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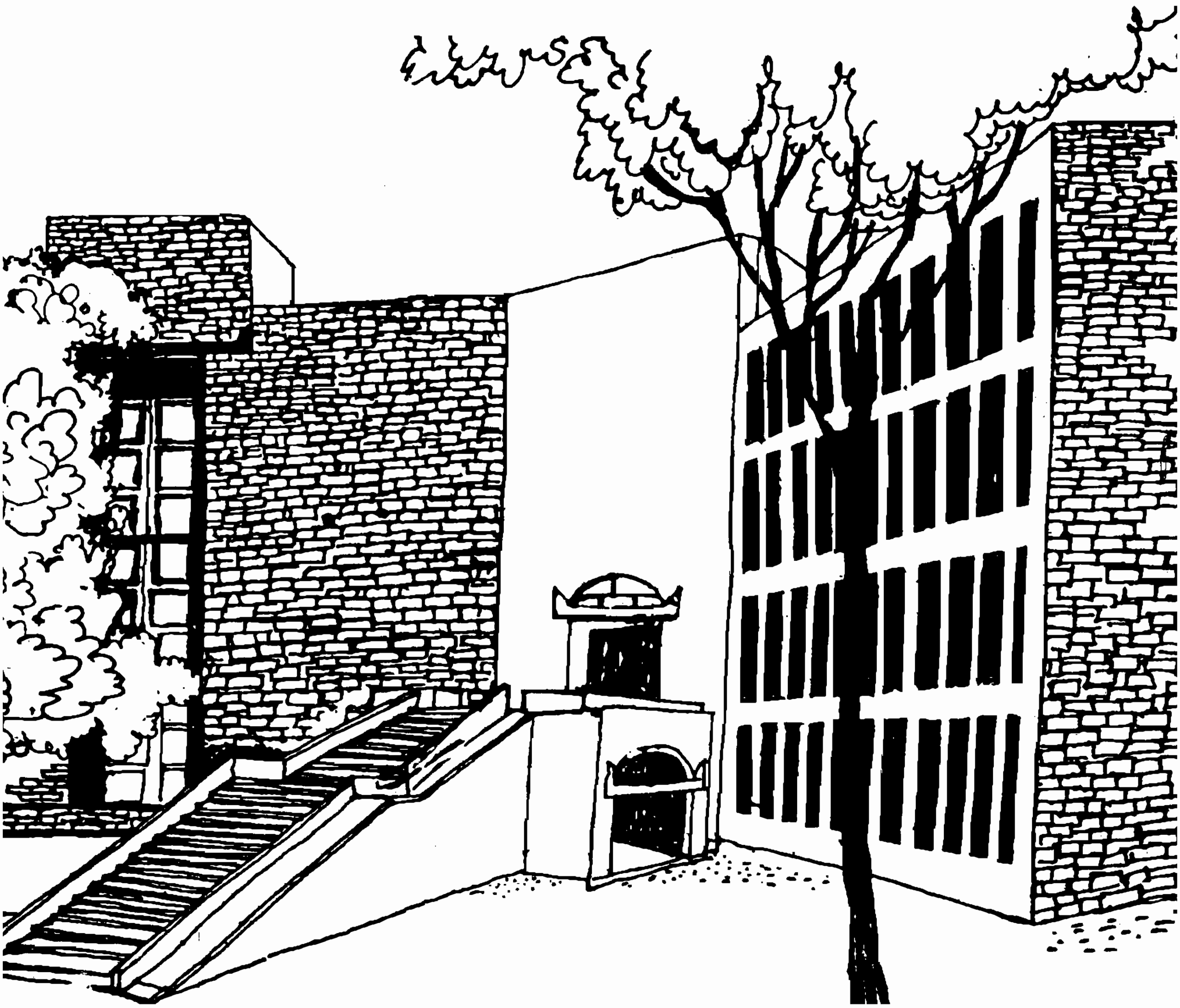

PRIVATISATION PROGRAMME IN BRITAIN AND EAST EUROPEAN COUNTRIES: SOME LESSONS FOR INDIA

By

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ABSTRACT

In 1979, when the Conservative party was elected in the UK, it was no more than a gut feeling, impatience and inability to improve the working of the nationalised industries, it was felt that the *invisible hand* of the market may hold the key to success of these industries. Nevertheless, on surface it was projected by the Party and the government that the present value of aggregate net benefits to UK consumers would be higher when the state owned companies would be under private management.
In India, the debate about improving the performance of PSUs started as early as late seventies as PSUs were not generating enough resources and as a whole were a drain on the public ex-chequer. The main issues in this debate, in India, are private vs public ownership, valuation of public enterprise shares and exit policy for labour and enterprises. A successful privatisation programme shall not only unshackle the economy but also give more time to politicians to concentrate on managing the economy rather than meddling in day to day affairs of business enterprises.

