investments in telecommunications and the recapitalization of MISC in Malaysia the huge write offs in Malawi, and the assumption of exchange-risk on CCC's loans in Jamaica are all examples of this. In some cases, these transactions are sufficient virtually to eliminate the short-term revenues to the government, while it is the case that SOEs often need some reform before sale at Govt.'s expense), the size of these transactions suggest that they may be another form of rent distribution.

Under pricing of public assets is the most ubiquitous method of attracting the buyers, however, we suggest that under pricing may lessen the expected benefit of sales on other goals of privatization, revenue raising, capital market development and efficiency objectives, to note that from the general record of privatizations via public share issues, it is clear **that** under pricing is not a random event, but is systematic to such sales. In terms of first-day pricing, of the eleven sales for which we have detailed enough data, nine were under priced **and** five substantially so. For the two issues which were not under priced, the timing of the Sri Lankan sale was widely criticized, while the overpricing of the Jamaican CCC issue was a direct result of the over-enthusiasm generated response to the previous (under priced) NCB offer. The story is generally unchanged when three month prices are examined. That our sample is not unusual is suggested by the fact that other countries (e.g. France Japan and the UK) show a similar history of under pricing in Stock Market sales (Vikers and Yarrow, 1988) The revenue loss to governments consequent on under pricing is clear from the moderate in Trinidad and Tobago to the outstanding in the case of Malaysia. With regard to the impact on capital market development, it is clear that the persistence of under pricing reflects the attempt by government to satisfy certain objectives through the sale of sahres. The key goal here is that of wider share of ownership. Under pricing encourages share applications from small agents in two ways, first through lowering the cost of a given asset bundle in the presence of wealth and credit constraints, and secondly when underpricing is signalled well in advance. In this event, the riskiness of investment is intentionally reduced and this will induce more sisk-averse- agents to apply for shares. The wider share ownership objective is then made instrumental through the

Vickers. J and Yarrow. G. (1988), Privatization : An Economic Analysis MIT Press, Cambridge, MA., USA.

government's choice of share allocation scheme. However, we would argue that underpricing is a costly and inefficient method of achieving the objective of wider share ownership. If this is the government's true objective then the 'give-way' option should be explored more fully.

Given the strongly political nature of divestment it is quite probable that underpricing will remain embedded in capital market sales, with the attendant negative externalities for capital market development. Allied to underpricing has been the stipulation of restrictions on the extent of individual share ownership, principally to head off concerns about the re-concentration of ownership in the hands of private sector elites. Such restrictions which are present in virtually all public share issues in the countries studied here, generally limit any individual shareholding to a maximum of 10% of the total equity. Though such measures may have a political reason, they do only at the cost of further institutionalization of efficiency reducing free rider problems associated with widely dispersed equity ownership.

In conclusion, detailed analysis of the evolution and design of privatization programme suggest that a key place must be accorded to the innately political nature of divestiture. Govt.s seek to achieve political objective, especially distributional ones, while at the same time trying to ameliorate the crisis in the SOE sector and respond to the set of normative arguments forming the case for privatization. Much of the evidence cited above implies that, when they have the power, governments respond to trade-offs in these competing objectives by sacrificing goals other than the political. This conclusion, though is modified by three considerations. First, the risk aversion of govt.s caused by fear of failure is lessened as controversy decreased. This allows consideration of economic goals to predominate. It is interesting to contrast here the experience of Jamaica and Malaysia. In the format, political convergence on broad economic policy and on the merits of privatization, in particular have allowed the current government to concentrate far more on the economic adjuncts of privatization, namely consideration and regulation and the revenue maximising design of sales. In Malaysia, on the other hand, the continuing desire to meet the goals of the New Economic Policy (NCP) has led to a situation in which though asset ownership is broad, assets are systematically under price and risks massively underwritten by public sector institutions, thereby compromising the market objectives of the programme. However, the new phase of the NEP and the privatization Master plan does suggest that this ultra cautious stance may be relaxed somewhat in the future.

Second it is erroneous to regard the economic objectives of privatization as forming a consistent set. In reality, there are conflicts within this set just as there are between economic and political objectives.

However, finally the above analysis assumes that the government is in control of all the relevant variables that determine the outcome and pay-off of privatization transactions. In an important class of cases, this is not an accurate characterization. This brings us to an analysis of reputation, credibility and precommitment in the following section.C: REPUTATION / CREDIBILITY AND PRE-COMMITMENT :

In discussing the objectives of privatization of privatization programs that government's reputation with the private sector i = and its desire to signal intent to external donors would be important determinants of the price and shape of transactions. Reputation considerations derive from two innate features of privatization transactions, namely asymmetric information, and uncertainty in the enforce ability of contract. As we shall show, a situation where a government has a poor reputation results in a sub-optimal outcome from both the public finance and the social welfare perspective. In this section, we present a simple model illustrating this problem, and discuss different ways in which governments have adapted privatization programs using pre-commitment and reputation-creation strategies to get round the problem.

The main focus of the reputation issue concerns policy making (i.e. Privatization) over time, by considering the problem and its solution in a static, one-shot, situation. For this we use a simple, highly stylized version of the model developed by Backus and Driffill, 1985 [1]. The essential feature of this model is that once the sale of an asset has been finalized the government is able to renege on its conditions of sale in order to earn additional revenue. This could be achieved in a number of ways, for example by changing the tax structure for the industry, by altering the conditions for access to the foreign-exchange auction, by imposing price controls on the industry, by changing remittance conditions for profits in the case of foreign-owned companies, by changing the regulatory framework, or ultimately when the government has provided sweeteners to the purchaser, there will be a cash incentive not to honor these, and thereby increase its pay-off. The government's perceived propensity to renege on the sale contract (some of whose elements may be implicit) will contract (some of whose elements may be implicit) will affect the amount the private sector is willing to pay for the asset.

We consider a government which, facing some (un specified credit constraint, seeks to raise revenue. This can do through the sale of an asset, but it can also augment this revenue through post-sale default. However, the private sector purchasers will take into account the likelihood of the government default in deciding whether to accept the offer for sale. We assume that no sale will occur if the maximum price the private sector will pay is less than the offer price. The government's anticipated total revenue raised at the time of sale, and 'r' is the revenue raised through future default. We define the government's utility

[1] Backus, D. and Driffill, J (1985) 'Inflation and Reputation', America Economic Review 75, 530-38.

function as : $U = f\ r, (r^{-} - r)$

Where the first argument implies that the government gets utility from revenue now rather than later for a given split between P and r), while the second argument suggests that the government none the less derives extra utility in the situation where the monetary value of its default is greater than the purchaser had expected (labelled r^e). Intuitively we see that, while government wishes to maximize short-term revenue by maximizing o, it also has an incentive to 'fool' the private sector.

We also assume that the private sector's utility function is defined as $Up = g\ (r\_ - r^e)$ where $I\ r - r^e\ I > o$... (2)

Which simply states that for a given p (where p = q - r), the private sector does not like to be fooled. Following Backups and Driffill and Vickers we simplify the analysis by choosing an arbitrary functional form for (1) and (2) :

$U = - ar^2 + (r_2 - r^e)$____________(3)

$U = - (r - r^e)^2$ ...(4)

From this the Nash equilibrium solution can be derived as follows:

SUg / Sr = 2 Sr + B = 0 = r = B/2S ....(5)

SUp/ Sr = 2 (r - r) = 0 = r = r = B/2x_______(6)

Substitute back into the utility functions Ug and U we get government and total utility Ug = u = -B ~74 x.

These are clearly lower than would be the case if the government were able to set $r = r^e = o$, such that Ug = U =o, which is Pareto improvement on the Nash solution.

However, it is clear the Nash solution is a direct result of the inability of the government commit itself to a node fault scenario. Given the nature of its utility function, where it has an incentive to default in order to fool the private sector, then the private sector will expect this default and consequently not accept the asset at the higher price. This is a standard example of the prisoners problem. hence if government then has a clear economic incentive either to improve its reputation or to circumvent the credibility problem by designing binding contracts. Given the structure of the government utility function, this is not possible in a one-shot sale, as above. However, once we consider a dynamic setting, the issue of policy credibility and reputations becomes clearer.

d) CREDIBILITY AND REPUTATION IN ADYNAMIC SETTING :

To motivate this discussion, we need a realistic model of hope the private sector might eventually come to trust the government. We suggest that an appropriate characterization of this dynamic can be found in a Bayesian framework, in which, rather than trusting the government ability, the private sector update its assessment of the government's nature over time in response to its observations of the government's actions. Suppose that, in contrast to the Nash solution, the nature of the government's utility function is unknown at the beginning of the process, but that the private sector makes some ex-ante estimate of the government's "honesty" (p) . If the government defaults on the initial sale then 'p' will fall to zero (as it has revealed its true nature), and thereafter the private sector will expect a default and its offer price will fall accordingly. If however, the government doer not default, then the private sector will revise its assessment, p, according to a Bayesian updating rule.

Letting the no-default state be N, the honest government be H and the dishonest D, the Bayes theorem states that the purchaser's revised estimate of the government being honest is **then** conditional probability that it is honest given that it did not default in this period. This is expressed as

$$P_{t+1} = \text{Prob } (N/H) \qquad (7)$$

$$= \frac{\text{prob } (N/H) \text{ prob } (H)}{(\text{prob } (N/H) \text{ prob } (H) + \text{prob } (N/D) \text{ prob } (D)}$$

Under such a scheme the private sector gradually revises its estimate of the government's honesty as each sale unfolds. The result of such trust updating, and an illustration of the policy issue facing government. This shows a case where the private sector initially sets p = 0.25. If after three sales no default has occurred the Bayesian rule would see the private sector's porbability estimate of the government's honesty rise to 65% and after 10 sales with no default the vale of 'p' exceeds 99%. If, however the initial probability was 75% then the 99% certanity level would be reached after 6 sales. Clearly the the initial probability estimate is crucial in determining the speed with which the government approaches full credibility and hence maximum revenues. Thus, in a world where offer prices by the private sector reflect their ex-ante probability estimates, then it will be in the interest of government to act so as to influence this estimate. One instrument for doing this lies in the design of privatization programme .

TABLE - 6.1

NUMBER OF PRIV ATIZATIONS BY COUNTRY AND BY METHOD OF SALE

COUNTRY	TOTAL	PUBLIC SALE	PRIVATE SALE		MC & LEASE			
			DOM a	FOR JOT b	DOM	FOR JOT a b B		
Jamaica	41	3	15	6	4	2		19
Kenya	1	1	0	0	0	0	0	0

Jamaica	7.20	2.25	1.10	3.56	0.29
Kenya	0.09	0.09	0	0	0
Malawi	0.61	0	0.19	0.42	0
Malaysia	0.55	0.27	0.12	0	0.16
PNG	0.18	0	0	0.18	0
Sri Lanka	0.15	0.04	0	0.11	0
Trinidad & Tobago	2.34	0.24	0	2.10	0
Average	1.59	0.41	0.20	0.91	0.06

Source : Country case studies.
Notes -
a) Not including the value of management contracts or leases.

b) the figures represent the total or privatization proceeds to date a sum of the propreotions of those proceeds to GDP in the respective years of sale.

TABLE 6.4

NUMBER OF PRIVATIZATIONS BY COUNTRY AND BY FUNCTION OF ENTERPRISE

COUNTRY	TOTAL	COMMERCE MNFG & SERVICES	FINANCE & BANK-ING	TRANSPORT & COMMUN.	WATER & ENE-RGY	REG. MRKTG.	AGR.
Jamaica	41	30	1	5	0	0	5
Kenya	1	0	1	0	0	0	0
Malawi	17	10	0	0	0	0	7
Malaysia	24	13	2	4	0	0	5
PNG	4	2	0	1	0	0	1
Sri Lanka	6	6	0	0	0	0	0
Trinidad	5	2	2	1	0	0	0
Total	98	63	6	11	0	0	18

Source : Country case studies
Note - 6.4 Table
a) Including management contracts and leases

TABLE 6.5
PRIVATIZATION PROCEEDS BY COUNTRY AND FUNCTION OF ENTERPRISE

COUNTRY	TOTAL	COMMERCE MNFG & SERVICES	FINANCE & BANK-ING	TRASNPORT & COMMUN.	WATER & ENE-RGY	REG. MRKTG.	AGR.
Jamaica	230.7	104.2	16.1	110.3	0.0	0.0	0.1
Kenya	9.1	0.0	9.1	0.0	0.0	0.0	0.0
Malawi	7.2	5.4	0.0	0.0	0.0	0.0	1.8
Malaysia	180.3	18.6	8.7	133.5	0.0	0.0	19.5
PNG	4.5	0.8	0.0	1.0	0.0	0.0	2.7
Sri Lanka	10.7	10.7	0.0	0.0	0.0	0.0	0.0
Trinidad	94.5	6.3	3.3	84.9	0.0	0.0	0.0
Total	537.0	146.0	37.2	329.7	0.0	0.0	24.1
Average	6.8	2.6	6.2	33.0	0.0	0.0	4.0

Note : Excluding management contracts, leases and closures.

TABLE 6.6
NUMBER OF PRIV: ATIZATIONS BY METHOD AND FUNCTION OF ENTERPRISE

FUNCTION	TOTAL	PUBLIC	PRIVATE SALE			MC & LEASE		
			DOME-STIC	FORE-IGN	JOINT	DOME-STIC	FORE-IGN	JOINT
Commerce, Manufacture & Services	63	7	26	13	4	4	1	8
Finance & Banking	6	4	1	1	0	0	0	0
Transport & Commun.	11	3	0	5	2	1	0	0
Water & Energy	0	0	0	0	0	0	0	0
Regulatory & Mrktg.	0	0	0	0	0	0	0	0
Agricul.	18	0	9	4	0	3	1	1

Source : Country case studies

TABLE 6.7
VALUE OF PRIVATIZATION BY METHOD AND FUNCTION OF ENTERPRISE
(US $ MILLION)

FUNCTION	TOTAL	PUBLIC SALE	PRIVATE SALE		
			DOMESTIC	FOREIGN	JOINT
Commerce, Manufacture & Services	146.0	41.9	54.2	39.7	10.2
Finance & Banking	37.2	32.6	4.6	00.0	**00.0**
Transport & Commun.	329.7	99.2	0.0	176.5	**54.0**
Water & Energy	0.0	0.0	0.0	0.0	0.0
Regulatory & Mrktg.	0.0	0.0	0.0	0.0	0.0
Agriculture	24.1	0.0	20.6	3.5	0.0
Total	537.0	173.7	79.4	219.7	64.2

Source : Country case studies
Note : Excludes management contracts and leases.

TABLE 6.8
AVERAGE OF PRIVATIZATIONS BY METHOD AND FUNCTION OF ENTERPRISE
(US $ MILLION)

TYPE OF ENTERPRISE	AVERAGE	PUBLIC SALE	PRIVATE SALE		
			DOMESTIC	FOREIGN	JOINT
Commerce, Manufacture & Services	2.38	5.98	2.08	3.05	2.55
Finance & Banking	6.20	8.15	0.00	0.00	0.00
Transport & Commun.	29.97	33.07	0.00	35.30	27.00
Water & Energy	0.00	0.00	0.00	0.00	0.00
Regulatory & Mrktg.	0.00	0.00	0.00	0.00	0.00
Agriculture	1.26	0.00	2.29	0.88	0.00
Average	7.01	12.40	2.27	0.55	10.72

Notes : This table excludes the value of management contracts and leases.

CHAPTER - VII

GOVERNMENT CREDIBILITY AND PRIVATIZATION

INTRODUCTION :

Continuing from the preceding chapter *VI,* the discussion in chapter VII follows that the government faces time path, bound objective to minimize the revenue loss termed as Bayesian trajectory. The experience of privatization is to demonstrate two ways in which governments have attempted to minimize revenue losses: the first approach involves signalling strategies which increase the slope of the Bayesian trajectory, the main examples here concern the underpricing of shares and the sequencing of sales. The second method is the use of instruments through which government can short circuit the gradual reputation trajectory. The strategies here are government precommitment and consideration of post-default punishment options.

7.1 ACCELERATING THE REPUTATION PROCESS THROUGH THE DESIGN OF PRIVATIZATION :

A) UNDER PRICING AND SEQUENCING :

As demonstrated above, under Pricing of shares in the primary market is an endemic feature of the privatization process in a large number of countries. While it is true that underpricing is used to achieve a number of objectives (has discussed in the previous chapter), it is also widely viewed as a way of enhancing government's credibility. Credibility and Reputation are perceived to be made on the basis of 'successful' sales, where success is measured interms of the over-subscription for shares and the premium revealed on first-day trading. The implicit argument is that the first-day trading premium generated *fry* pricing shares below the Bayesian trajectory in the initial sale will serve to signal the government's reputation and therefore raise the price. The private sector is prepared to pay for later sales more rapidly than otherwise. Using under pricing in this manner is problematic, however, since it has adverse effects on other privatization objectives and also is often an inefficient strategy for creating a reputation. First, it can have a number of serious distributional effects, since it represents a cumbersome method of effecting a lumpsum cash transfer from the issuer to lucky share applicants implemented through the equity market. Second, it may have adverse effects on the development of the capital market operating principally interms of moral hazard and adverse selection effects. Third, and more importantly for the discussion here, there is the problem that underpricing may become self-defeating in that, as a result of either the adverse selection problem or political dynamics, it becomes locked into the privatization process. It is then possible that the 'under-pricing' trajectory never crosses the Bayesian trajectory, and thus the government must accept a permanently low level of revenue.

