

## Privatization

Privatization is the process by which the production of goods or services is removed from the government sector of the economy. This has been done in a variety of ways, ranging from the public sale of shares in a previously state-owned enterprise to the use of private businesses to perform government work under contract.

The leader in this innovative strategy was the Thatcher government of Great Britain from 1979 to 1990. Previous governments had tried limited denationalization, which is the restoration of nationalized enterprises to their previous owners, but with limited success. Privatization involved totally new owners. In some cases the state enterprises that were "privatized" had never been in the private sector.

Governments all over the world were confronted in the seventies by the problems inherent in state ownership. Because state-owned companies have no profit motive, they lack the incentive that private companies have to produce goods that consumers want and to do so at low cost. An additional problem is that state companies often supply their products and services without direct charges to consumers. Therefore, even if they want to satisfy consumer demands, they have no way of knowing what consumers want, because consumers indicate their preferences most clearly by their purchases.

The result is misallocation of resources. Management tends to respond to political, rather than to commercial, pressures. The capital assets of state businesses are often of poor quality because, it is claimed, it is always easier for governments to attend to more urgent claims on limited resources than the renewal of capital equipment. In the absence of any effective pressure from consumers whose money is taken in taxation, state industries tend to be dominated by producer interests.

Before the British water industry was privatized in 1989, for example, analysts estimated it to be undercapitalized by over \$11 billion. The result was a water supply that failed to meet European standards for quality and safety. Similarly, the post office had steadily cut back its services. First telegrams disappeared, then Sunday collection, then Saturday second delivery. These changes made life easier for producers at the expense of service to consumers. Most serious of all, the losses of state industries consume funds that are needed for private investment.

Privatization began against this background of steadily poorer performances from state industries. The Thatcher government started with the 1979 sale of a batch of shares in British Petroleum (BP), the state oil giant. The sale reduced the government's holding to below 50 percent. By British Treasury rules, this made BP a private company, and free to behave accordingly, seeking capital for investment on the market and making its own decisions on a commercial basis. The government sold more blocks of its BP shares later.

The military and civilian airplane manufacturer, British Aerospace, was sold in February 1981, followed by the radiochemicals group, Amersham International, and the state trucking group, National Freight Company, a year later. After this the pace began to accelerate. Britoil was sold in 1983, the British Ports in 1983, and Jaguar Cars in 1984, which also saw the sale of British Telecom, the state monopoly telephone service. It was sold as the largest company ever floated on a stock market, and attracted 2.3 million shareholders, many of them buying shares for the first time.

The Telecom sale demonstrated the government's desire to satisfy the various interest groups involved in public-sector operations. The previous management became the new board of the private corporation. The workers were given an allocation of free shares and were allowed to buy more from a reserved block on a basis that offered free matching shares. The telephone-using public was offered a choice if they bought shares: a share bonus if they held their shares for three years or reductions on their telephone bill. Rural dwellers were satisfied by a requirement that the new company continue its remote country services. Urban dwellers received assurances about the number of pay phones. Special services to the disabled were to be continued.

In short, the government "bid" for the support of virtually every group that might have objected. This pattern was to be repeated and refined in subsequent privatizations. The Thatcher government could take this tack because the private sector performed so much better than the state sector that the gains could be shared among many groups while still leaving a huge bonus for the government. Not only were subsidized losses converted into taxable profits, but the revenue from the sales accrued to the public treasury.

The policy of identifying and satisfying various groups made privatization a popular strategy, and a difficult one for subsequent governments to reverse. The opposition Labour party in Britain opposed every privatization, pledging itself to reverse each one, but later abandoned its pledge. The fact that share offers to employees were taken up by over 90 percent of the work force undoubtedly contributed to this about-face.

The British government usually aimed to set the opening share price at 10 to 20 percent below its expected market price. This was done for two reasons: to deal with the difficulty of pricing companies that had never properly kept accounts, and to encourage ordinary people to invest. Over the decade the number of private stockholders in Britain more than tripled. In 1979 there were four times as many people in labor unions as there were stockholders. By 1989 the stockholders outnumbered the union members (though in many cases they were now the same people).

The British privatization of nearly four dozen major businesses and several hundred small ones set an example not only of the techniques that could be used, but also of the success that could be anticipated. The formerly underachieving state-owned British industries outperformed the market average once they entered the private sector. With the exception of the oil businesses, which were marketed to professional investors because of their high-risk nature, the privatized stocks rose in value faster than the stock market average, as shown by periodic surveys in London's Financial Times and Privatization International.