Privatisation Programme in Britain and East European Countries: Some Lessons for India

'Selling of the family silver....'

Lord Stockton

1. Origin of Privatisation Programme in the UK

The British government's proudest achievement in the eighties had been the privatisation programme as it has not only transformed the standing of the British economy in the eyes of its peers but also this programme has been accepted by most of the countries. Governments of other countries are trying to emulate the British experience and hope to revitalise their state sector firms. One might hasten to add that the birth place of *Keynesianism* also provided antidote for it. In 1979, when the Conservative party was elected it was more like a gut feeling and impatience and inability to improve the working of the nationalised industries, it was felt that the *invisible hand* of the market may hold the key to success of these industries.

It is difficult to pin-point a single criteria which can encompass the whole of the British privatisation programme as the Conservative government was accused of a hidden agenda. The word *privatisation* was not mentioned in the 1979 manifesto of the Conservative party. Nevertheless, on surface it was projected by the Party and the government that the present value of aggregate net benefits to UK consumers would be higher when the state owned companies would be under private management. The benefits could be measured in terms of the level of output, the quality and variety of goods and services available and effects on employees, exports and tax-payers. The programme was intended to change motivation of management toward profit making and it was believed that under private ownership resources would be used as consumer dictated, rather than the wishes of the government which reflected short term political pressures and problems of managing the public sector's overall demands for capital (De Alessi, 1974 & 1980).

It was also expected that the transfer of ownership will be associated with some change in the types of incentive systems that can be offered to managements. Thus under private ownership, rewards can be linked to the company's share price via share ownership, while poor financial performance might be penalized by the threat of takeovers by another firm.

2. Privatisation and what it means in the U.K.

'We must roll back the frontiers of the state.'

Ex-Prime Minister, Mrs. Margret Thatcher

Before Mrs. Thatcher's re-election in June 1983 the privatisation programme included only those firms that operated in a competitive environment. Firms like British Aerospace, Britoil, Cable and Wireless and Enterprise Oil are important and big companies but they do not enjoy monopoly power and hence when they were privatised they did not pose any major regulatory problems. The privatisation of British Telecom (BT) in 1984 reflected a shift in policy. Regulated private enterprise was now regarded as superior to a state owned natural monopoly, where competition was impractical. Under this philosophy the scope of privatisation is unlimited. At this point let us understand the terminology used for privatisation programme in the UK encompasses liberalisation of the economy.

i. Denationalization: the sale of public sector assets. It includes not only nationalized industries but also companies and local authorities' council houses.

ii. Deregulation: (a synonym is *liberalization*) the removal of legal barriers to entry to a previously protected market to allow private enterprise to compete; i.e in a deregulated environment public sector provision (financing) and public sector production are replaced by private provision and production. An example of this is bus services.

iii. Franchising: the public sector continues financial provision but for private sector production. Examples of this type are refuse collection, street cleaning by local authorities, and meals and laundry services in hospitals which are contracted out.

3. Benefits to economy, government and consumers

Economy:

The British economy posted a substantial improvement in its productivity in the eighties compared with the post-war period upto 1980. Some critics have argued that this rise in productivity is the effect of high unemployment; but they have missed the point. No doubt that unemployment rate was high till mid eighties, but gross employment was also all time high and the rise in unemployment can be largely attributed to demographic factors.

Table-1: Selected UK Economic Indicators

	1979	1981	1988
GDP[1]	100.0	96.7	121.0
Manufacturing Output	100.0	85.9	107.8
Output/head	100.0	99.9	121.3
Manufacturing output/head	100.0	99.5	148.1
Unemployment rate	4.9	9.4	8.6
Retail price inflation	13.4	11.9	4.9
Real earnings	100.0	105.3	126.0
Profit share (% of GDP)[2]	20.4	16.5	21.0
Public sector debt repayment (% of GDP[3]; -ve means borrowing)	-6.4	-4.1	2.4
Government expenditure (% of GDP)	43.4	46.1	38.6
Tax revenue (% of GDP)	34.1	37.8	37.2
Current account (% of GDP)	-0.3	2.7	-3.1

1. Average of income, output and expenditure measure
2. At factor cost
3. At market prices

Source: *Economic Trends, Employment Gazette* and *New Earnings Survey* (various issues)

Table-2: Comparative Inflation and Unemployment Performance

	Inflation[a]		Unemployment[b]	
	1980	1985	1980	1985
Germany	4.9	2.3	3.0	7.2
France	11.6	5.9	6.3	10.2
Italy	21.5	9.2	7.5	10.1
Japan	3.9	1.5	2.0	2.6
Sweden	11.9	6.9	2.0	2.8
United Kingdom	19.1	5.8	6.4	11.2
United States	9.1	3.0	7.0	7.1

a. GNP/GDP deflator
b. Standardised unemployment rate

Source: *OECD Economic Outlook*, December 1988

Figures in tables 1-4 suggest that the competitiveness of the economy compared with its main trading partners improved during the eighties. An important question now is whether the British economy that grew at a rate of 2% p.a. in the long-term in the sixties and the seventies has improved its long-term growth rate to 3% p.a. which it achieved in the eighties. The answer would be known in the mid-nineties, after the British economy comes out of its present recessionary phase.