If the price itself cannot be relied on to signal reputation sufficiently, an alternative route may be to use the sequencing of the sale of assets, by concentrating in the early stages on the sale of assets in sectors where the scope for default is more limited. Typically this would entail competitive as opposed to monopolistic sectors, sectors open to greater foreign participation, and also sales of relatively small assets. In our study, there were 95 privatizations, 63 were in the manufacturing, commerce and services sectors; and only in two countries where privatization was well entrenched in the policy corpus, had the programme moved significantly into the sale of utilities. This pattern of sales is corroborated by broader reviews of privatization.[1]

Sales have tended to affect SOEs that are small in terms of assets and employment (and) privatization appears to have occured most frequently in manufacturing and services sectors, predominantly reflects the weakness of the domestic private sector, it is also a response to the private sector's unwillingness to commit large investment funds in an environment of policy risk. This unwillingness is one aspect of the difficulty for government's careful sequencing that may bring a return by allowing privatization of these larger enterprises.

B) PRE-COMMITMENT :

More fundamentally, through, using the sale price both to indicate the intrinsic value of the asset and to create confidence through reputation may not be possible (or if possible may operate too slowly) . When neither the quality of the asset nor the quality of the seller is known the private sector faces a

[1]Berg.E. and Shirley. M. (1987) Divestiture in Developing Countries : World Bank Discussion papers 11. Washington D.C.

signal extraction problem, since it observes only one piece of information, namely the price, Faced with this signaling problem, the government can well offer the easiest way of the information overload problem of price signalling and allowing it to jump to almost immediately.

These non-price instruments can be divided into precommitment by the vendor (legal or otherwise) against further default, and punishment options by the seller or by other agents in the event of such default. Although these are conceptually separate, it is natural to see them as linked issues, on the grounds that only if the buyer is able to penalise the vendor after the breaking of a pre-commitment will that punishment be credible. Thus, it may be optimal (i.e. intertemporally revenue maximizing) for the government to introduce full or perfect punishment possibilities into privatization sales in order to make its pre-commitments credible. As suggested above, this is essentially a method of circumventing the reputation problem by eliminating the uncertainty -that asymmetric information introduced into the sale process.

Broadly, pre-commitments and punishment possibilities can be classified into two main sorts, 1) those are instrumented through third parties, 2) those that are implicit or explicit to a bilateral contract. An example of the general form of third party pre-commitment is the recently created Multilateral Investment guarantee Agency (MIGA) and other investment promotion schemes which provide insurance against loss of earnings as a result of non-commercial risk (including re-nationalization). In privatization, though, these would mostly impact only on sales to foreign investors. Another more common example comes through the Agencies of IMF and World Bank adjustment lending which attempt to bind government policy actions.

In general, for reasons such as these, third party strategies are rare. More typical are pre-commitments and punishment possibilities built into the individual sale contract. However, although these offer the most rapid way of dealing with the reputation problem, they frequently compromise other objectives of the privatization programme. To document this point, we present two examples of explicit pre-commitment / punishment provisions from the Jamaican privatization programme.

The National Commercial Bank (NCB) of sale, as noted earlier, was critical to the whole Jamaican privatization programme. The ramifications of political controversy for the design of the sales have already been analysed, here we focus on the government's methods of pre-commitment with respect to potential buyers. While the NCB itself was a consistently profitable institution (implying that, as a private firm, an appropriately priced share issue would have been enthusiastically received), the Jamaican Government still had a reputation for extensive intervention in the private sector. Thus one of the key means in persuading individuals to buy shares would consist of designing a visible and credible method of locking the government out of future interventions in the running of the NCB. This was made all the more important by the decision to sell only 51% of the equity, leaving the government in control of 49% after the sale. Hence, reputation issues would be central to the success of the privatization programme in Jamaica.

Ultimately the government chose a pre-commitment option which tied its hands by rendering certain entrenched provisions of the company virtually immune to alteration. These were 1) that the government's remaining 49% share was declared non-voting, and 2) that any individual's share holding could not exceed 7.5% of total equity. These provisions could only be changed by unanimous agreement at a meeting of more than 90% of shareholders with voting rights. The Memorandum of Association of the bank was similarly entrenched. These restrictions, which far exceed normal private sector practice in Jamaica, indicated the seriousness of the government's desire to signal its intention not to default. This conclusion is under-scored by the fact that when the government was considering the inclusion of a 'golden share' arrangement, its advisers warned that such an action would raise fears of future intervention and thus render the NCB unsaleable. The Government consequently dropped the idea.

If the privatization of NCB was significant, the sale of Telecommunications of Jamaica (TOJ) was regarded as crucial for economic growth, since by 1988 telecommunications was regarded as critical bottleneck in the restructuring of the economy. In order to obtain the necessary quantity and high quality of capital investment required to overhaul the telecommunications sector, the government had to sell the company to a foreign operator. Given the size of the new investment proposed (approximately US $ 300 million over a 5 year period), the government needed to convince the buyer that the investment would not be jeopardized by default in the future (either by way of re-nationalization or through price controls), even if there was a clear short-term economic incentive to do so. The methods chosen in this case were a combination of legal pre-commitment and the prescription of a punishment process. In brief, these were as follows:

a) TOJ was granted an exclusive (i.e. monopoly) 25 years licence for domestic and foreign telecommunications in Jamaica which would be renewed automatically for another 25 years, unless, with the 2 and 1/2 years notice, the government acquired all TOJ assets at a fair market value as determined by a firm of valuer acceptable to both parties.

P) In the vent of a revocation of the licence, TOJ was allowed two years to sell its assets. If it was unable to do so, the government would be obliged to purchase the assets at a fair market price.

c) In the event of such a repurchase, the government was obliged to pay either in cash or upto 95% of total in promissory notes denominated in US dollars or UK Sterlings over a period of 15 years at 2% above London Inter-Bank Operating Rate (LIBOR) for similar deposits.

d) TOJ price setting regulations guaranteed the company, an annual 17.5 - 20% return on share holders funds. Further, the design of the regulatory regime made no attempt to impose cost savings on the firm.

Essentially, these provisions offered the foreign owners to TOJ an investment free of expropriation risk, with a guaranteed return. These extraordinarily detailed agreements, in fact, offer a example of almost perfect pre-commitment since the Jamaican Government specified a punishment strategy that would leave the putative owner of TOJ indifferent, between holding TOJ equity and accepting government compensation.

Interesting as these transactions are in themselves, the key point for the discussion here is that these precommitment / punishment strategies, motivated by the revenue maximization objective of the government, served to reduce economic efficiency below the optimal position. In the case of the NCB, share holder control of management was compromised by the entrenched provisions, while for TOJ a 50 year monopoly position was locked in under the simple rate of return regulation, that these punitive pre-commitments were deemed necessary to establish the government's credibility in the privatization programme. Is the Jamaican government had been eroded during the previous decades. It also suggests that there are costs to poor reputation other than bad economic performance, namely the costs of the problem of lack of credibility. These costs may emerge as explicit trade-offs in the implementation of privatization programmes, especially in countries where governments have interventionist reputations but wish to embark on privatization programs of substantial size.

The second form of bilateral pre-commitment / punishment strategies are implicit commitments, the main one being the creation of a wide share ownership base. Put it simply, the larger the number of shareholders, the greater will be the cost of default. Wider share ownership binds the government into a large number of individual contracts with its electorate, each of which is able to punish default. The logical implication of this is, of course, the 'give-away' option, now popular in Eastern Europe, through which shares on SOEs are distributed free to all tax payers, voters or citizens. This form of privatization can be seen as a means of effectively achieving a number of the main objectives of privatization. Aside from the creation of a near-perfect reputation and important reputation externalities in other areas, the method also facilitates a rapid and cheap divestiture on the part of the state. In doing so, it quickly allows for a private market valuation to emerge, with consequent implication for the development of capital market trading and optimal resource and risk allocation, it avoids the re-concentration of wealth in hands of these investors who have the liquidity to purchase privatization shares, and it represents a 'pure' form of privatization by giving back to the private sector the freedom to choose how to allocate the asset bundle which was hitherto (nominally at least) been held in its name.

While, in many of the countries which have sold enterprises through public issues, wider ownership has been used as a political and reputational tool, no government in our country studies have explored the 'give-away' option.

The impact of reputation and policy credibility issues on the design and implementation of privatization programmes has rarely been explored in other studies of privatization in developing countries. This may once again be the result of the importation of developed country models where credibility in government policy is not such an important issue to the developing country context. However, this analysis suggests that, though often unremarked, governments are obliged to take account of policy credibility considerations when implementing sales-especially when divesting large enterprises and / or involving foreign buyers. In as much as a number of countries are seeking to expand their programmes and start privatizing utilities, we would expect methods of securing private sector credence in government policy to become more important. However, as noted above, across the scope of our study, the use of pre-commitment and punishment contracts have emerged as the most widespread and most effective methods for enhancing a government's reputation. While these may be revenue maximizing (when compared to the base case of reputational updating), they run the risk of locking in inefficiencies over the long term and hence vitiating the key objective of the sale.

C) OTHER CONFLICTS IN OBJECTIVES :

In the earlier sections, discussed the ramifications of the innately political nature of privatization, and examined the ways in governments attempts to fulfill objectives of privatization that have shaped both programmes and individual sales, and analysed strategies which governments have employed to overcome reputational constraints that are outside their direct power to change. In both cases, these actions caused friction with other public professed, goals of privatization and that, in general, political aims were those chosen to be directly instrumented. As the distinction between the trust of political and other objectives increases, so the achievement of the main aims of privatization is made increasingly less likely.

A fundamental conflict facing all governments is that of achieving the economic objectives of privatization in the light of ancillary objectives, particularly the desire to improve fiscal balances (often in response to external pressure).

This is particularly troublesome in developing countries whether privatization often takes place in the midst of a fiscal crisis in which the government is confronted simultaneously by the urgency of loan conditionally on the one hand, and growing domestic political dissatisfaction on the other. Given this framework, the temptation is for governments to emphasize the short-run liquidity transformation (i.e. cash for equity) aspect of privatization.

Thus, an overriding goal of programmes tends to be the rapid reduction of fiscal deficits by the quick sale of enterprises, and the decision to sell a function of the forces leading a government to prefer cash to equity. This clashes in a number of ways with the rationale most often put forward for Privitazation, namely the enhancement of efficiency. Firstly, often the most profitable enterprises are sold, since they are the easiest to divest quickly. Not only are these enterprises generally net contributors to current revenue, but they are likely to be operating efficiently (in an internal sense).

Sale of these enterprises is unlikely to result in greatly enhanced efficiency, the limiting example of this type of dynamic was the fourth tranche sale of TOJ, which gave the foreign share holder a majority equity stake for the first time. This sale was carried out solely to earn foreign exchange so that the government could pass a quarterly IMF Performance test.

Second, we find that in a number of cases the profitability of SOEs is a function of their monopoly power (either natural, strategic or administratively determined). As stressed earlier sale of public sector monopolies to the private sector invariably means a transfer of monopoly profits to the private sector, there are no efficiency gain in this case. Too often the desire to bring enterprises to market and maximise immediate revenue has resulted in pressures to proceed with the divestiture of monopolistic enterprises, while the issue of the post-privatization regulation of private monopolies is either ignored until after the sale has occurred are at best inadequately considered.

The specific problem of conflict between revenue maximization and efficiency enhancement forms one part of a broader conclusion on the attainability of these two goals. Although improvements in public finance and gains in efficiency are exposed as the two most important objectives of privatization, to suggest that in many developing countries they have at best been only partially fulfilled. In countries studies, efficiency gains and revenue improvements have not been, or not be, substantial, for a variety of the reasons expounded above (as a result of the types of enterprises sold, the lack of regulatory systems to accommodate the widespread presence of market dominance, or more basic political pressures) .

The majority of firms that have been privatized are ones which have already been running relatively efficiently, either over a long period of time, or due to pre-privatization clear-ups. This is especially true of share sales to the public, where it is generally assumed that the offer for sale of loss making SOEs would not attract private investors. In these cases, it may well be that the net long run impact on pubic finance will be negative. On the other hand, there are clear examples of genuine and measurable success interms of post-privatization efficiency gains, although these are more common in other types of privatization efficiency gains, although these are more common in other types of privatization (i.e. direct sales to the domestic and / or foreign private sector, and management leasing), such as the textile mills in Sri Lanka, Iron and Steel Company of Trinidad and Tobago (ISCOTT) and hotel leasing / sales, Bus route tenders, and Agricultural marketing board sales in Jamaica. In these cases the net long run impact on public finance has been and will be positive.

A second conflict concerns revenue maximization and private sector development. The pronounced dualism of privatization sales was emphasized in our review of the experience of privatization to date. Concentration on the sale of large enterprises through public share sales or foreign purchase may result in higher revenues in each budget, but as successive country studies show, they will do little to 'crowd in' the small and medium scale domestic private sector, which lacks the resources to become a player in this type of programme. The problem is reinforced by the fact that short term revenue maximization involves the sale of monopolies as they are in many cases, governments have let stop the opportunity of creating competitive markets or breaking up Leviathan enterprises through a strongly pro-competitive policy, though both would have a positive effect on the development of the domestic private sector. A more common occurrence, however, is the creation of private sector entry determining oligopolies and monopolies.

There is also a tension in privatization programes caused by the necessity of meeting adjustment conditionalities. This tension is made manifest through pressure from external agencies to proceed with divestiture as rapidly as possible. However, speed of sale is seldom conducive to the full realization of the potential of privatization. First, there is pressure on governments to privatize enterprises before they are ready for sale. Increasingly multilateral agencies have come to realize that both SOE reform and privatization programme issues are time consuming and that three year adjustment loans are excessively blunt instruments of implementing privatization. [2]

It has been noted that most attempts to reform public enterprises have used SALs (Structural Adjustment Loans)... Yet public enterprise problems are complex and SALs generally have been selective and macro-oriented... It has also been noted that several components of public enterprise reforms take longer to implement than permitted under a typical SAL disbursing period.

Second, privatizations undertaken at high speed or under intense pressure are often poorly designed. For example, in Kenya the Uplands Bacon Factory sale was pursued in response to the moratorium on disbursements of a previous adjustment loan. Though UBF's sale was not directly part of any adjustment conditionality, and ultimately was not successful, the government clearly felt it would restore its credibility Mosley, 1991) [3]

[2]Galal. A. Public Enterprise Reform : A challenge for the World Bank, World Bank, Policy, Planning and Research papers.

[3]Mosley. P. (1991) 'Kenya in Mosely et. al (eds) AID and POWER.

In the event, however design faults arising from excessive haste caused the sale to fail. Similarly in Jamaica, privatization of the Caribbean Cement Company (CCC) was undertaken with extreme rapidity. Design problems are not only caused by external pressure. In the case of the land leases in Jamaica, failures arose where there was a conflict between improving the yield on agricultural land (an efficiency objective), and the government's desire to diversify the agricultural sector through the promotion of non-traditional interpreted.) This last trade-off reasserts itself in another way. In some countries, the goal of private sector development has been concerned with involving the private sector in projects which have previously been the province of the state, rather than being enterpreneurial (i.e. more dynamic, risk-taking) behaviour through the encouragement of competition. Thus, 'crowding in' the private sector can take the form merely of enticing the private sector into new underwriting of commercial risk. The classic example of this is the Malaysian Build operate Transfers (BOTs), where the creation of 'safety net' guarantees by government to protect private sector operators against future revenue shortfalls effectively undermines the whole purpose of BOT in the first place. The implication of such transactions is that competition is stifled and hence expectations of efficiency gains are downgraded.

CONCLUSION

Analysis of the privatization in countries selected shows that actual outcomes had been quantitatively disappointing. Privatization to-date has played a small role in reform of the SOE sector, and in India the pace is slower and the role of privatization is not significant in SOE sector reforms. It is in progress, not completed. However, aggregating across the programmes revealed certain common salient features.

Most importantly the analysis delineated how the design and outcomes of individual transactions and privatization programmes are strongly influenced by (l) the attempt by governments to address political issues, or gain capital from privatization, 2) the need to ensure credibility in privatization policy and 3) the intrinsic tensions in the broad goals assigned to privatization. The satisfaction of these constraints, however, can result in a failure to attain other objectives. Specifically, it is the goal of improved efficiency - which after all provides the central economic argument for privatization which is most often sub-ordinated (whether deliberately or through oversight)when trade-offs occur. Governments in developing countries could adopt far more rigorous competition and regulatory policies. The adoption of such policies could result in a stronger concern with efficiency enhancement in privatization transactions, even if privatizations purely around economic issues, the nature of economic structures in developing countries would often have a powerful limiting impact on the potential of privatization.

