The effects of privatisation on government economics essay

Privatization is the act of reducing the role of government, or increasing the role of private sector, in an activity or in the ownership of assets. Privatization has been prescribed as a means of improving the efficiency and profitability of public enterprises, which are not performing well. The privatization of government owned enterprises is nowadays a large-scale process for the transfer of state owned enterprises to the private sector.

The major aim of this policy is to reduce the drain on the government resources, caused by the persistent losses of public enterprises, and to create greater opportunities for private investors to expand and modernize these enterprises with the aim of liberalizing the economic environment for rapid industrialization.

Privatisation of SOEs is a multi-faceted, complicated as well as politically and socially sensitive process. A well-devised privatisation plan of SOEs essentially takes care of all the stakeholders, which include labour, consumers, investors, government and the economy. It helps to promote capital, goods and labour markets in the country. The privatisation process in Pakistan has passed through different phases and it has been very instrumental to redefine the relationship of private and public business with the government institutions.

HISTORY

The concept of privatisation is not new to the policy makers of this country. It may be traced as back as in 50s, when Pakistan Industrial Development Corporation (PIDC) was established in 1952 to boost up the industrial development in the country. During the 50s and the 60s, public sector used to invest in non-traditional activities especially where the gestation period was long and

private sector was reluctant to invest. The tide of nationalisation, which swept the whole economy in the first half of 70s, was reversed in 1977.

While a large number of private sector units were nationalized and public sector expanded at a rapid rate in the 70s, an effort to divest public

sector enterprises were made during the mid-eighties. However, the efforts to divest shares

worth Rs 2 billion of various profit making public enterprises in the mid-eighties and 14 loss

making industrial units for divestiture in 1988 did not succeed. Similarly, out of the six

profit-making corporations identified for partial divestiture in 1990, only 10 per cent shares

of Pakistan International Airlines could be divested. The slow pace of privatization led to

the establishment of a Privatization Commission on January 22 1991, which offered 105

industrial units, four banks, and two development financial institutions for sale. Subsequently, initiatives were undertaken for privatization of thermal power units of the Water and Power

Development Authority (WAPDA), private sector managment of some sections of Pakistan

partial divestiture of the Telecommunications Corporation of Pakistan (TCP).

Although the PC mandate initially restricted to industrial transactions, by 1993 it had expanded to also include Power, Oil & Gas, Transport (aviation, railways, ports and shipping), Telecommunications and Banking and Insurance. all the remaining manufacturing units with the exception

of Pakistan Steel, have been placed on the privatization list.

To date, Government of Pakistan had completed or approved 167 transactions at gross sale price of Rs 476. 421 billion.

Some of the Recent examples are Kot Addu Power Plant (KAPCO), Oil & Gas Concessions, United Bank Limited, Habib Bank Limited, KESC and PTCL.

Rationale

Objectives of privatization at different points in time have varied. During the period

1988-90, privatization was pursued to divest 14 loss making manufacturing units and raise

funds by selling shares of profit making units for retiring public debt and thus reducing debt servicing (See Rothschild, 1990). Privatization Commission in 1991 did not explicitly spell

out the basic rationale for privatization. Nevertheless four major objectives that could be

discerned from various statements issued by the government are:

- Improvements in the level of efficiency in the production processes;

- Reduction in the debt burden of the government and fiscal deficit;

- Broad-basing equity capital; and

- Releasing resources for the physical and social infrastructures.

The objectives of privatization outlined in the publication cited in the privatization commission’s Mission statement are:

- Creation of market based economy

- Promoting the expansion and efficiency of private sector enterprises

- Encourage competition, specially by abolishing the monopolies and promote

integration of the domestic economy into the world economy

- Support wider capital ownership and encourage employee owner relationship

- Establish and develop capital markets for mobilization of domestic savings

- Reverse the flight of capital abroad and repatriate capital already transferred

- Mobilization of private sector resources for future investments

- Promote economic flexibility

- Maintain or create employment

- Improve the quality of goods and services

- Maximise receipts from privatization to pay off public debt and reduce the public

sector deficit

- Substantially reduce the size and scope of the public sector

- Substantially reduce the financial drain of public enterprises on the government

- Decrease the opportunities for misuse and corruption of public property by government

officials and public sector managers.

These objectives are indeed laudable but quite ambitious. Though, privatization is

neither necessary nor sufficient for realization of some of these. For example, mobilization of savings, reversing the flight of capital and promotion of savings and investments do not

need privatization and they can not be achieved just by pursuit of privatization. In the

following we examine the arguments that privatization lead to reduction in fiscal deficit,

improvement in the efficiency levels, broad base the ownership and higher level of investment

in the physical and social infrastructures.

Reduction in fiscal deficit

Privatization in a perfectly competitive market with complete foresight may have no

impact on fiscal deficit because the expected sale price determined as the reserve price of

assets would be exactly equal to the discounted flow of net benefits. If the private sector

offers higher prices than the reserve price, fiscal deficit situation would improve. However,

the private sector's willingness to do so, of course, depends upon the assessment of profits in the post-privatization period and willingness to share the expected higher profits with the

public sector.

Increase in the efficiency levels

While private producers are forced to reduce their cost to minimum for their survival,

public firms may not make sufficient efforts to reduce production costs as they are under no

compulsion to ensure an acceptable return to the equity holders. Similarly, private managers

have more flexibility in taking the decisions than the public sector firms. Moreover, public

investments may be influenced by political considerations, thus adversely affecting the

allocative efficiencies. While in a competitive framework, privatization would always help

in realising allocative efficiency, X-efficiency and non-market efficiency gains, in a

monopolistic framework this is not necessarily true. The cost in public monopoly at equilibrium point may not be minimal unless it is effectively regulated. Whether privatization would

result in higher level

of efficiency or not is an empirical question. For conflicting evidence see Stigler (1975);

Wolf (1979), Baumol (1996) and Kemal (1996).

Releasing the resources for physical and social infrastructures

A well functioning and profit making public enterprises can also be divested for releasing

the resources for development of infrastructures if the resources for infrastructure are not

available.

Broad-basing of ownership of equity capital

Broad-basing the ownership of equity capital is for the reasons of distributive justice.

But it presupposes that small investors have sufficient investible funds to buy the shares of

public industrial enterprises and that unless the public enterprises are divested shares are not available to them. Both of these assumptions may not always be valid. Moreover, the assumption is that allocating a part of the shares at face value for the workers would result in improvement in the welfare for these workers.