Table-3: Productivity Growth (GNP/GDP per worker; per annum)

	1967-73	1973-79	1979-83	1983-87
Germany	4.4	2.2	1.3	1.7
France	4.4	1.3	1.6	2.1
Italy	4.9	1.7	1.0	2.5
Japan	8.4	3.0	2.5	3.5
United Kingdom	3.3	1.1	2.1	2.3
United States	0.9	0.0	0.2	1.4

Source: *Economic Trends* and *OECD Economic Outlook* (various issues)

Table-4: Relative Output/Worker (US=100 at 1980 Purchasing Power Parity)

	1951	1960	1970	1980
Germany	37.1	50.9	63.5	77.9
France	38.9	48.2	63.9	80.7
Italy	34.1	57.9	67.9	79.4
Japan	16.0	23.5	46.1	62.8
United Kingdom	55.2	56.7	60.4	66.5

Source: *OECD National Accounts* (various issues)

Government:

'Public expenditure is more like a curate's egg than a shrinking cake'

Ex-Chancellor of the Exchequer, Nigel Lawson

The British government has definitely benefited from the privatisation programme. First, instead of meddling in the industrial affairs it can concentrate on its main business of governing the country. Second, government having removed most of the hidden subsidies in the economy, it does not have to resort to fire fighting measures as soon as public sector borrowing requirement increases a little (table - 1 shows that government expenditure was more or less in line with the tax revenue in 1988). The proceeds of the privatisation programme eased the growth pains as the British government did not have to cut its expenditure drastically in the eighties and was still able to achieve low inflation rate and high growth rate (tables 1 & 5).

Table-5: Treasury Receipts (in £ billion)

Financial Year	£million
1979-80	377
1980-81	405
1981-82	493
1982-83	488
1983-84	1,142
1984-85	2,132
1985-86	2,702
1986-87	4,400
1987-88	4,650
1988-89	5,000
1989-90	5,000

Source: HM Treasury (1985, 1986, 1987)

Consumers:

As long-term investors the British people are going to enjoy long term benefits from a lean and competitive economy (table 6). As *stags*[1] some have already made some money from the privatisation programme. As tax-payers they pay less tax and having reduced top income tax rate for individuals and for companies there is a built-in incentive in the economy for them to earn more. As consumers of erstwhile public sector companies they may be able to get better product and services at a competitive price. Finally, they would be able to enjoy long term benefits in terms of pay, dividends and goods from an efficient economy.

Table-6

Company	sale price/ share	date of floatation	1987 value/ share	present val/ share*
British Aerospace	150p	1981	639p	324p
Cable & Wireless	168p	1981	397p	579p
Amersham Intl.	142p	1982	598p	421p
Britoil	100p	1982	292p#	
Asso. British Ports	112	1983	527p	348p
Enterprise Oil	185p	1984	275p	463p
Jaguar	165p	1984	562p#	
British Telecom	130p	1984	307p	323p
British Gas	50p	1986	112p	254p**
British Airways	85p	1987	173p	215p++
Rolls-Royce	85p	1987	142p	122p^^

Have been merged with other companies.
** face value 135p, ++ 125p, ^^ 170p
* Source - Financial Times, Dec. 19,1991

4. The Efficiency effects of privatisation programme : An example - Telecom industry

Privatisation programme has been criticised in the U.K. by some academics for giving too much importance to ownership of industry at the expense of effective competition (Kay & Thompson, 1986). Whether there had been any improvement in performance over the previous state has not

1. A stock exchange colloquialism for some one who applies for a new issue of securities in the expectation they will immediately rise to a premium on the issue price, and can be sold at a profit before the issue price has to be met.

been investigated at microeconomic level. In case of telecommunication industries one of the social obligations, under nationalised industry regime, may be interpreted as the need to keep prices to customers down because it supplied necessities for which demand was inelastic. This objective was reflected in the waiting lists for telephone connections, which a purely efficiency based policy would have solved it by price rises. However, there is some statistics available from OFTEL about prices which indicates that privatisation has reduced prices (table-7).