CHAPTER VIII

PRIVATIZATION - ECONOMIC STRUCTURES IN DEVELOPING ECONOMIES

INTRODUCTION :

This chapter sets up analysis of privatization in different economic structures, based on certain premises ;i) privatization has has been less successful in the low-income economies, than in well developed and more diversified economies; ii) the pace of progress of privatization is largely due to changes in the structure growth and development of the economy, and iii)efficiency impact of privatization is similarly due to development of market structures and regulatory capacity. This chapter examines in Section-2 : the extent to which the domestic private sector in developing countries can provide a competitive environment through which the economic efficiency gains are expected to flow from privatization or that can be realized to generate the resources as to absorb privatization sales. The study also focuses on capital markets in the privatization process, namely savings mobilization, (in section 3 through 9)disciplined on management of regulatory capacity and its likely impact on the post-privatization environment. This chapter also probes into the constraints that economic structure imposes on privatization and the feed back from privatization to these structural factors.

8.1) PRIVATE SECTOR CONSTRAINTS AND LIMITS TO GROWTH :

In this study, selected sample countries can be divided into four sets. The first is Malaysia and Jamaica which despite their differences in population size, have similar development indicators interms of income levels, urbanization, market depth and the share of manufacturing in GDP. The second set is Trinidad and Tobago and Papua New Guinea (PNG) which are small mineral exporting economies in which the manufacturing sector accounts for a relatively small proportion of total output. The third comprises two African economies of Kenya and Malawi. Kenya is the most industrialized East African economy, while Malawi is a poor agricultural economy. Finally India and Sri Lanka both having similarities with respect to urbanization and industrialization and poor income levels. Though the selected sample of countries chosen and sub-sample sizes are small, these countries represent reasonably adequate size characteristic or arch types for many low and middle - low-income developing countries, and hence the common characteristics of their domestic private sectors go along with to explain the nature of liberalization process and privatization in many similar developing economies.

Data on the structure of the Private sector usually limited, partial, and more dependent on infrequent external analysis than on data produced regularly by state statistics bureau. As the country studies show, a large proportion of firms are small, measured by employment and turnover, and are owner-managed, with limited access to long term finance.

8.2) THE DOMESTIC PRIVATE SECTOR AND COMPETITION :

Markets are frequently concentrated, being dominated by one or more large state/owned enterprise sector or foreign owned enterprises accounting for the major proportion of output. Except in Malaysia, industrial (non-agriculture) sectors are characterized by low levels of capacity utilization (often due to foreign exchange rationing) and high levels of effective protection. In the smaller economies, the bulk of private sector employment is generated in micro-enterprises, while firms with work force of more than 50 people contain most of workforce. Firstly Trinidad and Tobago and Jamaica, study suggests that market dominance is significant in a wide range of sectors, and that dominant firms in these sectors are state-owned. In Kenya the manufacturing sector is similarly concentrated, with 50% of all firms employing less than five people, and only 10% employing over 50, while average SOE size in the Kenyan manufacturing size

The most valuable sources are World Bank Industrial sector memoranda.

is approximately 120 employees,[2] while speaking about India certain sectors are reversed for the Public Sector and the dominance of SOEs are also significant.

Though not universal, SOE domination is widespread, whilst this may be expected, for example in the oligopolist transport, energy communication, and possibly finance sectors. This suggests that these economies are significantly different from those implicit in the models of competition underpricing the privatization debate. In the large countries Malaysia, and India are evidences that private sector in general is deep enough to provide a sufficient degree of competition in the industrial sectors, although even, the relative balance is still in favour of public enterprises.

The advantages of size and capital intensity as instruments for enforcing market dominance are, in many cases, compounded by the presence of interlocking directorship ones, to act conclusively. Malawi is the most extreme case with the interlocking shareholdings and between press holdings, but it is also a traditional feature in Jamaica, Sri Lanka and Kenya. In the industrial sector, divestiture of a number of enterprises is operating in similar sectors. Divestiture of these enterprises operating in similar sectors, issues together may well itself, provide the basis for a competitive market regardless of the

[2] B.Grosh, 'Economic Performance of Kenya Parastatals' : Lessons from the first two decades of Independence - (Development Policy Reviews), 53-58.

structure of private sector ex-ante. Similar situations exist in other sectors. For example, the simultaneous privatization and deregulation of urban transport systems in Sri Lanka and Jamaica have created efficient and competitive markets. An identical situation arises in the agricultural sector in Caribbean, where wholesale sales of land (Jamaica) and sugar plantation land (Trinidad and Tobago) could provide the basis for a competitive market.

8.3) MOBILIZATION OF DOMESTIC SAVINGS :

Another limiting factor is the extent to which private sector can generate an adequate supply of savings for investment although this issue is never directly addressed in the theoretical literature on privatization, it is clearly a necessary logically shows empirical verification and a sufficient condition for successful privatization. Savings can be generated from two sources-domestic and foreign. Savings behaviour has been at the centre of research concerning the performance of developing economies. In particular, the extensive debate on financial liberalization revolves around concerns that repressed financial systems combined with loose monetary and fiscal policies have distorted the prices of savings. In many low-income economies aggregate savings are low, poorly intermediated, and often held in non-financial forms. Moreover, financial repression has contributed to an extensive growth of capital flight, and the preference for holding non-financial assets. The domestic savings available for long-term fixed capital formation or equity investment are thus frequently shallow. This correlates quite closely with an observed split between foreign and domestic participation in the privatization programmes.

In addition to a low average propensity to save, savings patterns of household sector are highly skewed and subject to extreme variability over time. Moreover, the domestic savings pattern in many low-income developing countries are dominated by seasonal effects and are broadly precautionary and speculative aimed at consumption smoothing in the face of very low and violently fluctuating under certain agricultural income streams [4] rather than being long term and secular trends oriented. Such savings patterns are rarely conducive to large scale risky capital investment. There are also often marked difference in saving pattern between Urban and Rural communities. Rising incomes due to a switch from subsistence (rural) to contract-wage (Urban) structures are likely to generate increasingly higher levels of speculative savings.

These conditions are likely to be necessary to ensure that there will be a sizeable degree of domestic savings mobilized for equity investment.

[3]P.Mosley : 'Kenya' in : Mosley (ed td) Aid and Power : The World Bank and Policy - Based Lending. Routledge, London.

[4]A.S. Deaton - 'Savings in Developing Countries', World Bank Research Observer, 1989.

An additional factor worth tracing concerns the way in which the macro-economic environment influences the mobilization of savings for privatization. The environment in which privatization has been instituted in most countries has been characterized by deep economic crises, frequently accompanied by severe income compression, upward price adjustment for basic commodities, and considerable reductions in real-wages. This is indicated in Table 8.3 that indicates there is a substantial range in the levels of aggregate gross domestic savings among the selected developing countries.

Privatization is an integral element of adjustment programmes designed to rectify such macro-economic dis-equilibria, but its success is comprised by the presence of conditions which are not at all conducive to savings mobilization and equity investment. This is a paradox of privatization to face the conditions which are against its effective implementation. The reason to this trend is the foreign sector, which macro-economic adjustment would improve its relative purchasing power. The supply response of foreign capital to structural adjustment is weak exchange-rate devaluation and weak competition of the seller at combine to give foreign investors a strong advantage in taking up privatization issues. We now turn to link between the foreign and domestic private sectors.

8.4 THE FOREIGN SECTOR AND PRIVATIZATION :

If the domestic private sector can not provide competition necessary to ensure efficient performance of former SOEs or the resources to absorb them, the requisite competition may be provided by the foreign sector, either through foreign owned companies operating directly in the domestic economy, or through import penetration. However, across most of developing countries, regulations on foreign direct investment are tight and effective protection in the most sectors is high. Recently, policy towards foreign participation has been liberalized, foreign investments welcomed only in export-oriented sectors, and direct competition with domestic producers is not widely encouraged, consequently programmes of incentives have been developed aimed at attracting foreign direct investments, which centre around export-processing zones and either incentives / initiatives.[5] In a number of cases, there are structural factors which provide natural barriers to competition for the domestic economy. The most striking examples are Papua New Guinea (PNG) and Malawi, where transport costs drive a significant edge between 'f o b' and 'c i f '[6] prices.

[5] It is a common feature of World Bank supported Liberalization process, Mosley. P. et. al. 1991.

[6] f o b & c i f : Free on Board and Cost, Insurance and Freight.

Structural constraints not withstanding however, most countries have instituted trade and tariff reform policies aimed at the abolition of quantitative restrictions and the equalization and reduction of nominal rates, often under the auspices of World Bank lending though the level of overall protection is falling on average. The serious debt crisis faced by many developing economies limits their access to foreign savings as a source of financing investment. Consequently, the extent to which the foreign sector can provide an effective spur to competition in the domestic market remains limited. While SOE sector operating in international markets are exposed to competitive forces. Taken together these observations suggest that the domestic private sector in a number of developing countries is limited. In the context of privatization policy - that a change in ownership without both reform of private market structures and the enhancement of regulatory capacity will not generate efficiency gains is thus of prime importance in developing countries.

Though the policies of foreign participation in the privatization process are relatively straight forward the political factors of foreign participation are for good reason much more complex and even in the economic arguments for greater foreign participation are compelling. The sale of public assets and more importantly, the sale of monopoly entitlements to the foreign sector involves the transfer of control and monopoly rents from the domestic to the foreign economy. It is of little surprize then that in most countries there is an unwillingness to sell major assets to non-nationals. This sensitivity is frequently the result of a colonial experience, and indeed localization was frequently one of the main reasons for the original nationalization programmes.

8.5) PRIVATIZATION - ROLE OF THE CAPITAL MARKET :

This section examines the linkages between the management of a programme of privatization and the Stock Markets in our sample countries. It starts with considering the extent to which the presence of the capital market assists in the Liberalization / Privatization process; how it facilitates the mobilization of savings the extent to which in 'packages' investment bundles, and also to which extent, secondary market activity values the assets and their trade-ability.

The second objective is to analyse the extent to which privatization can fulfil the objectives of capital market developments and in particular how the promotion of privatization impacts on the nature and speed of development of the capital market. This issue is rarely addressed in the literature on privatization in industrialized economies but in developing economies where privatization frequently runs in tandem with capital market development, it acquires a higher profile. We start by briefly describing the characteristics of capital markets in developing economies.

8.6) CHARACTERISTICS OF CAPITAL MARKETS :

In our study six countries have Capital Markets (namely Jamaica, Kenya, Malaysia, Sri Lanka, India and Trinidad and Tobago) while both Malawi and PNG are actively examining options for creation of stock exchanges. With the exception of Kenya, all have used the Capital Market in their liberalization & Privatization programmes, although to varying degrees. Apart from Malaysia and India, where capitalization since 1980 has consistently represented nearing 30% and 50% of GNP respectively, the capital markets in these countries are small. The depth of these markets (even including Malaysia and India) is low, especially in comparison with matured markets, and more appropriately, with the New Industrialized countries (e.g., Hong Kong, Singapore, and Taiwan etc). The record of these markets in 1980s has been mixed. In majority cases, markets have deepened especially in the latter half of the decade. Thus in Jamaica, Malaysia,Sri Lanka and India, capitalization has risen as a percentage of GNP, turnover rates have mostly increased and a greater number of stocks are traded now compared to a decade ago.

8.7) RESOURCE MOBILIZATION :

There are a number of separate issues involved in assessing the capacity of capital markets to mobilize domestic resources, the first one is search costs, the essence of the capital markets to provide the mechanism through which the aggregate demand of a large number of small buyers can be channelled into the supply of entitlements to a small number of large assets. In the absence of such market, sellers incur extensive search costs in identifying buyers with sufficient resources and capacity to acquire the assets. Second, in cases where the distribution of wealth is highly skewed, direct sale of public assets to only agents that have accumulated resources, can exacerbate the adverse welfare effects of concentration of asset ownership. These adverse effects of ownership concentration can, without appropriate regulation, lead to situations where dominant agents / firms act to limit the economic effects of privatization in terms of pricing and production. A number of countries which do not have developed capital markets have found that the scope of privatization is limited by the inability to mobilize domestic resources from a sufficiently wide base; to avoid an increase of a capital market not only creates difficulties in the sale of large assets, but, when other types of sales occur, can lead to the exacerbation of monopoly power in the domestic private sector.

Third, capital markets can assist in eliminating one of the major barriers to fixed capital accumulation by reducing the minimum size of investment in financial assets for any individual agent, and simultaneously provide the mechanism for its readability Privatization programmes, which claim the broadening of economic participation as one of their objectives, confront a significant barrier in the absence of a capital market. Fourth an extension of this issue is where foreign savings represent an alternative source of demand for privatized enterprises. Here the political factors of divestiture to the foreign sector are difficult and as we have noted there are numerous have represented the only source of capital for privatization. Governments have only viewed the advantages of foreign participation in the domestic economy but not the disadvantages like dependency problems.

Fifth, Capital markets permits Govt.'s to deal with the 'lump sum' of asset sales, especially through the use of multiple tranches in the divestiture of the same enterprise. This has the benefit of reducing the demand on domestic resources by any single tranche (there by avoiding relative price changes and subsequent crowding-out) and allowing the smoothening of governments revenue, thereby avoiding losses through accidental under-pricing.

8.8.) TRANSPARENCY OF PRIVATIZATION POLICY :

The capital market can affect the management of a privatization programme. Generally, public share issues on established markets impose conditions of clarity, transparency, and consistency on the vendor. Although is not necessarily the case, since it is possible to sell assets in poorly regulated markets, repeated use of weak markets is not sustainable, especially if the participation of foreign capital is required. For example, public share issues required independent statements of valuation of firm to be sold, full disseminated information, a declaration of actual and contingent liabilities, clear statements of corporate policy and future disclosure obligations. A privatization programme based solely on direct sales can be consistent with being an 'honest broker' however it is less easy for the government specifically to create such a reputation using this approach.

8.9) IMPACT OF PRIVATIZATION ON CAPITAL MARKET :

The principal function of capital market in any economy is to intermediate and allocate commercial risk, and this capacity will develop over time depending upon the nature of assets flows through the market. However a privatization program based on a programme of asset sales through the capital market will, in general, affect the nature of risk intermediated by the market and also the capacity with which the market manages this intermediation. It is clear that most of the effects of privatization on the development of recent capital markets are not unique to privatization per se. Privatization issues are often large in relation to other equity issues and to the market. Second the assets sold through privatization may have characteristics different from those prevailing in the market. Third privatization issues have a higher profile than other issues and tend to involve a greater number of players many of whom are new to equity trading. Fourth privatization programmes are often used as a way of stimulating other market developments such as launch of new instruments and the development of securities market regulation. These features suggest that the impact of privatization on capital markets will not be neutral and that the dynamic impact of privatization on capital market development need close attention.

CONCLUSION

Thus, to sum up, Privatization affects the capital markets in four ways :

a) it increases the volume of equity listed on the market, b) it alters the number and type of players on the market, c) it impose demands on the technological, regulatory and operational capacity on the market, d) it will constitute a significant intervention by the government in the capital market. However, all these issues have important short-term implications for capital development.

In the chapter we have presented the interactions between the structure of the private sector, the capital market, the regulatory regime and the implementation of the privatization. Capital markets are generally small and their absorptive capacity is limited, while their capacity for efficient and credible regulation is weak. While it is the case that there are feedback effects from privatization to the development of the private sector, to the deepening of the capital market, and to the enhancement of regulatory capacity in the short-run, the dominant effect is from the structural constraint to the nature of the programme. The lifting of these constraints represents a goal of the development process in general, rather than merely an impediment to the privatization process in particular and it is no accident in the countries which have run successful programs, namely Jamaica, Malaysia and India are on most of the measures better advanced than those where the programmes have been stumbled such as in Kenya, Sri Lanka, Malawi and Papua New Guinea.

CHAPTER IX

INDIAN ECONOMIC REFORMS

INTRODUCTION :

The economic argument for free play of market forces have been strengthened by the recent developments in Indian regulatory frame work. Regulation is a halfway between public ownership and market operations, competition and competitiveness will invariably be the best way of introducing efficiency into state Owned Enterprises. If efficiency is divided into allocative efficiency and operational efficiency than conditions of constrained competition require that (i) allocative efficiency be ensured either through franchising or regulation and (ii) ownership efficiency invariably be weighted in favour of private ownership. To test these points of view as hypotheses, India's liberalisation schemes have been considered handby. This chapter divided into four sections.

Sections- A) Structural Reforms in India,

B) Performance and evaluation of State Transport units (STUs) in India,

C) Public sector's disinvestment,

D) Future Reforms.

The Government of India has adopted a package of major policy reforms aimed at macro-economic stabilisation and restoration of the growth momentum to the economy. These initiatives are being implemented at a time when the Indian economy faces a serious Balance of Payments (BOP) crisis. The strategy consists of measures aimed at achieving a sharp reduction in the fiscal deficit, combined with reforms in the key areas of Trade Policy, Industrial Policy, the Public Sector and the Financial Sector. The effectiveness of these measures in bringing about the desired structural adjustment in the economy while maintaining the momentum of growth depends critically upon the availability of adequate external finance.