The sale of public housing in Britain to its tenants attracted little international attention because there was no public flotation. But the purchase of their homes by people who had been living at subsidized rents made major economic impact. In 1979, 35 percent of Britons lived in state-owned homes at rents that failed to cover the government's costs. The annual expenditure from 1979 to 1988 of \$8.6 billion was not met by the income of \$4.5 billion.

The homes were offered at discounts based on the number of years of residence, starting with 20 percent below market price for a two-year tenant and rising to 50 percent for those who had lived there for twenty years. The largest discount was later raised to 80 percent. Turning tenants into homeowners brought major social changes in Britain, including the upgrading of the quality of houses as people began to invest in and protect their new assets. By 1988 the total revenues that accrued to government from housing sales alone surpassed those of all other sales combined.

By the late eighties the British Treasury was receiving annual revenue from privatization sales averaging \$8 billion, while total government revenue was roughly \$300 billion. The revenues from privatization helped the Thatcher government cut income taxes over the decade from a bottom rate of 33 percent down to 25 percent, and from a top rate of 98 percent down to 40 percent.

Other countries were anxious to share these advantages for their own state industries. Foreign privatization ranged from massive sales in advanced countries such as France and Japan to the sale of hundreds of small enterprises in developing countries such as Bangladesh.

The French program took place in the "cohabitation" period of a socialist president and a conservative prime minister. It was passed in mid-1986, with the first sale, glassmaker Saint Gobain, in December of that year. This, like the sale of the banking group Paribas in February 1987, was a huge success, attracting so much popular support that the shares were heavily oversubscribed, like the British sales.

The first nine companies were successfully sold before the world stock market slide of 1987 brought a halt to the French program. The French copied the British idea of reserving at least 10 percent of the shares for the work force, and of keeping a "golden share," a single share retained by the government, to prevent foreigners from gaining control of strategic industries.

Japan mounted large-scale privatizations, including its tobacco and salt monopoly in 1984; its telephone service (NTT), floated in 1986; and following that, Japan National Railways (JNR), the world's biggest sale. JNR was broken into six regional passenger carriers, one freight company, one firm to lease high-speed bullet trains to four of the others, and a ninth company to sell JNR landholdings, estimated at \$50 billion. No advanced economy outside Britain even approached this scale of privatization.

Following the collapse of communism in eastern and central Europe, first Poland, Hungary, and Czechoslovakia, then Romania and several of the former Soviet republics began to privatize. The problems

in these economies, blighted by more than forty years of command planning and central controls, were very different from those faced by the advanced economies. Decades of low wages meant that little wealth was available for investment, and no stock markets existed on which to make sales. Very often, there were no laws to protect or even permit private ownership, much less the supporting infrastructure of contract law and financial support services such as banks and accountants.

For this reason the formerly socialist economies found themselves forced to blaze a new trail of privatization, sometimes using the distribution of "coupons" to the population as a means of spreading ownership. Very often some degree of "informal" privatization was permitted, in which management effectively expropriated what had been state property. Unlike Britain, which had about 10 percent of its economy in state hands and had sold three-fifths of it over ten years, the socialist countries were now faced with privatizing 60 to 80 percent of their economies within half that time. The scale and the problems were of altogether different proportions.

By the beginning of the nineties, hardly a country in the world did not have a privatization program. Many countries learned from the experience of the early leaders. These included the techniques of writing off past debts, allocating shares to workers, splitting monopolies into competing elements, and establishing new regulatory agencies to calm public fears about the behavior of the newly privatized operations.

By restoring market incentives and commercial reality, privatization achieved a worldwide reinvigoration of ailing state-owned industries. It diverted billions of dollars from the support of loss-making government concerns into the expansion of wealth-creating private businesses. It augmented growth rates and made tax reductions possible. Britain, which in the seventies had one of the lowest growth rates in Europe, enjoyed one of the highest in the 1980s.

It went from one of the highest-taxed countries to one of the lowest. Privatization contributed, in large measure, to the revival of confidence in capitalism and the market economy, evidenced by the large number of countries which turned in that direction, and to its eventual triumph over the rival system of central planning, controls, and state ownership.