Table - 7 BT Regulated Price Changes 1984-86 (%)

	Nov. 1984	Nov. 1985	Nov. 1986
Exchange Lines			
Residential	7.1	8.5	3.7
Business	6.8	8.8	3.9
Local Calls			
Peak	6.8	6.4	18.9
Std.	6.8	6.4	6.4
Cheap	6.8	6.4	-3.6
National Calls (< 56 kms)			
Peak	6.8	6.4	1.6
Std.	6.8	18.3	1.1
Cheap	23.1	6.4	2.7
National Calls (> 56 kms)			
Peak	-14.8	-6.2	-16.0
Std.	-13.9	-4.9	-17.0
Cheap	6.8	6.4	-6.2

Source: Oftel 1988

One another measure applied to study performance of privatised and nationalised industries is the total productivity index (Pryke, 1982; Molyneux and Thompson, 1987). Table - 8 shows that, although the US Telecom system was run by a state regulated , privately owned company and the British system by a state organisation, the average pace of productivity growth was not too dissimilar in the two industries, given the erratic behaviour of British output and total productivity. The two country comparison is interesting as two countries grew roughly at the same rate so the scope for raising total productivity growth through scale economies may not have differed greatly between the two networks. With the regime change inaugurated by the Telecommunication Acts of 1981 and 1984, the TP cannot be calculated in the same form for the privatised industry. However, Table - 9 presents the best available calculations of post-privatised TP performance, which suggests an improvement of almost one and half percent a year.

Table - 8 UK and US Average Annual Telecom Growth 1957-79

	UK	US
TP	3.01	3.45
std. dev.	4.17	1.28
Telecom Output	8.22	7.41
std. dev.	3.14	1.37

Source: Foreman-Peck & Manning (1988)

Table - 9 BTs Total Factor Productivity and Output Growth 1985-88

	TFP	Output
1985	2.9	7.8
1986	4.0	5.9
1987	3.4	8.8
1988	4.8	6.2
avg.	3.8	7.2

The total factor productivity indices suggest (table 9) an improvement in the productivity performance of the telecommunications industry because of privatisation, without taking into account the full range of BT's services or the quality of services. These are not major exclusions as calls and line rentals accounted for two thirds of BTs revenue. It is doubtful that BT, under the state monopoly, could have introduced the range of services , which it did. Improvement of services, on the other hand, can directly be ascribed to private ownership. Why then there are complaints from consumers. Most likely that the losers, households, voiced their indignation and gained publicity whereas the gainers, business, had no interest in advertising their gains.

5. Privatisation in Practice

The City's merchant bankers played an important role in the British privatisation. They treaded a very cautious path. In the early eighties as they were not sure about the market reaction, a small proportion of the shares were available directly to the British public. In the mid-eighties, however, a substantial proportion (40%-60%) was reserved for the public. Thus, it can be argued that the government maximised short-term political vote-catching return at the expense of resource optimization's. In the early eighties the shares were floated at a lower than a fair value to establish 'people's capitalism'. The programme achieved the desired results in the U.K.; a Treasury-commissioned survey estimated that in 1987 nearly 20% of the adult population in the country owned shares in publicly quoted companies compared with only 7% in 1979. It has been suggested that the long-term aims of the Conservative government in the eighties had been:

i. a share-owning democracy;
ii. a property-owning democracy.

Both aims blossomed as public discovered the taste of capital gains. Council houses which were sold at a fraction of their market value went a substantial way to prepare a favourable climate in which other public sector companies could be privatised. Although one or two issues failed[2], the first-time buyers who had discovered the meaning of *stagging* enthusiastically supported the programme and actively took part in it[3]. Both type of people -- long-term investors and speculators -- profited from the privatisation programme (table-6) Between 1983 and 1987 all those public sector companies were brought to the stock market were oversubscribed. To solve the problem of massive over-subscription a lottery was used to identify the lucky applicants (ex. The Trustee Savings Bank in 1986) and/or scaling down system of allocation (BAA, Rolls-Royce, British Telecom etc.) was used.

One of the main selling point to the public, according to the government, was that as the legal transfer of assets would end the meddlesome interference of government ministers and the Whitehall in the affairs of the former state-owned firms and corporations, the enterprises would provide better services to the consumers. In some cases, however, the government holds a 'golden share' which gives it the exclusive right to veto any takeover which it would regard as not in the strategic interest of the country. Such a share is held by the government in British Aerospace, Rolls-Royce, Britoil[4] and the Royal Ordnance. The privatisation programme has been accepted as a fact of life by majority of the public as is evident from softer and softer stand being taken by the opposition parties in their manifestos and in the Parliament. Before privatisation all firms were nursed and posted healthy profits for two to three years before they were put on the market. During the growth period of 1982-90 almost all the newly privatised

2. In 1982 more than two-thirds of the available shares of Britoil were unsold.
3. In Nov. 1987 the privatisation programme of British Petroleum flopped, but that was due to very low esteem which the stock market enjoyed after the October 1987 Stock Market crash.
4. The government in 1987 waived its right of veto when BP made a hostile takeover bid for the newly privatised Britoil.

companies showed a higher profit and growth, and generally all expanded their labour to meet higher demand[5].