SECTION- A

a) PROGRAMME FOR STRUCTURAL REFORMS :

1. Government of India has initiated (in 1991 July) a comprehensive programme of macro-economic stabilisation and structural adjustment. In support of the initial phase of its programme the programme aims at restoring macro-economic balance and economic growth, regaining external credit worthiness and preparing the economy to respond effectively to emerging global changes and opportunities.

2. The reforms committed to the pursuit of equity and social justice, and blessed with a political system with a proven capability to provide both governance and freedom, the government's key economic objective is to restore sustained high growth which is essential to alleviate poverty and raise the standard of living.

In pursuit of these - reforms strategy is follows :

a) a liberalised trade regime characterised by tariff rates comparable to other industrializing developing countries and the absence of discretionary import licensing.

b) an exchange rate system which is free of allocative restrictions for trade

c) a financial system operating in a competitive market environment and regulated by sound prudential norms standards

d) an efficient and dynamic industrial sector subject only to regulations to environmental security, strategic concerns, industrial safety and major trading and

e) an autonomous, competitive and streamlined public enterprise sector geared to the provision of essential infrastructure goods and services.

3) Due to the initiates taken over the past four decades, India now has a prosperous agriculture and a strong and diversified industrial base, it has capital markets and institutions which are on par with those of many advanced industrial nations; it has a large well-trained skilled labour force, and is endowed with a vigorous and growing private sector.

The economy's performance was impressive in the decade of 1980s - Stimulated by liberalisation initiatives of Shri Rajiv Gandhi's administration GDP growth accelerated to 5.6% p.a. compared to an average of 3.5% during the previous 3 decades.

4) It is on the strength of these achievements, and with a firm commitment to removing the constraints in growth originating from the present macro-economic imbalances and long-standing structural impediments, that the government initiated a comprehensive programme of macro-economic stabilisation and structural reform.

b) RESTORING MACRO-ECONOMIC STABILITY :

5. The macro-economic objective of the Govt. centre on the

restoration of internal and external balance consistent with sustained economic growth. There is one basic direction of Eco-policy required to achieve these objectives. A substantial change in the composition of aggregate demand and supply must be engineered. Public sector consumption needs to be reduced in favour of higher domestic saving, while investment and net exports needs to grow in relation to GDP.

6) Key macro-economic targets of the Govt. are

a) rapid recovery of GDP growth from about 3.5% in 1991-92 to about 6% by the mid 1990s

b) an inflation rate of about 9% - 10% in 1991-92, falling to 7.5% up 1992-93 and 6% by 1995-96

c) an easing out of present critical payments situation and a re-building of foreign exchange reserves from the low level of U.S. Dollars 2.1 Billion as of Nov.l, 1991 to U.S. Dollars 2.5 Billion by the end of 1991-92 over the next five years foreign exchange reserves would be built up to about 2-3 months of worth of imports. The external current account deficit is expected to decline from about 3.5% of GDP in 1990-91 to about 2.7% of GDP in 1991-92, falling gradually to about 1.5% of GDP by 1995-96 as export growth strengthens under the influence of improved competitiveness and a recovery of demand in world markets.

C) FISCAL POLICY:

7. The medium term objective is to reduce substantially the Central Govt. fiscal deficit within the broader context of an adjustment of the overall public sector deficit. The fiscal

deficit target of the Union Govt. Budget is 6.5% of GDP - a reduction of about two and an half percentage points of GDP from the estimated 1990-91 outcome.

8) The fiscal adjustment outlined in the 1991-92 budget provides for a rough balance between expenditure and revenue measures. The targeted reduction of the fiscal deficit is central to the success of the overall programme. The Govt.'s efforts at fiscal consolidation would include a major thrust for a more efficient expenditure control system. A thorough review of the existing system would be undertaken to remove existing deficiencies and to significantly strengthen its effectiveness. Particularly security would be given to transfers and loans to public enterprises.

d) EXCHANGE RATE POLICY :

9) The adjustment in the exchange rate of the rupee by 23% (in terms of rupees per dollar) in July 1991 provides for a significant real depreciation which will improve export incentives and international competitiveness. The Govt. of India intends to keep the nominal effective exchange rate stable by relying on appropriate fiscal and monetary policies to maintain competitiveness and ensure the balance of payments objectives.

e) MONETARY POLICY :

10) There has been already a significant lightening of credit and monetary policies through higher interest rates and higher cash reserve requirements. Consistent with foreign exchange reserve target and anticipated slow-down in GDP growth, broad money expansion is targeted to decline to a rate of 13% in 1991-92, with

a further deceleration in 1992-93. However, the Govt. is committed to a further tightening of monetary policy if necessary to defend the external positions.

f) OPEN ECONOMY / OPEN TRADE REGIME - IN INDIA :

Trade reform is an essential element in securing supply responses to facilitate the overall restructuring of the economy and to restore external payments viability. Rapid export growth is essential for regaining access to international capital markets, and providing external debt service. The thrust of trade reform is therefore to aim at a quick revival of the momentum of exports and to expose domestic industry to greater external competition.

There are five key medium term objectives in the trade policy agenda.

First, the broadening and simplification of export incentive measures and the removal of restrictions on exports, Second, the eliminations of Quantitative Restrictions (QRs) on all imports,

Third, the disalination of exports and imports with the exception of a few items and

Finally, moving to foreign exchange system which is free of allocative restriction for trade.

In support of these objectives, the Govt. of India announced a package of trade policy reforms on July 4th and August, 1991.

g) INDUSTRIAL POLICY :

The Govt. of India placed a statement on Industrial Policy before Parliament on July, 24, 1991. This marked a major step forward in the Governments on going programme of Industrial reform.

12) The new policy has elimated investment licensing requirements for all new, expansion, and diversification projects except in 18 industries. Further, the MRTP Act has been amended to remove all requirements for pre-entry approval of large or dominant companies. Except for certain industries related to security and strategic concerns, social aspects, concerns related to safety, overriding, environmental issues, and manufacture of chemicals involving hazardous processes, pre-entry regulations governing industrial investment have been removed.

13) Foreign investment and foreign technology agreements in India have hitherto had to obtain specific prior approval from the Government. In case of foreign investment, automatic approval from the Government is now available for proposals with a foreign equity share of up to 51 percent in high priority industries.

14) Foreign technology agreements where royalties are limited to 5 percent of domestic sales and 8 percent of export sales, along with lump sum payments of up to Rs. 10 million, are now automatically approved. In high priority industries, free foreign exchange would be available for the payments, where as in other industries these payments would have to be covered by eximscoop.

15) Recognizing the need to strengthen the incentives for foreign direct investment, the Government has set up the Foreign Investment Promotion Board (FIPB) to consider and to approve

substantial foreign investment proposals. The Government of India is well aware that a prerequisite for a successful policy for industrial restructuring is a 'Safety net' or Social insurance to provide support for displaced workers in the organised sector, through the National Renewal Fund,

h) EFFICIENCY OF FINANCIAL INTERMEDIATION TO BE ENHANCED:

16) To move closer to a market-based operation of the financial institutions, interest rates on term loans have been decontrolled (subject to a flow of 15 percent), while all regulated deposit interest rates were increased by one percentage point. Interest rates on Commercial Bank loans has been controlled earlier (with a floor of 18.5 percent set for non-priority loans, now raised to 20 percent). Measures have been taken to strengthen capital markets, interest rates for debentures have been freed, mutual private sector, and full satisfactory powers are to be given to an independent agency to regulate security markets.

Entire with the recommendations of the 'Narasimham Committee' (a high level committee on capital markets), further reforms of the financial sector will be implemented.

17) The aim of financial reforms would be to increase the efficiency of financial intermediatories through a well sequenced programme for

(a) deregulation of the interest rate structure,

(b) enhancement in the flexibility and autonomy of financial institutions and banks to adjust resource flows to emerging needs and priorities,

(c) Strengthening the prevailing prudential regulatory framework applying particularly to capital adequacy norms and assessment of bad debt in banks portfolios, and

(d) enabling expansion of private and co-operative sector banks (including foreign banks) in the banking sector.

i) PUBLIC ENTERPRISE REFORMS (SOEs)

India is severely constrained budgetary circumstances create both the need and opportunity for rationalising the public sector activity, and for placing reliance on the private sector for resource mobilisation and investment many public sector enterprises (PSEs) fail to cover the cost of capital they employ and incur cash losses.

18) There are currently 244 autonomous Central Government Public Enterprises (CPEs) and 845 State-level public enterprises (SPEs) covering multiple areas of activity. The budgetary stringency faced by the Government underlines the importance of quickly formulating provisions for restructuring and closing sick and unviable public enterprises, and opening up selected units and sectors to private capital.

19) Privatisation of selected firms on partial divestment in specific sectors is increasingly being pursued. The 1991-92 Budget confirmed the Govt.s decision to sell partial equity (up to 20%) in CPEs, totalling Rs.25 Billion, through mutual funds.

A more comprehensive programme of divestment of public holdings is under consideration.

20) Given the Govt.'s commitment to making the objective of

poverty alleviation an integral part of the adjustment process, it intends to formulate and adopt a programme of specific measures aimed at strengthening social safety nets and initigating the inevitable costs of adjustments. As an initial step in this direction, the establishment of a national social security fund (the National Renewal Fund) in 1991-92.

(The Source is Text of Finance Minister of India's letter to the President, World Bank, Nov.11, 1991 and presented in Parliament, February 26, 1992.)

j) REFORMS IN 1990s

India today is a land of opportunity, as the economic reforms take root, the market with a vast untapped potential is unfolding for all. The old isolationism of India is giving way to a new zeal for globalization. India is one of the very few countries to have had positive economic growth rates in the years immediately following the initiating of a programme of macro-economic stabilization and liberalisation. The Indian economy has also had the distinction of coming out of a crisis in its external sector without recourse to debt rescheduling.

India has long been perceived as an economy shackled by bureaucratic controls and administrative regulations, deeply suspicious of foreign capital, protected by import tariffs, and dominated by Public Sector Enterprises (PSEs). This perception persisted even as India began to change in the eighties. The growth dynamism of the Indian economy in 1980's, however, could not be sustained in the face of the growing fiscal imbalances.

the Gulf war of 1990 finally brought the economy to a brink. Inflation was rising, industrial production was falling, and foreign exchange reserves were at an all time low of $ i Billion - barely enough to cover India's normal import needs of about a week.

The 1991 India's crisis had its origins in two factors. The growing fiscal imbalance of the 1980's aggravated by the use of high - cost borrowings to meet consumption needs of the economy, had created a macro-economic environment which was destabilizing. Also, while the Gulf war of 1990 did contribute to the crisis, it was the non-competitiveness of Indian industry and trade brought about by years of insulate from domestic and international competition and from foreign technology that lay at the root of the proleleur faced with a severe balance of payments crisis, India had the choice of slapping on more import controls, and the programme has emphasized gradualism and evolutionary transition rather than shock therapy.

The initial conditional for economic reforms in 1991 are different, India's gross saving rates are around 22% and a growing financial market.

k) <u>PSEs REFORMS;</u>

Public utilities eg., electricity generation, transmission and distribution, telecommunication, municipal water supply and railways in most countries were accorded monopoly status for a long time, recently many developing countries have permitted entry' in the utility sector. Development of markets, new products and new technologies make entry feasible in certain segments of the erstwhile natural monopoly markets. The recent justification for entry is also based on two arguments. The first argument is that the costs of public ownership or regulation of private utilities might exceed benefits. The second is that statutory monopoly status freezes the scope for innovations and there by affects dynamic efficiency. Baumol, Panyar and Willing argue that ever in a natural monopoly situation would act in the people interest if entry is free. They argue that the threat of entry can dispute the incumbent's behaviour. Baumol. W.Pangar, J.P. Willing R N (1982) <u>Contestable Markets and the theory of Industry Structure</u> - Harcourt, Brace - Jovamorch.

1) <u>REFORMS FOR STATE OWNED ENTERPRISES (SOEs):</u>

a) Entry of Public Sector Enterprises in infrastructural and Public utility services also allowed.

b) Disinvestment of shares of certain profit making PSEs on selective basis and in a gradual manner.

c) Phasing out of budgetary support in the form of non-plan loans to loss making PSEs from 1994-95.

d) Sick PSEs will be referred to the Bureau of Industrial and Financial Reconstruction (BIFR) for decisions regarding restructurings or closure.

e) Stress on market orientation, particularly in application of commercial and economic principles to pricing and greater dependence on markets for raising resources for further expansion.

SECTION - B

PRIVATIZATION OF STATE TRANSPORT UNDERTAKING IN INDIA:

With the severe and continuing resource crunch faced by the Indian Economy and the pressure on policy makers to step up the rate of economic growth. State Transport Undertakings (STUs) in India are more monolithic in structure and less productive in nature. Here we make an attempt to study the reasons for and against nationalisation and modalities of privatization of the STUs in India.

a) NATIONALISATION OF PASSENGER ROAD TRANSPORT :

The nationalisation of passenger and Road Transport was promoted by the Road Transport Corporations Act (1948) which empowered the State Govts. to undertake the organisation of **road** services. The Act was subsequently revised and replaced by the Road Transport Corporations Act (1950).

Prior to Nationalisation, competition was tierce between the private operators, but the services rendered were concentrated only on profitable routes. Only large cities and towns attracted the attention of private bus operators and the rural areas and the tribal belts were ignored. Besides, arbitrary rates **varied from** operator to operator, and one period to another, with no consideration to the passenger, or maintenance and development of roads.

Important reason given in favour of the Nationalisation was that the size of the fleet of the private bus operators was far from optimum, leading to wastage of economic resources and a mismatch between the demand for and supply of road transport. The Road Transport Corporation Act (1950) enabled the Central Govt., to suggest to the State Govts to take over such routes from the private operators as they deemed fit in the best interest of the public and receive the capital contributions from the Central Govt., in the ratio of 1:2. Then the State Govts. reacted favourably and setup public corporations in this connection.

b) PROFILE OF STUs :

There are 67 STUs in India, of these, 21 are statutory corporations, 27 government companies, 8 run as departmental enterprises and 11 municipal undertaking. The combined fleet strength is 106,590 of which 35.6% are with the STUs. The estimated number of buses in the country on 31st March, 1989 was 278,300. The STUs had an investment of INR 32.83 Billion as on 1989. The total revenue earned and the total cost incurred by these corporations for the year 1988-89 was INR 40,08 Billion and INR 44.36 Billion, respective.

The total effective distance covered by the STUs during the year 1988-89 was 8.635 Billion Km. The total no. of employees in these undertakings as on 31st March, 1989 was 712,000 and passengers carried in this period was 53.6 million a day and high speed Diesel oil consumption for passenger buses was 1.75 million tonnes.

Road Development Plan for India (1981-2001), Indian Road Congress, 1984.

Cl PERFORMANCE EVALUATION OF THE STUs:

The performance of the STUs could be measured in terms of their adequacy, efficiency and economy.

The 'Adequacy' of the services provided by the STUs could among other things, be evaluated by indicators such as the extent and quality of services provided. The breakdowns for 10,000 effective KM declined from 1.03 in 1983-84 to 0.64 in 1988-89. However, the rate of breakdown relating to the city and district services for the various corporations shows that the STUs in Kerala, M.P, Orissa and Meghalaya were still very close to the 1982-83 Mark. The position relating to city services was very critical. The accidents rate per 10,000 effective K.M in 1988-89 was 1.58 in the case of Delhi Transport Corporation (DTC) 1.76 in the case of Bombay Transport Corporation, 11.96 in the case of Calcutta Transport Corporation and 27.29 in the case of Kerala. The rate of accidents declined from 82 per thousand kilometres in 1982-83 to 50 per thousand kilometres in 1988-89 for the whole STUs.

As regards to the regularity of services, the STUs in Tamilnadu presented the picture of exceeding a 100% regularity, the STUs pertaining to U.P., Bihar, Meghalaya and West Bengal had a regularity of less than 90% in 1988-89, it was between 90% and 95% in Maharashtra, A.P. and Karnataka, the percentage punctuality was between 95% and 100% in case of STUs in Tamilnadu during the same period. [2]

[2] Nanda Gopal & Mishra, Performance of STUs in "Efficiency through

Whereas the population in the country has been increasing at an average rate of 2.4% p. a. the passenger road transport facilities are highly inadequate. Against the travel mobility index being 5 for India, the travel mobility index stands at 100 for France and 160 for U.S.A. The number of buses per thousand is only 0.25 for Indian against 2 for U.S.A., 1.15 for Japan and 1.560 for Australia.

The "Efficiency". the fleet utilisation of the STUs increased from 82% in 1982-83 to 88% in 1988-89. The utilisation per bus on road per day in K.M. increased from 257 K.M. in 1982-83 to 350 K.M. in 1988-89.