6. Criticism of the Privatisation Programme.

One of the arguments advanced in favour of privatisation is that a private sector firm is efficient and a public sector firm is inefficient because of sub-optimal utilisation of its resources and this results in ever growing subsidy which a government has to provide every year. As noted earlier, in case of the British privatisation all the public sector firms showed a healthy profit before they were privatised. The critics have argued that if firms like Jaguar, Ferranti, British Airways etc. could be efficient under public ownership for couple of years, they can remain profitable year after year as well.

In a class-ridden Britain, employees' unions of companies like British Telecom and British Airways opposed privatisation of their company as they feared job losses at a massive scale[6], but they were guarantied a substantial portion of shares in their companies at a favourable rate. In 1987, about 3.5 million workers owned shares in their companies and 96% of the workforce in the British Telecom are shareholders of their company.

The aim of the supply side reform of privatisation programme in the U.K. was to increase allocative and productive efficiency. If this form of industrial policy is successful then the performance of the British economy will improve. The result seems to be in favour of the reforms. The British economy, being labelled as the sick man of Europe by other West European countries, witnessed rejuvenation in 1980's. Still there is no definite way to prove that the reforms have changed the structure of the economy and the economy is in better shape than ever before. However, it is true that the performance of the economy in terms of productivity has improved dramatically, trade union reforms have led to reduced strikes and financial deregulation has intensified competition among banks and other financial institutions (table 6).

The privatisation programme is often opposed on the grounds that it leads to unemployment. The UK privatisation programme does not support this view. As a matter of fact during the later half of her second term and the third term of Mrs. Thatcher, when the programme was in full swing, unemployment reduced substantially and standard of living of people also improved.

5. For example, in 1981 Jaguar made only 14,000 cars with 7,000 workers; in 1987 it produced 47,000 cars with 13,000 workers.

6. Till the mid-eighties British unemployment went on rising and peaked at 3.3 million in mid-1986. But as noted earlier it was more due to demographic factors rather than the privatisation programme.

7. Regulating newly privatised industries

In public policy debate in Britain, it has often been claimed that the privatisation of firms with market power tends to improve internal efficiency; but at the risk of worsening allocative efficiency unless some of the effects of profit seeking behaviour are held in check by sufficiently rigourous competitive and/or regulatory constraints.

Since 1984, the UK has privatised five major industries which had significant 'monopoly' element and are considered to be 'natural' monopoly. These are telecommunications, gas supply, airports, water and electricity. Before privatisation except for the airports, there was no regulating body to supervise other industries. It was thought that governmental control and public accountability through the parliament is enough to regulate these industries. In the new market driven environment the erstwhile public sector monopoly industries require a regulating authority for each industry. Although there are some similarities in the operation of the regulating authorities, differences exist in substance and detail. Regulation of these industries, because of their nature, is necessary not as an *aid* to the operation of competitive markets but as an *adjunct* to or *substitute* for competition in circumstances where entry is either slow, unsustainable or inefficient. The regulating mechanism practised in the UK for the above-mentioned industries may be broadly categorised as:

a. Competition Between Existing Firms : In this method, two or more competing units are formed from one single public sector company. For example, former CEGB (Central Electricity Generating Board) has been divided into several generating companies. Another way to introduce competition is by allowing earlier two or more non-competing industries to compete. An example of this is water and sewerage companies in supplying services to greenfield sites.

b. Entry : The classic instrument of competition is entry: above normal profits made by an incumbent encourage new firms to supply the good or service. Threat of entry itself is enough to prevent the emergence of excess profit. In this way a competitive element is introduced in the telecommunication industry. A new entrant, Mercury Telecommunication, is allowed to give connections and use the BT network at an approved cost-based prices determined by the regulatory authority (OFTEL).

c. International Competition : This is a special case of competition by entry; gas and electricity industry in the UK are going to have competition from the French electric generating companies and the Norwegian gas companies.

d. Yardstick Competition : This method operates within the framework of regulated prices, with indirect competition between utilities providing a yardstick or bench mark which the regulator can use for determining a standard level either of costs or of annual price reduction. This method, if used for the water industries, the annual price rise allowed would be average costs achieved by them all. However, the water regulatory body (OFWAT) has indicated that it may use variety of techniques of comparison before allowing the price rise.

e. Public Sector Competition : Under this form private companies are allowed to compete directly with a public sector company. Electricity generation by nuclear power plants is in competition with conventional electricity generating plants and local authorities' owned airfields compete with BAA airports.

f. Capital Market Competition : It is argued that threat of takeover through the stock market would ensure efficiency in production and underperforming management would be thrown out by the new management. As this method can be abused by a big producer to form a monopoly, the government holds a golden share in all the industries, which were in the public sector earlier, to veto a merger.

8. Privatisation in the East European countries

The lack of market environment is a strong argument for privatisation, but at the same time it is an obstacle to privatisation programme. The lack of legal and regulatory framework which exists in a developed financial market is absent in the East European countries. It is believed that anti-monopoly policy, domestic price liberalisation, import liberalisation and reforms of the tax laws are all expected to influence enterprise behaviour.

Hungary

Hungary introduced a legislation to permit a wide range of small economic units, small enterprises etc. in early 1980s. As a result, by the late 1980s, many of Hungary's shops and small business had already been leased out to existing managers, so that Hungary was well ahead of the other two countries studied here in this respect. Hungary privatised its state owned industries through the State Property Agency (SPA) as owner. The agency was established in February 1990 and it privatised the state firms in much the same way as done in the UK.

For bulk of the state enterprises, the Hungarian programme recognizes three types of privatisation: state initiated, enterprise initiated, and externally initiated. In the first category, about 500-600 firms should be privatized between 1991-93. Those expected to have a future will mainly be sold through the stock exchange, while the weakest firms will be reorganised or entirely liquidated. A variety of methods of sale will be used, including open and closed auctions, share issues, and leasing of state assets. In the second category, about 300-400 firms are expected to be chosen to be privatized in the next three years, while the third category is expected to be especially important for small and medium enterprises. It provides an opportunity for any potential buyer of a firm, domestic or foreign, to make a proposal to the SPA.

Market institutions like commercial banks, a bond market and a stock exchange market are well established and in November 1990, a new law on competition and prices, enterprise law and other legal arrangements were introduced. These laws appear to be working quite satisfactorily. However, doubts remain about the banks, since they still hold bad debts of poorly performing enterprises. As a result, it is most likely that bank balance sheets will require major restructuring as part of a large scale privatisation programme.

Poland

The stabilisation programme introduced at the beginning of 1990 involved elimination of shortages, new structure of relative prices and increased competition due to trade liberalisation. This programme caused a 'creative destruction' and many small scale privately owned enterprises closed down but it also created opportunity for many private entrepreneurs to open up new enterprises. In 1990, private enterprises increased two and a half times in number while many state enterprises grew by three percent only.

Originally, in 1989, the mainstream approach to privatisation in Poland was close to the British approach, with careful valuation of assets, and their sale to individuals, to Polish private firms, and to foreign investors through public offerings or negotiated sales. This approach faced the problems of the lack of domestic capital and valuation of the existing enterprises. The government, sensitive to political pressure, has changed its position and significantly diversified the methods of privatisation. The 1990 Act on Privatisation provides a general and flexible framework for the privatisation process, allowing for different methods of privatisation and different forms of ownership: free distribution through vouchers, the sale of shares; individual and communal property, employee ownership. According to the law, state-owned enterprises can be privatised at the initiative of their own management and workers' council either by transforming the enterprise into a Treasury-owned joint stock company whose shares should be disposed of within two years, or the liquidation of an enterprise in order to sell its assets, use them as a contribution to a new company, or lease them for a fixed period. Poland has also adopted an unorthodox method of privatisation for large firms requiring a diversified ownership structure. About 70 percent of shares of such firms, after converting into a joint stock company, would be distributed freely among citizens, workers, the Social Security Fund and other financial intermediaries. Rest of the shares, the State will sell off at a later date.

Czechoslovakia

Unlike some of the other East European countries, Czechoslovakia has a balanced macroeconomic position. It has very little external debt ($8.7 billion) and as a result of prudent fiscal and monetary policies in the past, she has a very little monetary overhang (i.e the stock of forced saving held by the population). But it has far less experience of private sector activity, high dependence on 'Soviet' oil and gas, and its high exports to the erstwhile Soviet Union. There are significant social resistance to the removal of consumption subsidies. An unusual feature of the Czechoslovak privatisation process is the Law of Restitution. The law covers all the nationalised enterprises since 1948. According to this law, a former owner has six months to notify a claim, and once approved, compensation takes the form of physical restitution of the asset concerned.

The privatisation process in Czechoslovakia falls in two categories: the small-scale programme involving sales of businesses for cash; and the large-scale programme based on the distribution of vouchers (or investment vouchers) to the population. Both parts of the programme will make use of auction.

9. Difference between the UK and the East European countries privatisation programme

The privatisation programme in the East European countries is at a much larger scale than the privatisation programme of the UK. In the UK it took place in an already established market environment, complete with all the required supporting institutions and infrastructure. The British privatisation programme was prepared for a long time . For example, in 1970-71 telecommunication department was removed from the PTT (Post, Telegraph and Telephones) department and worked as a single unit. The British Telecom was always working in the market place and there was no problem of managerial input and the network of financial intermediaries. In a command economy, where an enterprise is a part of 'Gosplan' or 'input-output matrix'; it is different. Britain privatized only 5% of their industries in 10 years time whereas the East European countries are attempting to privatize as much as 50% or more of their industries in three years time.