The K.M. per litre of Diesel consumed increased from 4.02 in 1982-83 to 4.25 in 1988-89. The fleet life per tyre increased during this period from 62,000 K.M. to 100,000 K.M. The bus staff ration decreased from 9.78 to 8.63 during the same period. The percentage fleet utilisation in some corporations was as low as 60% and less in the case of STUs in Bihar, Tripura, Mizoram and Manipur, the scene was not much different in the case of the STUs in Assam, Meghalaya and Orissa. The situation of city services was worse, the bus utilisation per bus on road per day was less than 300 K.M. in case of Maharashtra, Kerala, Karnataka, Rajasthan, Orissa,Goa, M.P., Punjab, Bihar, Assam, Mizoram,

Competition, edtd by G.Gouri, I.C.P.B., Commonwealth Secretariat, 1993.

Opcit (1) Road Development Plan.

Meghalaya, Tripura, Maharashtra and Himachal Pradesh.

The losses of these corporations have increased over the years as against a targeted loss of INR 10.2 million in VII Plan. These Corporations incurred a net loss of InR 2.2. million. One of the reasons for the STUs loss in the excess of cost per K.M. over the earnings. A spirit in the levels of interest, depreciation, personnel and materials costs coupled with a sharp increase in taxes led to the increase in the operating ratio of these enterprises.

d) SCOPE FOR PRIVATIZATION OF STUs:

The transformation of the country from agrarian to an industrial economy has placed a great demand on the road transport system. However, the financial resources available to **the** central and state are inadequate to face the challenges posed **the** growth rate of two sheelers and motor cars has been in leaps and bounds and has over taken the road networks. This leads to over whelming question. Can the STUs fulfil the need of transport system ? According to statistics, the strength of the STUs is only one-third of the total passenger transport fleet strength in India. There are only two options, either substantially improve the STUs or increase the involvement of the private sector in system.

The approach for privatizing STUs have to be based on three elements viz., Ownership, management and financing, all these three are possible.

The STUs own buses, bus stations, workshops for repairs, printing presses, housing for employees and medical complexes. The fleet strength of the STUs has a growth rate of 5% per annum. The average age of fleet is six years, their losses do not enable them to go in for modernization.

Many STUs have tried to overcome this problem by hiring buses from private operators under a system in which the private owners hand over the buses but continue to hold the responsibility of their repairs etc. Another approach to privatization could be that the routes be franchise to the private operators. Under this private operators would have to follow the regulations drawn fry the controlling authority as regards the schedule, routes, stoppages, fares, minimum and maximum number of services to be provided etc. This technique would be either revenue yielding or loss minimising but in the latter case, it would turnout to be competitive.

The demand for derationalising certain routes needs to be considered in view of the shortage of passenger road transport facilities in smaller and towns, districts, villages, tribal hilly areas due to private operators would not operate their services in-dusrial sectors because of low occupancy ration.

The privatisation of the ownership of the STUs in terms of nature of their services. The reasons for losses is STUs were treated to their in capacity manifested in the maintenance of the fleet and low occupancy ratio also responsible.

At the inception of independence it was thought that the nationalisation of the passenger road transport was a must for providing adequate, efficient and business like road transport services in India. Experience shows that the momentum of nationalisation sustained for only some time. In 1980's this system showed sections shortcomings in terms of expansion of fleet efficiency of operation and public responsiveness. The resource crunch faced by the central and state governments, further jeopardised the growth of the STUs.

All these emphasise the need to privatise the STUs. Privatisation could take place in three aspects of the business viz., 1. Ownership, 2. Management and 3. Financing. Such a step would not only reduce the financial burden on the state and the STUs but would also lead to increased efficiency through competition.

SECTION - C

a) PUBLIC SECTOR ENTERPRISES - DISINVESTMENT:

As a part of Economic reforms in India it was decided by the Govt. of India that the scheme of disinvestment of equity in Public Sector Enterprises (PSEs) which commenced in 1991-92. In view of this the Govt. of India appointed a committee to examine the issue of Disinvestment of shares in PSEs (The committee submitted its report in April, 1993). The terms of references of the committee were :

1. To devise criteria for selection of PSEs for disinvestment.
2. To advise on limits on the percentage of equity to be disinvested in respect of PSEs.
3. To suggest the target clientel including Mutual Funds,

Financial Institutions, Banks, Non-resident Indians, Foreign Institutional Investors and Resident Investors.

4. To make suggestions on the modus operandi of disinvestment, whether through public offer or private placement.

5. To lay down the criteria for valuation of equity shares of PSEs.

6. To make recommendations on any other subject matter germane to the disinvestment plan.

In its general approach, the committee was guided by several important factors such as :

a) The contributions made by the public sector in general to economic development, and entrepreneurial skills,

b) The institutional, technological and fiscal compulsions that have led to review of public sector investment,

c) The experience gained in disinvestment in the recent part taking into account the unusual circumstances in capital markets,

d) The need to enhance the competitive strength and ensure expansion of these enterprises while protecting the interest of workers, and

e) Above all, the requirement of consistency with the ongoing economic reforms in the areas of industrial licensing, foreign trade and investment and financial section.

b) CRITERIA FOR SELECTION OF PSEs FOR DISINVESTMENT DURING 1992-93

The committee noted that the a Government disinvested its shareholding in 30 Public Sector Enterprises during 1991-92. The extent of disinvestment worked out to above 8 percent of the Govt.

shareholding in these enterprises and the total amount realised was Rs.30.38 crores.

c) THE PRESENT STATUS OF INVESTMENT DURING 1992-93

1. Advertisement was given inviting tenders for purchase of shares of 8 central PSEs namely, Steel Authority of India Ltd., (SAIL), Bharat Petroleum Corporation Ltd, (BPCL), Hindustan Petroleum Corporation of India Ltd., (HPCL), Hindustan Zinc Ltd., (HZL), Rashtriya Chemicals and Fertilizers Ltd., (RCFL), HMT Ltd., National Aluminium Company Ltd (NAL), and Neyvelie Lignite Corporation of India Ltd (NLCI Ltd).

2. A minimum reserve price was fixed on the basis of recommendations of three merchant bankers - Industrial Credit and Investment Corporation (ICICI) of India, Industrial Development Bank of India (IDBI) and SBI Capital Markets Ltd.

3. Having this criterion, the bids eligible for acceptance amounted to a total sale of value of Rs. 681.95 crores for 12.87 million shares in eight companies.

4. Advertisement was again issued on Nov.28th, 1992 for disinvestment of shares in 14 PSEs. The en-tended terminal date for reviewing the bids was December 22, 1992. The bids for 12 of these companies for a value of Rs.1183.3 crores were accepted.

5. The Government invited a third round of bids for sale of equity in 15 PSEs for a total of 553 million shares in March, 1993. While bids were received, it was decided to accept bids for a total of 10.1 million shares aggregating Rs.46.73 crores.

6. The Government has also decided in principle to disinvestment shares in selected companies in favour of employees in 1992-93.

d) LIMITS ON THE PERCENTAGE OF EQUITY TO BE DISINVESTED

The committee recognises the need to broadly indicate the objectives that are sought to be achieved through disinvestment in public sector equity.

a) As an immediate objective to mop-up resources of non-inflationary character to meet the budgetary needs which include requirements of development activities.

b) To subserve in the medium term, the overall fiscal objective of gradually reducing the fiscal deficit and bringing about a positive impact on future liabilities and income flows to the Government.

c) To improve efficiency by bringing about a more competitive atmosphere with emphasis on the cost and quality of product and service to the customers of public enterprise sector.

d) To enhance the efficiency of individual enterprises by imparting a new dynamism in the management of enterprises through diversification of ownership and control as also larger and freer access to the capital markets in India.

e) To realise the extent of ownership, control and regulation in different activities consistent with the technological needs and developments in industrial policy.

f) Target level of ownership should be attained through disinvestment after fully recognising the preparatory action

g) The target level of ownership in respect for public sector should be 51% to enable control over management. A target level of 26% of public ownership may be considered in exceptional cases. Such cases may include enterprises which currently have a dominant market share or where separate identity has to be maintained for strategic reasons. In others, it could be zero.

h) There should be a set of specific reasons for continued government ownership of enterprises except in sectors which are reserved for public ownership. In all other sectors, Government should justify its continued holding of equity on considerations as an investor not as owner. The Government may hold more than 26% of the total equity in enterprises with outstanding prospects, but the investment would need to be justified on the basis of growth potential and the scope for larger realisation and not on the basis of desirability of government control.

Arising from the above, the committee considers that the percentage of equity to be disinvested should be generally under 49 in industries reserved for the public sector and over 74% in other industries.

The committee, therefore, recommends that limits to the levels of disinvestment should be desired from the target level of government ownership in each enterprise in the medium terms, thus.

a) The target levels of ownership could be zero; 26% to ensure limited control, 51% to have effective control and 100% for full ownership.

b) While determining the final level of government ownership it must be recognised that there may be group specific or enterprise-specific intermediate levels of disinvestment depending on the state of preparedness of each enterprise, stock market conditions and the requirements of government.

c) The desirable levels of public ownership may be reached with greater advantage to PSEs concerned and government by expanding the equity base through public offering than disinvestment

d) The economic efficiency and financial gains to government through disinvestment in respect of each tranche in each enterprise need to be continuously assessed so that there is no compulsive disinvestment merely to reach the target levels of ownership by government.

e) THE COMMITTEE RECOMMENDATIONS :

The following considerations in determining the target level of disinvestment,

a) A target level of disinvestment for the medium term (say 5 years) should be derived from desirable level of public ownership in an activity or unit consistent with industrial policy,

b) Settle the modalities and accounting procedures for settlement of large arrears, if any, of dues payable/receivable between PSEs and the government among the PSEs or between PSEs, government and financial institutions.

c) Appoint a Merchant Banker for each of the PSEs to assist in initiating some of the preparatory measures mentioned above

d) Arrange to create a market - friendly image for PSEs by projecting and publicising the strong points of each PSE among the investing public in advance of the next disinvestment exercise.

f) MODUS OPERANDI OF DISINVESTMENT:

The procedure of funding shares, combining different public enterprises in lots and restricting the disinvestment in favour of public sector mutual funds, was adopted in 1991-92 as this was the first exercise in disinvestment. For the year 1992-93, the sale of shares was made enteprise-wise and to a wider clientele in order to get optimum benefits.

g) THE COMMITTEE STRONGLY RECOMMENDS THE FOLLOWING PREPARATORY STEPS:

a) Where the PSE is not in a company form,

1) determine whether it should be converted into a single or multiple companies,

2) decide upon the capital structure differentiating between debt and equity, and

3) evaluate whether an independent regulatory commission should be established for the concerned sector, and, if necessary, put such a commission in place,

b) Estimate firmly the on going investment plans for expansion or modernisation or technical collaboration,

c) Project the pattern of financing of such expansion through additional debt or expanded equity,

d) Review existing debt-quity structure including scope for bonus issue to government to capitalise accumulated reserves where the reserves are disproportionately large in relation to the paid-up capital; where loans are disproportionately high, review scope for conversion of such loans into equity or consider other ways of distributing/lowering the burden of debt so as to keep the equity base at a level attractive to the capital market.

e) Examine the feasibility of issuing convertible bonds as a measure of raising adequate resources of the PSEs.

1) The price at which a share can be sold is determined more by investor perception of the worth rather than any mechanical measure of intrinsic worth. Hence, the importance of information gathering and full disclosure to generate credibility and investor interest.

2) Rise or fall in share values of an enterprise soon after disinvestment does not by itself indicate that shares were under priced or overpriced at the time of disinvestment.

3) Difficulties of valuation in a multi-unit and multi-product scenario have to be reckoned.

h) IN ASSESSING THE INTRINSIC WORTH OF A SHARE :

The Committee recommended the following:

a) Among the three criteria viz., Net Asset value, Profit earning capacity value and discounted cash flow value, discounted cash flow has the greatest relevance, though it is difficult,

P) An explicit assessment of the scope and limits for selling non-income generating assets (land or buildings) and rationalising labour force should be made.

c) Government Policies affecting future profitability (guaranteed rate of return) may have to be spelt out. Such assurances, wherever required, may be extended only after careful assessment of the implications of such assurances on the eco-efficiency rather than immediate attractiveness of the shares to investors.

There are two acceptable and transparent processes for divestiture of governments share holding.

X) Offering shares of Public Sector Enterprises at a fixed price through a general prospectus. The offer is made to the general public through the medium of recognised market intermediaries.

2) Sale of equity through auction of shares amongst predetermined clienteles whose number could be as large as necessary or practicable. The reserve price for the public sector enterprises equity is determined with the assistance of merchant bankers.

i) <u>CRITERIA FOR VALUATION</u> OF <u>EQUITY SHARES</u> OF PSEs :

In general, three methods for valuation of shares are adopted, viz., Net Asset Value Method, Profit Earning capacity value method and Discounted Cash Flow Method. While NAV would indicate the value of the assets, it would not be in a position to indicate the profitability or income to the investors. The profit earning capacity is generally based on the profit actually earned or anticipated. The discounted cash flow is a far more comprehensive method of reflecting the expected income flows to the investors.

The special circumstances that require to be assessed in the context of valuation of shares of public enterprises are:

d) The influence of social constraints in the past working of the PSEs and the extent of benefit occuring due to provision of certain under priced facilities like land should be captured and presented while reckoning the intrinsic worth of the PSEs.

j) AS REGARDS INVESTOR PERCEPTION, THE COMMITTEE RECOMMENDED THE FOLLOWING :

a) Each company has to be studied carefully with the help of a merchant banking firm, taking into account factors such as value of Assets, its market share, potential profit earning capacity and the prevailing price in the market for share of similar enterprises in the private sector.

b) It is essential that the PSE and the merchant banker concerned present all positive aspects of the enterprise in the prospectus.

c) While fielding PSEs in the capital market, the main line of activity of the PSEs concerned and the extent of investor's Fancy for the particular industry at the material time may have to be taken into account.

d) Wherever disinvestment is made through public issues, the offering price would need to be fixed with a close assessment of the need to project the issue as a success to pave way for subsequent offerings, and at the same time, avoiding any criticism of under-pricing.

Keeping in view the international experience and our own requirements, a standing committee on Public Enterprise Disinvestment is recommended.

(Report of the committee on Disinvestment of shares in PSEs,

SECTION - D

FURTHER REFORMS:

Most of the reforms initiated since June 1991 pertain to the external sector and large scale private corporate sector, the large private firms have now access to foreign capital and foreign technology and are free from industrial licensing and import controls. These units depend on the State governments for allocation of land, power connection, water supply and many infrastructural facilities. Debureaucratisation at the state level is an urgent need. Some states eg., Gujarat and Maharashtra provide single windown Clarence facilities for approval of new projects.

Since the sector depends on the public sector for many critical inputs and infrastructural services, efficiency in the provision of critical inputs and infrastructural services is vital for the success of reforms in India. The discussion paper on administered pricing (Govt. of India - Ministry of Finance - 1984, a discussion paper on administered pricing) favoured the adoption of long run marginal cost (LRMC) basic prices for public sector products and services. Even with the completion many expenses by World Bank and others, the prices are still determined on the basis of accounting costs among one of the fully distributed costs raising one of the fully distributed costs method (Sarkar V - 1992, Public Sector Pricing, theory and applications - Indian Economic Association Trust for Research and Development, New Delhi.)

The accounting cost based prices do not reflect the current economic costs of the services. Only the current long run economic costs are relevant for the new entrants. The problem is serious in the case of critical inputs like power, water and telecommunication services. The non-availability or poor quality of these essential services can constraint industrial growth.

The PSE reform recently begun Rangarajan committee report on disinvestment of shares of PSEs favoured 49 percent of equity of PSEs in the reserved list and 74 percent of equity of PSEs in the unreserved list. Currently no concrete programme, except for referral to BIFR, for dealing with loss-making PSEs. It outright sale is not politically feasible, then other options like contracting out management should be explored. Privatisation alone will not bring about efficiency unless the road blocks facing the enterprises are removed and they function in a competitive environment.

At present most of the incentives given by the Government reduce the user-cost of capital. With Globalisation, capital intensity in industry might increase. Since employment generation is an important policy goal, currently Government is relying on command and control (CAC) polices in environmental protection in medium industry. This policy involves specifying source specific standards for industrial units and enforcing them on the polluting units by administrative and penal measures.

"SELLING PSE SHARES":

The Government needs to get on with the business of selling shares of PSEs without waiting for the stock market to turn buoyant, if it does not want to repeat its last years (1995-96) dismal record in meeting the disinvestment target. The present Finance Minister (Chidambaram) has reiterated the government's decision to disinvest upto 74% of its stake in PSEs in the non-core sectors. And if the Government can indeed garner the political courage to implement the policy pronouncement, the sale of majority stakes will attract higher bids, perhaps twice as high as the hither to practice of selling small chunks for portfolio investment has. Besides, the sares of such core-sector PSEs like the Indian Oil Corporation would find ready buyers (hence attractive bids) , as Oil PSEs are expected to post huge increase in profits with the dismantling of administered prices, which is now on the cards. There are sound fundamental reasons why PSEs share quote poorly on listing, and even a bullish market would sufficiently discount for the general under-performance of PSEs. Clearly, if the Government is committed on disinvestment often enough is really can not expect higher prices for its shares.