10. What is expected from the East European privatisation programme

As noted earlier, the Hungarian privatisation programme envisage selling of over half the capital stock of the country within three years using the British approach. It is doubtful that it can be achieved. It is more likely that the programme would proceed slowly. To accelerate the process the authorities may resort to selling the state enterprises at low prices or give-away prices. Both methods would entail lower revenue for the State and hence raising the taxes or cut-back in the expenditure to accommodate lower revenue.

In Poland and Czechoslovakia, where many shares will be given away and the proceed of the privatisation process is not supposed to contribute to the state budget, there is little doubt on the feasibility of the proposed timing. However, a very serious problem for both countries is the sheer administrative complexity of privatisation using vouchers. No one has done it before, and the banking system in both countries is ill-equipped to cope. However, with outside help, and a good deal of luck and persistence, the programme may well be managed.

One may wonder that with all the problems why these countries want to go ahead with privatisation process. Answer is, that it is believed, that political freedom can only be sustained by economic freedom.

11. Some Lessons for India:

The main issues in this debate are private vs public ownership, valuation of public enterprise shares and exit policy for labour and enterprises. In India, the debate about improving the performance of PSUs started as early as late seventies as PSUs were not generating enough resources and as a whole were a drain on the public ex-chequer. Some discussion about privatisation also took place in the late seventies but apart from some isolated instances nothing was done. Since early 1991, after India drew first tranche from the IMF the debate about privatisation has gained momentum.

The issue of ownership in the UK and other countries which have gone through the path of privatisation was clear cut right from the beginning. The Thatcher government and the newly elected governments' of East European countries did not want state to own and manage enterprises as it was felt very strongly that government's business is to manage the economy. Most of the enterprises were mismanaged under government ownership rather than managed. To solve this problem, only way out was to divest itself of ownership. In India, on the other hand , not only labour but a majority of intelligentia still thinks that government should own these enterprises. Their is fair amount of distaste for people making money and distrust towards those who are driven by profit motive. They give example of complex economic structure in India where a large proportion of stocks of many private sector enterprises is owned by financial institutions. Many of such companies are managed by large business houses or by professional managers who do not have a majority stock holding. In this way, the argument goes that, there is indirect public ownership anyway. They ignore the fact that the directors, professional or other individuals who hold majority of privately held stock and hence enjoy the right to manage that company take ultimate risk for the enterprises' failure or success and buck stops with them. It is the ultimate financial risk, failure of loosing management control and fear of takeover by another company or group through stock market brings out the best among them.

This is what a governmental control of an enterprise cannot provide. Civil servants do not have to bother about takeover risk and politicians, whose interference in publicly owned companies is legendary, do everything in public interest where 'public' means mainly he himself or his party at most. They neither have a fear of takeover after making a financial mess nor they have to pay the price of indecision as public purse relative to the biggest enterprise in India is quite large. The fountainhead of state enterprises' financial profligacy and politicians meddling in enterprises' day to day affairs runs from their dependence on budgetary allocation. Therefore, 'wonder' manager of many Indian public sector companies and now Chairman of the Krishnamurthy panel favours private ownership. The lesson India can learn from the UK privatisation programme and also from our successful public sector managers is that a better financial performance and productivity can only be achieved when government divests itself of ownership.

Valuation of public sector enterprises' stock is not easy. Secretary of Public Enterprises thinks that the government has done a smart job and has got as much money as possible for the government from the disinvestment. He is partly right because making prospective stock buyers aware of a public sector company is a time consuming process. Some economists think that all the media hype and advertisement is expensive and unnecessary drain of resources. Nothing can be further from truth. The information about cost of advertisement campaigns of major UK floatation is hard to get. But, from whatever little has been made public, we know that expenses as a percentage of proceeds in case of British Telecom (BT) was 6.8% and that in case of British Gas was 6.4%. The expenses include direct sale costs like underwriting & commissions, banks and registration costs, marketing, advisers fees and small share holders incentives like bill vouchers and bonus shares. This is not enormous sum of money if one recognizes that a public sector company making claims in public to attract prospective investors is also setting up a yardstick for itself and is evaluated against that in future. It is a time consuming business and given short time Government of India had, it was almost imperative in the 1991-92 fiscal year to work by fiat. However, for the present fiscal year i.e. 1992-93 GOI has no such excuses as all the hurdles like the issue of public sector enterprises listing on stock exchanges, percentage of disinvestment and the public sector enterprises where disinvestment is to take place, have been sorted out before February 29, 1992 in line with the Memorandum of Understanding given to the IMF/ the WB in October 1991.

public has a right to ask why the government is not planning ahead and doing nothing about forthcoming public sector disinvestment. The 1992-93 budget has already taken Rs 2,500 Crore from the disinvestment proceeds and government is unlikely to forgo this. The explanation given by the government officials is that it is waiting for the Krishnamurthy panel to submit its report which is due by May 30, 1992. This is a lame excuse. The Committee is looking into alternative ways of disinvestment of PSU equity rather than just modalities for disinvestment in 1992-93. Implementation of the Committee recommendations will take some time.