Now the government is considering accessing international markets to acquatize its disinvestment target (for instance, tapping the GDR market) , and this is welcome. Indeed, this is just another reason not to postpone the first transc of disinvestment programme for this fiscal, which was planned for September, 96.

In the last fiscal, the disinvestment effort was supposed to raised Rs. 7,000 crores. The actual record was a lowly Rs.557 crores. (Editorial - The Economic Times, 16th September, 96.) This fiscal target is Rs.5,000/- crores. The government needs to better the target if the massive investment in the PSEs (with barely 4 percent returns on capital employed) are to cease being a drag on the economy.

CONCLUSION

Competition is regarded as the key to improving the performance of the State Owned Enterprises (SOEs) the absence of effective competition believing the free trade philosophy the economic reforms began as a result of 1991 crisis.

In order to establish an ideal environment for competition the above mentioned reforms took place as a policy initiatives. The theoretical base depends on twelve fundamentals in order to promote full and fair competition between SOEs and Private Enterprises . They are

a) no governmental barriers to entry

P) a competitive industry structure

c) equal access to loans and credit

Role and extent of competition in improving the performance of public enterprises, United Nations (UN) proceedings of an Inter-Regional Seminar, New Delhi, 1989.

d) equal access to foreign exchange

e) equal application of laws

g) no price controls or subsidies

h) equal access to raw materials and supplies

i) equal access to markets

j) equal application of laws concerning 'hiring and firing' of employees

k) freedom to reorganise and even change business

1) no preferential protectionism.

The challenge of competition therefore is for governments to develop appropriate policy frameworks within, acceptable limits, against the background of an ideal competitive free markets. The development of a management culture built on trusty dedication and vision would be required to propel the enterprises private or public to new heights.

CHAPTER - X

ECONOMIC POLICIES FINDINGS AND SUGGESTIONS

INTRODUCTION :

In 1980s many developing countries were followed adjustment, as countries underwent painful programs like Stabilization and embarked on measures designed to bring about medium term improvements in the structure of the economy. Particularly on the supply side. Privatisation lay at the confluence of these goals. Many governments embraced the idea of privatization as a possible solution to the dire straits into which the SOE sector had fallen, and as a means of stanching flow of funds to these SOEs from the public sector. Further privatization has been instrumental in policy programmes aimed at broaden adjustment issues. **In part** this was because privatization viewed as a n integral part of a reform package including trade liberalization, Price deregulation, fiscal stabilization and these policies were conceptually quite separate. More logically, however privatization as a part of adjustment because its close links to the longer term objectives of private sector and capital market development.

Governments also embraced privatization because the SOEs had disappointed in their role as distributors of rents towards favored income. The Laissez afire approach to the efficient management of SOEs had fostered a small group of rentiers for whom the distributional effect of state ownership were positive and often sizeable, but at the cost of falling efficiency in operations and increasingly unsustainable fiscal disequilibrium.

Second, attempts to spread benefits more widely through price control and cross-subsidization not only were excessively blunt, but were also undermined by poor output quality, erratic service and the emergence of rationing.

10.1 OUTCOMES :

Despite the apparent priority accorded to privatization by governments the results by and large have not supported expectations. In part this is because of the expected effects will only be manifest in the medium term, but more important is the fact that much less progress in actual implementation has been made than was initially envisaged. With the exception of Jamaica, there has been no substantive shift in ownership of national wealth from public to private sectors, and even in Jamaica the cumulative proceeds of privatization from 1981 to 1990 constituted only 7.2% of GDP elsewhere notably in Malaysia, which quickly acquired a reputation as a major privatized, the scale of privatization in the 1980s was a little. there has however, been some measurable improvement in the overall performance of the SOE sector during the period. For one thing the creation of new SOEs has come to a virtual halt, not least in areas such as manufacturing and services. But more importantly, SOE reform has directly contributed much more to the rationalization of public finances than has privatization and indeed has been an important factor in the overall improvement of fiscal balances, price and tariff restructuring, production rationalization restructuring of management and capital government has featured strongly in this period.

Where as accounting for the flow of funds from the privatization exercise is relatively straightforward, the identification of efficiency gains is more difficult. In many instances the sale of the public asset has been too recent to expect any such gains to be clear, but more often the nature of the sale and the environment in which it proceeded have served to negate any positive effects which might have been expected. Earlier privatization has almost as many objectives as the policy it was supposed to supplant, viz., state ownership of the means of production. As in the case of state ownership simultaneous achievement of all these objectives is not possible. Thus one of the key findings are internal ranking of the multiple goals of privatization usually greatly down-played the importance of attaining efficiency improvements. In particular the study examined the factors economic and political, public finance needs and the pressure from external creditors shaped sales in a manner unconducive to the achievement of this core objective.

Concerning Privatization and its broader objectives, namely private sector and capital market development changing income distribution and the meeting of loan disbursement conditions, achievements have been limited countries have made progress in attaining these objectives, but this has not in general been due to privatization. Private sectors have become more competitive during the decade but this was principally as a result of trade policy reform and domestic price liberalization rather than explicitly because of privatization. similarly, Capital market development and the pursuit of wider share ownership have depended more on financial liberalization and broader economic deregulation than on the stimulus created by the supply of equity in privatized enterprises. In both cases there have been some positive impulses from privatization but as we have argued these are limited by the structural constraints that weak private sectors and thin capital markets have themselves placed on privatization.

Income distribution (both international and internal) has proved to be one of the most binding constraints on the entire privatization process in a number of countries it has effectively suffocated all other aspects of the debate, while in others where privatization has turned on the complexities of these concerns it has induced significant distortions in the design and implementation of programmes. In the case of foreign ownership, these problems have been particularly acquire. Faced with limited domestic demand many governments have faced the choice of either selling assets to the foreign sector and incurring heavy losses, or continuing to hold them in the public sector. Further more the management of sales to the foreign sector has raises compete issues of regulation.

Finally the evidence of the 1980s has shown that privatization took place uncomfortably within the disbursement conditions of policy based lending. many countries have embarked on programmed of privatization within the framework of structural adjustment programmes and the pressure to meet these criteria has on occasion, led to poor management of the programme and inadequate preparation of enterprises for sale. More common, however has been the tendency for donors to tolerate slippage of loan conditionality as it became clear that the rapid implementation of privatization during a period of often quite severe stabilization measures could be a costly exercise. Despite of policy based lending rarely was a failure to privatize an enterprise a sufficient reason to half the disbursement of aid flows.

10.2 EVALUATION :

Though study is based on a selected small sample of countries in which privatization has in some cases been a marginal activity, it is clear the problems and issues in these countries provide appropriate archetypes for a wide range of economies. though the problems held in Eastern Europe of re-orientating an entire economy arr of a different type, for most other developing countries the issues raised here are germane, if of differing order of magnitude. Supporting this is the fact that a number of the more recent works which tough on privatization have echoed the findings and conclusions in this study.

We are trying to explain very significant short fall between the experience of privatization and original expectations, and focused on two important aspects, first, and fundamentally, we have stressed on speed, form and economic effects of privatization

World Bank,World Development Report, United Nations Development Programme, 1991, New York.

will be ultimately determined by the structural and regulatory limitations of the economy. However privatization does not occur in a vacuum and thus the second important argument of the study high lights the pervasive effects that political considerations have had on the design and implementation of privatization programmes. Consequently it is the tensions between the economic and politics of privatization and also between the various objectives of privatization itself, that have shaped privatization which will determine the short-term outlook for programmes in the next coming future. Concerning the first argument the thrust of the analysis has been to make explicit theoretical arguments for privatization which rely significantly on assumptions about economic structure that are more appropriate for developed than developing countries, comparing these with the features of selected country studies gives us a basis for deciding how to adjust developing economies of what privatization can and can not be expected to achieve in low to middle income countries. Significantly economic theory highlights the importance of information flows and incentive mechanisms for efficient management and of market structure and regulation for the efficient allocation of resources. In developing countries however information flows are frequently weak. Under public ownership, performance indicators have tended to be denominate in quantitative terms (such as employment, out put, public assets) and prices themselves, often set by and layered with extensive cross subsidization, rarely transmitted information on true resource costs. Moreover these distortions frequently pervaded all economic sectors regardless of ownership, through the effects of wide spread domestic price controls and complex trade policy. Transfer of ownership may eliminate some of the more extreme elements of the weak internal processing of information, but **this** will be of only limited value if broader price distortions remain.

Similarly limited market size (which means that natural monopoly becomes a common occurrence) extensive concentration of economic power, institutional linkages and limited import penetration in certain sectors have served to limit competition on the supply side. Monopolistic and Oligopolistic enterprises thus dominate the domestic economy many of which (especially in the smaller economies) are state-owned. Privatization of such enterprises without restructuring of the enterprise itself or without associated changes in market structure may have no measurable impact on enterprise performance. These structural limitations of the domestic economy in developing countries are so pervasive that effective regulation of market against the adverse effects of monopoly and oligopoly becomes an essential adjunct to virtually all substantial privatization initiatives, rather than, as in many industrialized economies a specific requirement in respect of the sale of a small number of monopoly utilities. One of the most worrying features of privatization in developing countries is the extremely low priority accorded to market regulation and competition policy. However, even if this were reversed the evidence suggests that a number of countries have some way to go before the capacity would exist to implement efficient and credible regulation.

The absence of efficient means of savings mobilization for equity investment remains an important constraint to implementation of privatisation[2] objectives in a number of the poorer developing countries such as Malawi and PNG, governments in these countries are constrained in the form and size of sales. what is more without trad-ability of assets they face lower realizable prices for them and by being unable to unbundle asset entitlements they face the prospects of re-concentration of asset ownership in the hands of a small private sector elite.

There are of course feed backs from privatization to the development of private sector capital market and regulatory structures but these are weak and the process of trying to accelerate privatization may be ultimately harmful. Over burdening the absorptive capacity of Govt., may ultimately result in privatization become a welfare reducing activity as rents are captured by powerful buyers capital markets are distorted and the loss of regulatory credibility produces negative externalities in other areas. Privatization has been a politically contentious policy often regarded either as a line of demarcation between political parties in pluralistic countries or as a threat to the economic well being of rentiers. Its implementation has as a result often been undertaken as an article of political faith, but at the same time with an extreme sense of caution. Moreover, in many developing countries it is closely combined with a range of other related adjustment policies and political objectives and has been pursued in the midst of painful stabilization policies / measures. Conflicts abound and for risk averse or cautious governments often lacking credibility in the eyes of domestic investors and foreign investors this has meant that the economic objectives of privatization are frequently a compromised as a result of political factors. While such expediency may in some case be economically rational in a dynamic sense (in that it is necessary to create a reputation with buyers to ensure market receptivity for the future) it does underlines the important fact that putting privatisation in the reform package can often be achieved only with significant revenue and efficiency costs. Similarly though privatisation is essentially concerned with the transfer of commercial risk to the private sector this is often compromised by implicit under writing of the private sector in privatization sales by politically cautious government.

The reality of privatization in developing countries has not met expectations. It remains a priority however and as many countries move into a second decade of privatization is valuable to consider what adjustments to the policy are require for privatization to play a useful role in medium term economic reform in developing countries.

10.3 ADJUSTING THE ECONOMY AND PRIVATIZATION :

There is no doubt in the current wave of market friendly development privatization will remain a major component of economic policy packages in the recent future. Moreover we have seen in Jamaica and Sri Lanka as opposition to the policy diminishes, programmed of privatization are likely to be less motivated and less designed around the narrow objective of securing success.

The first adjustment is required if privatization is to be effective in achieving its efficiency enhancing objectives is that it be clearly regarded as a medium term supply side policy a logical complement to broader private sector development. The ultimate goal of developing countries is a competitive private sector, and as goods and capital markets and regulatory capacity develop and deepen so privatization is inevitably going to greater the higher the level of development in the economy. Consequently objective of the policy should be the development of the private sector and the capital markets. Privatization should fall within these objectives, with more attention being paid to the direct economic objectives and allowing the politics to die away. Second it is doubtful that privatization can play any major role in the short run in the face of adverse structural economic conditions. Endemic investment, uncertainty problems of policy credibility and the political forces impinging on governments as they attempt to being about economic stabilization are not conducive to the success of privatization and in such a cases privatization for the short run should be down graded and donors should reassess its role within adjustment programs. Judicious privatization especially through the sale of smaller enterprises as still valuable, but attempts to accelerate privatization programmes will vitate the goals they are supposed to achieve on two fronts not only will the programme come up against the binding constraints of the economy but also the political intervention required to secure the success of privatization in-period of crisis may actually lock-in welfare reducing elements. Underwriting and under pricing arrangements guarantees on market access and over generous restructuring which are required to see sales proceed in such circumstances are precisely such impediments to efficiency enhancing privatization.

Finally in view of these concerns it is essential that the current capacity of the domestic private sector to absorb public asset sales and therefore expectations of the scale of privatization programmes is reassessed. Privatization pipelines are still extremely optimistic and across a number of countries they have already been seen to slip or to be implemented in a hurried and sub-optimal level. Only a fraction of the Sri Lankan pipeline for 1990 and 1991 has been implemented while the same is the case with the ambitious privatization master plain Malaysia and the second wave of Privatization in Jamaica and Trinidad and Tobago.

These views obviously put forward the questions how then governments to proceed in tackling the still prevent short term crisis of the SOE sector, that direct reform SOEs combined with market based regulatory frameworks will offer much more fundamental adjustments in resource use than will rapid privatization. An SOE reform would not persist and that it was only with the threat of privatization that efficiency gains could be locked in. However though this had in the early 1980s, it seems less powerful now. first there is evidence that the threat effect has been established, governments have abandoned the creation of SOEs as major tools of economic policy and the prevailing political sentiments is firmly based in the demand for efficient services from SOEs. Secondly having established privatization as a medium term option, SOE reform within a broader framework of market development is consistent in a way that it was not in an environment of non-market pricing and control. thus the establishment of market based regulatory structures for the SOE sector allows government to practice and develop their regulatory capacity to implement appropriate and effective competition policy and to create the information and incentive structures that will be robust enough to ensure that eventual privatization can be successful. Paradoxically then given the constraints placed on immediate privatization by the economic structure of many developing countries, one policy for strengthening market orientation in these economies is the intelligent reform of the SOE sector structures around sound economic principles. In combination with a reduction in the urgency currently assigned to privatization and the revision of programmes around a medium term efficiency oriented framework this will allow to assess more clearly the relative costs and benefits of competing policy alternatives in pursuit of the efficient supply of goods and services in a manner consistent with the ultimate welfare objectives of government and economy.

10.4 ECONOMIC POLICIES :

Made fashionable by the Britain in early 1980s Privatization is now vague around the developing world, it has become an important policy ingredient in the swing to reliance on markets which characterizes economic reforms now under way in the second and third worlds. In part this is because greater emphasis on free markets and on privatization as a means of markets works better.

Experience with the developed economies is generally seen as successful though that view is not exactly shared universally. Closer scrutiny of Privatization experience over the past decade in the developing economies suggests us in reality that the process and its outcomes are neither as simple nor as straight forward as is often envisaged.

This study found that the existence of reasonably competitive domestic markets for goods and services, a well developed capital markets with considerable breadth and absorptive capacity and sound regulatory structures which have evolved over decades. The absence of these essential prerequisites makes achieving all the benefits of privatization much more difficult the success of Privatization is largely dependent on strategic tactical choices for sale from a public asset portfolio, pricing and appropriate time sequencing.

The fundamental objective of Indian Privatization to bring rapid and sustained improvement in the efficiency of State Owned Enterprises (SOEs) successful and sustained growth and development depends on continuing increases in the productivity of capital aland and labour. Fostering an economic environment which promotes rapid, fast development will not be so easy within a generation the countries of east Asia have transformed themselves.

To ease out the 1991 crisis stabilization measures undertaken by the Indian Government and the initiation of a medium term strategy for consolation of macro economic stability and undertaking long structural reforms in the foreign trade and payments regime, the tax system, industrial policy and financial sectors.

The controls began in 1950s and served a purpose in the initial years of development had overtime became inefficient and dysfunctional very often the system served only to protect established producers from competition by new entrants.

As the part of Indian reforms Government has took many measures to dismantle the controls.

* Industrial licensing was abolished for all except a selected list of hazardous and environmentally sensitive industries.
* The separate permission needed by MRTP houses for investment and expansion was abolished.
* The list of industries reserved for the public sector was reduced from 17 to 6 in addition private sector participation was allowed even industries in the reserved list.
* Access to foreign technology was made much freer.
* Privatization began to improve the efficiency of industrial units, SOEs started privatizing slowly.

*   Import controls through licensing has been **virtually** abolished except for consumer goods.

Import duties have been reduced in stages.

*   Foreign Exchange rate of Rupee is today determined by demand and supply conditions in the market.

10.4.A) FOREIGN INVESTMENT POLICY :

Foreign Investment is viewed as a means of building inter firm linkages in a world which transnational corporations are increasingly operating on the basis of network of Global connections. Net foreign investment inflows into India grown up to $ 20 billion in 1996-97. Recognizing the Foreign Investment importance the reform package designed to attract Foreign Investors.

*   The Foreign Exchange Regulation Act (FERA) was amended.

*   India signed the Multilateral Investment Guarantee Agency (MIGA) convention and became a member to promote foreign investment.

*   Foreign Investment approvals up to 51% of equity in a specified list of 34 priority industries was made automatic.

*   Investment above 51% equity was also permitted on the basis of case by case approvals given by Foreign Investment Promotion Board 9FIPB).

*   The procedure for Indian companies to invest abroad and develop Global linkages also streamlined and made easier.

10.4 B) CAPITAL SECTOR REFORMS :

As a part of reforms the capital market also been initiated changes, SEBI has been in operation and given statutory power in February, 1992. The Office of Controller of Capital Issues was abolished in May, 1992.

* SEBI governs various aspects of the stock market and intermediaries operating with a view to improving trading practices.

* Private sector mutual funds has been allowed to operate subject to SEBI rules.

* A National Stock Exchange (NSE) is being set up to serve as a model exchange providing a nationwide screen based trading and electronic clearing and settlement systems.

* Foreign institutional investors such as pension funds mutual funds etc., have been allowed to invest in the capital markets subject to SEBI registration.

10.4 C) STATE OWNED ENTERPRISES (SOE) REFORMS :

Reforms in SOE sector aimed at increasing the efficiency of the SOE sector and reducing the deficit which, loss making units impact on the budget.

Budgetary support in the form of non-plan loans to loss making SOEs is being disinvested. SOEs also allowed to form Joint Ventures and also to raise fresh equity from the market to finance their expansion plans.

Structural reforms also involves social costs may arise for several reasons. Fiscal discipline forces limits on government spending and this may affect the pace of implementation of programmes in the social sector. Economic restructuring may involve temporary loss of jobs in certain sick companies and unviable units as labour is redeployed into new units.

10.4 D) SOCIAL SAFETY REFORMS :

* A National Renewal Fund has been set up to fund schemes for compensation retraining and redeployment of workers affected by the economic restructuring.

* the public distribution system has been strengthened and expanded in 1700 identified blocs.

* Expenditure on social sector including rural development health education substantially given preferences in resource allocation.

10.4 E) INDIAN PRIVATIZATION IN 1997 :

Disinvestment commission chairman G.V.Ramakrishna stated that "unless there was no coordinated approach towards disinvestment there is likely to be a loss to the exchequer through lower realization of sale vale". The specific recommendation made for six SOEs on 17th April, 1997. They are Bharat Aluminium Company Ltd., (BALCO), Madras Fertilizers Limited (MFL), Bongaigon Refineries and Petrochemicals Limited (BRPL), Manganese Ore India Limited (MOIL), I.T.I. Ltd., and H.T.L.

The process of Privatization differ from company to company. Outright sale of HTL shares, 74% off loading equity of Government in BALCO, ITI and BRPL. 50% off loading in MFL and 49% in MOIL. Immediate privatization of 40% BALCO. For HTL 50% shares being offered to a strategic partner through competitive bidding. In the case of BRPL 50% of shares sales to Indian or Foreign

Company. For ITI the initial sale of 50% shares of to a strategic partner with an agreement for further dilution of Govt, equity to to 26% through public sales.

In MFL the commission suggested that Govt. , to hold 50% and rest 50% for public offer. In the case MOIL Govt., should not sale more than 49% because of the performance of the company is good and its public monopoly there is no point to transfer this as private monopoly.

10.4 F) POLICY SUGGESTIONS :

India needs a pragmatic approach not an ideological approach to SOEs in order to succeed privatization.

Here we had outlined four issues of important bearing.

Firstly that the selection of strategic partners should be through a process of pre-qualification in order to identify and short list only suitable bidders who could bring in necessary technological or financial inputs for the SOE concerned.

Secondly, the issue of the voluntary retirement scheme (VRS) that in view of the considerable uncertainty among the various managements and employees there needs to be a clear cut policy statement of the terms VRS on a long term basis.

Thirdly, the need to provide adequate funds to the SOE managements for disinvestment process out of the disinvestment fund which has proposed to establish recently by the disinvestment commission (February, 1997).

Finally, the condition for privatization of SOE shares through the book building process could be established to meet the requirement of investors could be facilitated if SOEs which were earlier divested and which are proposed for privatization are directed to join the Nation Securities Depository ltd., (NSDL) and have their shares registered with it to meet the various concerns of the investors, including speedy trasnferability of shares.

10.4 G) COMMERCIALIZATION / RESTRUCTURING SOEs :

By dismantling earlier regulations froms a large number of new directives and regulations. the aim is to overcome SOEs insufficiencies and strengthen cost-benefit thinking in SOEs management. The new directives and regulations has to focus on

a) industrial cost-reduction through greater cost discipline

b) control mechanisms on the use of investment funds to secure move.

c) steps to promote the improvement of enterprise management and finance, and

d) the use of indirect instruments for example profitability and the use of retained earnings to stimulate the intensification of production.

The main coefficients by which SOEs have to be evaluated based on net production, net profit. Profitability as the measurement criterion of rational resource use in production. In order to commercialize SOEs before going for privatization.

Private ownership can produce greater efficiency than the Government only in the presence of adequate competition in the economy. Competition provides the incentives for firms to allocate resources efficiently the only strategy is disinvestment of government equity, in this context the problems are under pricing the share prices and paying high commission for under writings, these will jeopardize the privatization results. Restructuring SOEs before privatization is vitally important. Underpricing shares causes wastage of money of tax payers, selling shares quickly, and spending too much on underwriting and advisory fees. In privatization programmes too much attention has been paid to change of ownership and not enough to competition improvement / efficiency in SOEs in all selected sample economies including India's SOEs.

CONCLUSION

This study examined the issues of Privatization schemes in the developing economies nearly a decade. The role of dependency school of thought in the process of development in observed developed economies is lacking relevance. And the role of Bretton Wood Institutions like International Monetary Fund (IMF) and World Bank is vital and these promotes and helps to initiate the Privatization process from externally.

The SOE sector's performance has been declining and the restructuring is imminent and that gives scope for privatization success that is the reason developing economies following the Public Sector's reforms.

The Govt.'s initiation began by the adjusting economic structures and adopting stabilization and liberalisation programmes.

Finally the privatization in all these sample economies started selling the State Owned Enterprises equity partially or fully depending on the firm to firm case.

Thus fulfilling all the objectives the Privatization in developing economies strongly believes in rectifying the Public Sector's list but in reality the fact is not the same.

Privatization can best be regarded as a medium term supply side economic policy, a logical complement to a broad private sector development rather than a Panacea for the all ills endured by those developing economies.

Privatization in India would bear fruit, if aspects of exit policy, simplified labour laws, health care and education at affordable costs and unemployment insurance are . . addressed carefully. This could be taken care of by further research.

TABLE

Macro indicators - Developing Economies(Studied)

Country	Population (millions)	GNP Percapita $1994	Average Annual Growth 1985-94	PPP Estimates of GNP 1994	Crrrent Intl. 1994	Central Govts defict / Surplus 1994	Normal Interest Rates of Banks Deposit Rate	Lending Rate
Malawi	9.5	170	-0.7	2.5	650	1.2	25	31
Kenya	26.0	250	A)	5.1	1310	-0.4	20	25
India	913.6	320	3.0	4.9	1280	-1.8	14	• 17
Trinidad & Tobago	4.0	320	-2.7	4.4	1130	2.0	7.8	17.5
Srilanka	17.9	460	2.9	12.2	3160	-3.0	15.3	13
PNG	4.2	1240	2.2	10.4	2680	-4.6	5.1	9.2
Jamaica	2.5	1540	3.9	13.1	3400	n.a.	36.4	49.5
Malaysia	19.7	3480	5.6	32.6	8440	8.9	6.6	7.6

TABLE II

MACRO INDICATORS-DEVELOPING ECONOMIES (Studied)

Country	Average Annual Inflation 1984-94	Current Account Balance (%of GNP) 1980'	1994	Gross International Reserves (months of imports coverage) 1980	1994	Net Present Value of external Debt. (%of GNP)	Net private capital flows (millions $) 1980	1994
Malawi	18%	-27.4	-44	1.4	0.6	73	30	-1
Kenya	11.7%	-13.7	-0.5	2.1	2.5	80	301	-272
India	9.7%	-1.7	-0.9	8.0	6.7	27	868	5497
Trinidad & Tobago	3.3%	-16.4	-3.1	1.4	3.5	98	83	0
Srilanka	11%	-18.7	-8.1	1.5	4.4	41	129	213
PNG	3.9%	-22.6	8.5	3.6	0.6	46	105	-231
Jamaica	27.6%	-5.6	-0.4	0.8	1.5	94	9	123
Malaysia	3.15	1%	-6.6	4.7	4.5	33	1913	6661

TABLE III

MACRO INDICATORS-DEVELOPING ECONOMIES (Studied)

Country	Structure of Economy 1994 (%ofGDP)			Total External Debt. % GDP (million S)		Gross International Reserves 1994 (million $)	Total External Debt. (million S) 1994
	Agri.	Industry	Services	1980	1994		
Malawi	31	21	47	821	2015	80	2015
Kenya	29	17	54	48.1	112.0	588	7273
India	30	28	42	11.9	34.2	24221	98990
Trinidad & Tobago	38	21	41	95.9	156.6	99	1052
Srilanka	24	25	51	46.1	67.6	1686	7811
PNG	28	38	34	29.9	57.5	120	2878
Jamaica	8	37	55	78.0	110.1	n.a.	4318
Malaysia	15	43	42	28.0	36.9	26339	24712

Source : World Development Report 1996, World Bank, Oxford University press.

TABLE - IV

PRIVATIZATION LEGISLATION AND STRUCTURES

Jamaica	N1BJ Divestiture Committee	1981
	NIBJ Divestiture Secretariat	1982
	National Hotels and Properties Divestment Unit.	NA
	Agro 21 Divestment Secretariat	NA
	PM's Cabinet submission on Privatization.	1990
Trinidad and Tobago	Bruce Committee	1979
	Bobb Committee	1984
	Ramprasad Committee	1984
Malaysia	Malaysia Inc. Policy	1983
	Cabinet Committee on Privatization.	1985
	Privatization Secretariat - Economic Planning Unit	1985
	Privatization Guidelines	1987
	Privatization Master Plan	1990
Papua New Guinea	National Executive Council (NEC) policy statement on Privatization - I	1987
	NEC policy statement on Privatization - II	1988
	Parliamentary Committee on Public Enterprises.	1980
	Presidential Commission on Privatization - I	1987
	Presidential Commission on Privatization - II	1989
	Public Investment Management Board	1989
Kenya	Ndegwa Committee on Statutory Bodies	1979
	Working Committee on govt., Expenditure	1982
	Task force on Divestiture	1986 & 1990
Malawi	Department of Statutory Bodies	1982
	World Bank Structural Adjustment Loans (SAL) I to III	1981 to 86
India	High level committee on Public Sector Commercial Banks	1990

(Narasimhan Committee)	
World Bank - SaL - Loans	1991 to 95
Committee on Issue of Disinvestment of shares in Public Sector Enterprises (Sri Ramakrishna - Chairman)	1976

TABLE - IV.1

NUMBER OF PRIVATIZATIONS BY COUNTRY AND BY METHOD OF SALE

	TOTAL	PUBLIC SALE	PRIVATE SALE			MC AND LEASE		
			DOMES-STIC	FORE-IGN	JOI-INT	DOMES-TIC	FORE-IGN	JOI INT
Jamaica	41	3	15	6	4	2	1	9
Malaysia	24	4	12	0	2	6	0	0
Kenya	1	1	0	0	0	0	0	0
Malawi	17	0	8	9	0	0	0	0
Sri Lanka	6	3	1	2	0	0	0	0
Trinidad and Tobago	5	2	0	2	0	0	1	0
Papua New Guinea	4	0	0	4	0	0	0	0
Total	98	14	36	23	6	8	2	9

Source : Country case studies.

TABLE IV.2

PRIVATIZATION PROCEEDS BY COUNTRY AND METHOD OF SALE

[a] (US$m.)[b]

	TOTAL	PUBLIC SALE	PRIVATE SALE DOMESTIC	PRIVATE SALE FOREIGN	PRIVATE SALE JOINT
Jamaica	230.7	66.2	36.8	117.5	10.2
Kenya	9.1	9.1	**0.0**	**0.0**	0.0
Malawi	7.2	0.0	2.2	**5.0**	**0.0**
Malaysia	180.3	85.9	**40.4**	**0.0**	**54.0**
Papua New Guinea	4.5	0.0	0.0	**4.5**	**0.0**
Sri Lanka	10.7	2.9	0.0	7.8	**0.0**
Trinidad and Tobago	94.5	9.6	0.0	84.9	**0.0**
Total	537.0	173.7	79.4	219.7	64.2
No. of Privatizations	79	14	36	23	**6**
Average value		12.4	2.2	9.6	10.7

Source : Country case studies
Notes :

a) The values of some of the small sales (inc. land sales) listed in Table 4.1 are missing.
b) Converted at the exchange rate applicable at the date of sale.
c) Not including management contracts or leases.

Thanks largely to the impact of the debt crisis, commodity price shocks and intense adjustment measures. Thus, the proceeds from privatization expressed as a proportion of the deficit

TABLE IV.3

PRIVATIZATION PROCEEDS BY COUNTRY AND BY METHOD OF SALE

[a](% of GDP)[b]

			PR:IVATE SALE		
	TOTAL	PUBLIC SALE	DOMESTIC	FOREIGN	JOINT
Jamaica	7.20	2.25	1.10	3.56	0.29
	0.09	0.09	0.00	0.00	0.00
Kenya	0.61	0.00	0.19	0.42	0.00
Malaysia	0.55	0.27	0.12	0.00	0.16
Papua New Guinea	0.18	0.00	0.00	0.18	0.00
Sri Lanka	0.15	0.04	0.00	0.11	0.00
Trinidad and Tobago	2.34	0.24	0.00	2.10	0.00
Average	1.59	0.41	0.20	0.91	0.06

Notes:

a) Not including the value of management contracts or leases.

b) The figures represent the total of privatization proceeds to date as a sum of the proportions of those proceeds to GDP in the respective years of sale.

TABLE IV.4

NUMBER OF PRIVATIZATIONS BY COUNTRY AND BY FUNCTION OF ENTEPRISE[a]

	Total	Commerce Manufac-cturing & services	Finance & Banking	Trans-port & Communi-cations	Water Energy	Regula-tory & Marke-ting	Agri cul-ture
Jamaica	41	30	1	5	0	0	5
Kenya	1	0	1	0	0	0	0
Malawi	17	10	0	0	0	0	7
Malaysia	24	13	2	4	0	0	5
Papua New Guinea	4	2	0	1	0	0	1
Sri Lanka	6	6	0	0	0	0	0
Trinidad & Tobago	5	2	2	1	0	0	0
Total	98	63	6	11	0	0	18

Note :

a) Including management contracts and leases

TABLE

PRIVATIZATION PROCEEDS BY COUNTRY AND FUNCTION OF ENTERPRISE

(US $m.)

	Total	Commerce Manufac-cturing & services	Finance & Banking	Trans-port & Communi-cations	Water Energy	Regula-tory & Marke-ting	Agri cul-ture
Jamaica	**230.7**	**104.2**	**16.1**	**110.3**	**0.0**	**0.0**	**0.1**
Kenya	**9.1**	**0.0**	**9.1**	**0.0**	**0.0**	**0.0**	**0.0**
Malawi	**7.2**	**5.4**	**0.0**	**0.0**	**0.0**	**0.0**	**1.8**
Malaysia	**180.3**	**18.6**	**8.7**	**133.5**	**0.0**	**0.0**	**19.5**
Papua New Guinea	**4.5**	0.8	**0.0**	**1.0**	**0.0**	**0.0**	**2.7**
Sri Lanka	**10.7**	**10.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Trinidad & Tobago	**94.5**	6.3	**3.3**	84.9	**0.0**	**0.0**	**0.0**
Total	**537.0**	146.0	**37.2**	329.7	**0.0**	**0.0**	**24.1**
AVERAGE VALUE	**6.8**	2.6	**6.2**	33.0	**0.0**	**0.0**	**4.0**

Note:
a) Excluding management contracts, leases and closures.

Participation in joint Ventures) in the privatization programmes of the seven countries accounts for almost 40% of total sales value.

TABLE IV.6
NUMBER OF PRIVATIZATIONS BY METHOD AND FUNCTION OF ENTEPRSIE

	Total	Public Sale	Private sale			Mc & Lease		
			Dome-stic	Fore-ign	Joint	Dome-stic	Fore-ign	Joint
Commerce, Manufctu-ring & Services	63	7	26	13	4	4	1	8
Finance & Banking	6	4	1	1	0	0	0	0
Transport & Commu-nications	11	3	0	5	2	1	0	0
Water & Energy	0	0	0	0	0	0	0	0
Regula-tory & Marketing	0	0	0	0	0	0	0	0
Agricul.	18	0	9	4	0	3	1	1
Total	98	14	36	23	6	8	2	9

TABLE IV..7

VALUE OF PRIVATIZATIONS BY METHOD AND FUNCTION OF ENTEPRISE
(US $m.)