Most probable reason is that multilateral agencies are insisting for stock market listing for further disinvestment, which if done would raise some awkward problems for the government and government may be accused of selling public wealth for peanuts. This is precisely the problem of public ownership. A 'private' owner would never sell his assets short, no matter how short time he has. To calculate the floor price, last year, it seems that the Department of Public Enterprise used the Controller of Capital Issues (CCI) formula - i.e. average of net asset value and yield value - which government itself has discarded in 1992-93 budget. Therefore, it is not surprising that the government received about one third more than its floor price on average in the second round of disinvestment. This year again, it seems that government shall loose a golden opportunity of raising a substantial amount of money from capital market or public by disinvesting a small proportion of a few companies and see its results under a competitive environment.

There are three main advantages in disinvesting using stock market and direct placement with the public rather than selling part of public sector equity to mutual funds just to raise Rs 2,500 crore to reduce fiscal deficit. First, government received Rs 3,081 crore by disinvesting less than 8% of shares of 31 public sector companies in December 1991 and January 1992. Today 20% share of the same companies would fetch roughly Rs 15,000 crore. Out of this only Rs 2,500 would be allowed to prune the current years' fiscal deficit and, say even, Rs 2,500 crore is put in the National Renewal Fund kitty, still Rs 10,000 crore will be left to retire domestic debt; which is roughly 2% of GNP. Thus, the Government would be able to save Rs 575 crore of interest in the fiscal year 1992-93 itself and Rs. 1150 crore interest, calculated at 11.5% rate of interest, every year thereafter. Second, by doing so, the government would be able to mop us liquidity from the market which shall bring down the growth of broad money supply drastically. This mopping up operation shall help in bringing down the rate of inflation in single digit by April 1993. This is exactly what Mrs. Thatcher did in the UK. She retired a large part of public debt from the proceeds of the privatisation programme and this helped in bringing down rate of inflation and balance of payment deficit in mid eighties. Third, with a lower stock of domestic debt government would be able to have more resources to invest in infrastructure facilities in the medium term.

Exit policy for labour and enterprises is probably the hot potato which no politician or labour leader wants to field. Suffice is to say that an exit policy which allows selective closure of sick units would help the economy and increase the market value of the public sector equity.

One may pause at this point and ask oneself that how the disinvestment/privatisation programme has been handled so far. The whole issue looks haphazard. Instead of doing it systematically and according to a set time-table it seems that the government has no plan and it is doing it according to the exigency of the situation. In case of PSU disinvestment constraints like market liquidity, legal requirements like PSUs listing on stock exchange etc. have been sorted out; even then government is dragging its feet.

In the past government disinvested 8% equity of 31 enterprises on the basis of partial information. Whatever information was available with the Department of Public Enterprises was made available to mutual funds and they evaluated companies performance and their future performance. In the first round of disinvestment, probably, it was a good tactic to use the book value information to set a floor price and ask for competitive tender. Auctioning at that stage could have fetched the government more revenue but due to a partial failure of the first round of disinvestment in December 1991, the government wanted to play safe and settle this quitely by persuasion and, if need be, by twisting arm. The second round of disinvestment was held in January 1992 was successful as the government received 33% higher than the reserved prices.

It is difficult to say that the government undersold the public sector equity or not at that time, because in a oligopoly situation their can be fair amount of price fixing[7]. Only if government had allowed lot more people to bid for the equity, one could be fairly sure that the government got the best prices for the equity. Anyway, valuation of public sector firms is a tricky matter and hopefully the Krishnamurthy panel would suggest better way of disinvesting the equity.

[7]. The unscarmbling of price of each company share from the package deal is not possible. But given the floor price of each bundle one may get approximate range of share price of a company. For example, SAIL shares were in the range of Rs 15-25 in the bundles, when SAIL shares were listed on the Bourses in May 92, it was fetching Rs 185-220. One should not jump to the conclusion that SAIL shares were sold cheap as market, in general, has risen by 100% between January 1992 and May 1992; and steel prices have been decontrolled. After the poor response for the public sector companies stock bundles in December 1991, there was no choice with the government except to price these bundles more attractively to mop up money required to reduce fiscal deficit. Nevertheless, had the government allowed more players to bid for these bundles, the government might have got better value of these shares.

A successful privatisation programme shall not only unshackle the economy but also give more time to politicians to concentrate on managing the economy rather than meddling in the individual enterprises and involved in fire fighting exercises whether it is air pilots dispute or textile mill workers dispute.

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