	Total	Public Sale	Priva'te sale		
			Domestic	Foreign	Joint
Commerce, Manufctu-ring & Services	146.0	41.9	54.2	39.7	10.2
Finance & Banking	37.2	32.6	4.6	0.0	0.0
Transport & Commu-nications	329.7	99.2	0.0	176.5	54.0
Water & Energy	0.0	0.0	0.0	0.0	0.0
Regula-tory & Marketing	0.0	0.0	0.0	0.0	0.0
Agricul.	24.1	0.0	20.6	3.5	0.0
Total	537.0	173.7	79.4	219.7	64.2

TABLE IV.8

AVERAGE VALUE OF PRIVATIZATION BY METHOD AND FUNCTION OF ENTERPRISE (US $ m.)

	Average	Public Sale	Private sale		
			Domestic	Foreign	Joint
Commerce, Manufctu-ring & Services	2.39	5.98	2.08	**3.05**	2.55
Finance & Banking	6.20	8.15	**0.00**	**0.00**	**0.00**
Transport & Commu-nications	29.97	33.07	**0.00**	**35.30**	**27.00**
Water & Energy	**0.00**	0.00	**0.00**	**0.00**	**0.00**
Regula-tory & Marketing	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Agricul.	1.26	0.00	**2.29**	**0.88**	**0.00**
Average	7.01	12.40	2.27	**0.55**	**10.72**

Note:

a) This table excludes the value of management contracts and leases, the UPSAK sales in Malayesia, some smaller privatizations in Jamaica, and Trinidad and Tobago's sale of DFC.

TABLE - V

EMPLOYMENT IN PUBLIC SECTOR IN 1989 IN INDIA

	PULBIC SECTOR IN LAKHS	PERCENT OF TOTAL	PUBLIC SECTOR ON % OF TOTAL (PUBLIC + PRIVATE)
01., Agri., hunting, foresting & fishing	5.55	3.0	39.0
02. Mining & Quarrying	9.56	5.2	90.0
03. Manufacturing	18.63	10.1	29.8
04. Electricity, gas & Water	8.69	4.7	95.7
05. Construction	11.46	6.2	94.3
06. Whole sale, Retail trade, restuarants & hotels	1.50	0.8	34.4
07. Transport, Storage and Communications	29.74	16.1	98.3
08. Financing, Insurance and Real Estate & Business Services	11.23	6.1	82.7
09. Govt. Administration	88.11	47.8	86.0
Total	184.44	100.00	71.2

Source : Govt. of India, Economic Survey, (1992-93).

TABLE - VI

PROFITS / LOSSES OF MAJOR SEGMENTS OF PUBLIC SECTOR IN INDIA

(RS. IN CRORES)
PROFITS + LOSS (-)

	1987-88	1988-89	1989-90
CENTRAL GOVT.			
a) Non-departmental enterprises	+ 2060	+ 2994	+ 3789
b) Railways	+ 84	+ 28	+ 140
c) Posts & Telecommunications	+ 263	+ 684	+ 788
STATE GOVERNMENT			
d) Forests	+ 544	+ 414	+ 540
e) Mines & Minerals	+ 27	+ 52	+ 61
f) Road & Water transport	- 1ll	57	93
g) Dairy Development	44	52	- 107
ft) Industries	20	10	- 160
i) Power Projects	- 116	84	35
j) Irrigation & Multi purpose Projects	- 1345	- 1841	- 1917
K) State Electricity Boards	- 2264	- 2705	- 4104
1) State Road Transport Undertakings	- 164	- 251	- 359
A. Total (4 to 12)	- 2493	- 4534	- 6174
B. Total (1 to 3)	+ 2407	+ 3706	+ 4717

Source : Compiled from Pulbic Enterprise Survey (1990-91) and Economic Survey (1991-92) .

TABLE - VII

NET PROFIT / LOSSES BY CENTRAL PUBLIC ENTERPRISES

(RS. IN CRORES)

YEAR	PROFIT MAKING ENTERPRISES	LOSS INCURRING ENTERPRISES	TOTAL	2 AS % OF 1.
1980-81	557 (94)	- 740 (74)	- 203 (168)	136.4
1981-82	1293 (104)	- 847 (83)	446 (188)	65.5
1984-85	2021 (113)	-1112 (92)	909 (207)	55.0
1985-89	4917 (117)	-1923 (106)	2993 (223)	39.0
1989-90	5751 (131)	-1962 (98)	3789 (229)	34.1
1990-91	5393 (123)	3121 (111)	2272 (234)	57.9
1991-92	6149 (134)	3674 (102)	2475 (236)	59.3

Note : Figures in brackets represents the number of enterprises. Any difference in the total number of enterprises indicates some enterprises which were neither profit making nor loss incurring.

Source: Public Enterprises Survey (1991-92). India

TABLE - VIII

FINANCIAL PERFORMANCE OF STATE ELECTRICITY BOARDS DURING 1991- 95 IN INDIA

(RS. IN BLN)

	1991-92	1992-93	1993-94	1994-95 RE	1995-96 **AP**
Gross subsidy on sales	74	94	114	133	150
to Agriculture	59	72	89	101	112
to domestic consumers	13	19	24	30	35
Inter-state	2	2	1	2	3
Uncovered subsidies	32	41	59	62	74
Gross subsidy on sales (% GDP market prices)	1.2	1.3	1.5	1.5	1.4

RE = Revised Estimates, AP = Annual Plans

Subsidies are defined as the difference between tariffs that would enable the SEBs to cover their variable costs and tariffs actually charged. If this does not include capital subsidies.

TABLE - IX
PROFITABILITY PROFILE OF NON-DEPARTMENTAL
CENTRAL GOVT. ENTERPRISES - 1990-94

	1990-91	1991-92	1992-93	1993-94
No. of Operating Enterprises	236	237	239	240
Profitable	123	133	131	130
Loss-Making	111	102	106	100
Profit of Promit Making Entps.	54	61	74	97
(% of GDP)	1.0	1.0	1.1	1.2
Loss of Loss Making Entps.	31	37	41	53
(% of GDP)	0.6	0.6	0.6	0.7

Source : Ministry of Finance, Economic Survey - 1994-95

TABLE - X

PRIVATIZATION (PARTLY) IN PUBLIC SECTOR ENTERPRISES IN INDIA

1993 - 94 PROGRAMME

01. Steel Authority of India Limited (SAIL)

02. Bharat Petroleum Corporation Limited (BPCL)

03. Hindustan Petoleum Corporation Limited (HPCL)

04. Rashtriya Chemicals and Fertilizers Limited (RCFL)

05. National Aluminium Company Limited (NACL)

06. Neyeli Lignite Corporation of India Limited

* After constituting Divestiture Commission in 1996 - Identified 40 Enterprises for privatization.

SOE Sectors other loss making Sectors (too) are in observation by the Disinvestment Commission.

TABLE -

SRI LANKA

GOVERNMENT OWNERSHIP OF SOEs

SECTOR	DIRECT (100%)	INDIRECT (100%)	MAJORITY (>50%)	MINORITY (<50%)
1.Regulation	28	3	-	-
2.Human Resources	50	1	-	-
3.Infrastructure	13	6	-	-
4.Commercial	97	35	7	6
5.Banking & Finance	12	3	3	1
	200	48	10	7

Source : Country case studies.

TABLE -

SRI LANKA

SUBSECTORAL DISTRIBUTION OF COMMERCIAL SOEs

SECTOR	PUBLIC CORPORATIONS	PUBLIC COMAPNIES	GOBU	TOTAL
Agriculture	15	2		17
Civil Engineering	3	3	-	6
Energy	2	2	1	5
Manufacturing	16	24	6	46
Media	3	1	1	5
Other Services	7	25		33
Road Transport	11	-	-	11
Trading	12	9	1	22
	69	66	10	145

Source : Country Case studies

TABLE - XIII

PNG

CSAs AND SOEs : GOVERNMENT EQUITY PARTICIPATION AS AT 199 0

CSAs	% GOVT. EQUITY	VALUE OF SHARES AT COST
National Airline Commission (Air Niugini)	100.0	7.91
PNG Banking Corporation	100.0	10.00
Agricultural Bank of PnG	100.0	26.18
Investment Corporation of PNG	100.0	5.58
Niugini Insurance Corporation	100.0	0.25
Bank of Papua New Guinea	100.0	15.00
Posts and Telecommunications Corporation	100.0	13.92
PNG Electricity Commission	100.0	42.98
PNG Harbours Board	100.0	7.98
PNG Water and Severage Board	100.0	1.77
		518.45

Sources: Country Case Studies

PNG*: Papua New Guinea

TABLE - XIV

TRINIDAD & TOBAGO

NUMBER OF GOVERNMENT ENTERPRISES BY SECTOR, 1985

Govt. Share-holding	Total No.of Cos.	Petrol and Related Inds.	Agri. and Related Inds.	Manu-facturing	Trans-port, Comms. and Broad Casting	Hotel and Related	Finance Banks and Insurance	Others
100%	37	9	7	9	4	1	1	6
51-99%	11	2	1		2	1	5	
50%	1				1			
< 50%	17		2	8	2	2	3	
Total	66	11	10	17	9	4	9	6

Source : country case studies
a) Encluding the utilities

TABLE - XV

STATE-OWNED ENTERPRISES

ENTERPRISE	GOVERNMENT OWNERSHIP (%)
1. DIRECTLY HOLD SOEs[a]*	
Mining Investment and Development	100
Smallholder Sugar Authority	100
smaller holder Tea Authority	100
Smallholder Coffee Authority	100
Tobacco Control Commission	100
Kasungu Flue Cured Tobacco Authority	100
ADMARC	100
Balaniyre Dairy	100
Malawi Dairy Industries	100
Wood Industries Corporation	100
Malawi Export Promotion Corporation	100
Air Malawi	100
Malawi Railways	100
Electricity Supply Commission	100
Malawi Broad casing Corporation	100
Blantyre Water Board	100
Lilongwe Water Board	100
Malawi Housing Corporation	100
Malawi Book Services	100
Reserve Bank of Malawi	100
Malawi Development Corporation	100
Indebank	100
Indefund	100
SEDOM	100

Source: Economic Report 1989. Malawi

a*: as at December 1989.

Table XVI

ENTERPRISE	GOVERNMENT OWNERSHIP (%)
2. ADMARC ASSOCIATED COMPANIES	
ADMARC Canning Co.	100.0
Auction Holdings Ltd.,	100.0
Buwa Tobacco Estate	100.0
Cold Storage Company	100.0
Fincorp Malawi	100.0
Grain and Milling Company	100.0
Kasidizi Estate	100.0
Livilidizi Estate	100.0
Maldeco Fisheries	100.0
Mangani Estate	100.0
National Oils	100.0
PEW Ltd.	87.0
National Seed Company	72.5
Cattle Feedlot Company	50.0
Chasato Estate	50.0
Dawanye Ltd.	50.0
Manica Freigh	50.0
Tobacco Estate Litd.	50.0
Cotton Ginners Ltd.	49.0
David Whitehead & Sons	49.0
Sugar Crop of Malawi	49.0
Dwangwa Sugar	42.0
Malawi Tea Factory	40.0
United Transport Ltd	35.0
Optichem	33.5
National Bank of Malawi	33.0
Bank of Malawi	22.0

Source: Economic Report 1989. Malawi.

b*: prior to Asset swap and divestiture

TABLE - XVII

SOE's - MALAWI

ENTERPRISE	GOVERNMENT OWNERSHIP (%)
3. MDC ASSOCIATED COMPANIES[b]	
Can Makers (MDC) Ltd.	100.0
Cold Storage Company	100.0
Malawi Restaurants	100.0
Merolga Knitwear	100.0
Plastic Products Ltd.	100.0
Development Finance Crop Malawi	88.0
Freshcold Fisheries	85.0
Packaging Industries	81.0
Brickand Tile Co.	67.0
IMEXCO	51.0
Jacaranda Properties	51.0
Match CO. (Malawi)	50.0
Portland Cement	50.0
Malawi Hotels	47.0
Malawi Distillers	41.0
Agrimal	40.0
Malawi Iron & Steel	40.0
National Oils	30.0
Pipe Extruders Ltd.	30.0
David Whitehead & sons	29.0
Carlsberg Malawi	27.0
B & C Metals	25.0
Encor Products	23.0
Commercial Bank of Malawi	20.0
Guthrie Corp (Malawi)	20.0
National Insurance Co.	20.0

Source : Economic Report, 1989; ADMARC, Annual Report 1983; MIDC Annual Report, 1983.

a) As at December 1989; b) prior to asset swap and divestiture.

TABLE - XVIII
KENYA

SECTOR	SUBSECTOR	MAJORITY OWNERSHIP	MINORITY OWNERSHIP	TOTAL
DEVELOPMENT INSTITUTIONS	Sectoral	9	0	9
	National	3	0	3
	Regional	4	0	4
	Commodity Board	10	0	10
FINANCE	Banks	4	2	6
	Financial Ints.	3	2	5
	Insurance	4	2	6
	Investment	1	1	2
COMMERCIAL	Sugar	5	0	5
	Tea	9	13	22
	Food Processing	5	12	17
	Livestock	2	2	4
	Textiles	6	12	18
	Plastics	0	8	8
	Beverages	2	1	3
	Engineering	1	12	13
	Fishing	1	3	4
	Chemicals	3	4	7
	Retail	4	3	7
	Tourism	15	16	31
	Mining	7	0	7
	Wood & paper	1	6	7
	Construction	10	3	13
	Transport	8	2	10
	Vehicle assemble	1	6	7
	Energy	4	0	4
REGULATION		55	0	55
PROFESSIONAL		11	0	11
MISCELLANEOUS		39	0	39
CO-OPERATIVES		5	0	5
TOTAL		232	110	342

Source : Govt. of Kenya, Working Paper on Govt. Expenditure, 1982

TABLE - XIX
SOE HOLDING COMPANY STRUCTURE

KENYA

HOLDING COMPANY	100%	51%-100%	25%-50%	<2 5%	TOTAL
ICDC	10	11	23	16	60
IDB			4	23	27
Agri. Development Bank	2	4			6
Kenya Commercial Bank	2				2
National Bank Kenya		1			1
Kenya National Insurance Company	1	1			2
Kenya Re-Insurance	2				2
Kenya National Trading co.	l	1			2
Kenya Tourism Dev. Co.	2	13	8	2	25
Kenya Tea Dev. Co.	9	8	1	21	39
Cotton Lint. Seed Co.	5				5
Kenya Airways	2				2
Total	3 6	38	37	62	173

Source Govt. of Kenya, Working paper on Govt. Expenditure, 1982.

TABLE - XX

SOEs BY PAID-UP CAPITAL, SIZE AND SOURCE OF BORROWING - KENYA

1. SOEs BY PAID-UP CAPITAL

	NO. OF COMAPNIES	TOTAL CAPITAL (M$m.)	GOVT. EQUITY (M$m.)	GOVT. EQUITY AS % OF TOTAL CAPITAL	AVERAGE CAPITAL (M$m.)
Federal	556	18,521	12,738	68.78	33.3
State	553	5,048	3,829	75.85	9.1
Regional	49	241	170	70.54	4.9
TOTAL	1,158	23,810	16,737	70.29	20.6

2. SOEs BY SIZE - MALASIA

	NO. OF COMAPNIES	CAPITAL >M$20m.	CAPITAL M$lm.-M$2 0m.	CAPITAL M$lm.-M$5m.	CAPITAL <M$LM.
Federal	556	135	117	106	198
State	553	52	114	150	237
Regional	49	4	9	11	25
TOTAL	1,158	191	240	1	460

3. SOES BY SOURCE OF BORROWING - MALASIA

	NO. OF COMAPNIES	GOVT. LOANS	FOREIGN LOANS	DOMESTIC LOANS	TOTAL LOANS	DEBT/ TOTAL CAPITAL
Federal	556	21.38%	27.54%	51.08%	100.00%	184.89%
State	553	34.67%	24.28%	41.05%	100.00%	169.53%
Regional	49	41.35%	11.81%	46.84%	100.00%	98.34%
TOTAL	1,158	24.13%	26.81%	49.06%	100.00%	180.73%

Source: Country case studies

TABLE - XXI

DISTRIBUTION OF SOEs BY SECTOR - MALAYSIA

SECTOR	FEDERAL	STATE	REGIONAL	TOTAL
Agriculture	5	19	3	27
Construction	8	26	1	35
Extractive	6	27	1	34
Finance	100	33	1	134
Manufacturing	153	155	14	322
Plantation	22	61	12	95
Property	44	53	1	98
Services	162	135	16	313
Logging	0	25	0	25
Transport	56	12	0	68
Others	0	7	0	7
Total	556	553	49	1,158

Source Country Case Studies