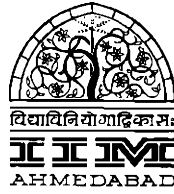

Working Paper

REVITALIZING THE STATE:
5. SLIMMING THE STATE FOR EFFECTIVENESS

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REVITALIZING THE STATE:
5. SLIMMING THE STATE FOR EFFECTIVENESS

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Abstract

Beginning with the eighties there has been a growing perception, in developed and developing countries alike, that the modern state has extended itself beyond its governance capacity. In many countries the state is perceived as soft and ill-governed. One response to the ill-governed state has been slimming, in the form of privatization and deregulation. In the paper four forms of slimming are examined: privatization of state-owned enterprises (SOEs), privatization of public services, privatization of the state's governance functions, and deregulation. Several cases of privatization of SOEs, both in the developed and the developing economies, point to complex compulsions, politics, motives, and consequences of such privatization. While empirical studies do not indicate that privatization strikingly improves the performance of privatized SOEs, there are other pragmatic reasons for a programme of selective privatization of non-strategic SOEs. The many modes of privatization and some considerations in its management are discussed. Privatization of public services seems to have considerable potential for cutting costs and improving the quality of services to citizens. There are many options in privatizing public services, and the problems associated with privatization of public services can be addressed effectively. Although in its infancy, selective privatization of the state's governance functions holds much promise for harnessing a society's management capabilities for effectively furthering the public interest. Certification, licensing, and justice are promising areas for selective privatization. Democratically functioning associations of organizations can play an especially important role in this sort of privatization. While neither regulation nor deregulation are panaceas, appropriate deregulation in statist societies or in over-regulated sectors can reduce corruption and black marketing, and bring down the operating and transactions costs of business. If some regulation is necessary, the institution-light alternative may be generally preferable to the institution-intensive alternative. Several effective ways of getting rid off excessive regulations are presented. It is concluded that slimming is likely to be effective when it is pursued for pragmatic rather than doctrinaire reasons, and that selective privatization is a powerful way of bringing private sector initiative and efficiency in the public domain and public purpose in the private domain.

There was a time, until the 1970s, when reconfiguring the state's portfolio of activities meant mostly adding activities. This happened both in the Western democratic interventionist-welfarist state as well as in the developmental state of socialist and Third World countries. Many Western nations, notably Britain, France, Italy, and Canada, nationalized several private enterprises and/or set up new public enterprises, as did Third World countries[1]. The tide, however, turned in the eighties and nineties, and the cry became one of shedding activities.

The Concept of Governance Capacity of the State

The viral growth of the state in the 20th century, primarily because of the growth of its commitments and activities, combined with a perception of its limited or diminishing effectiveness, led in the eighties to a global crisis of confidence in the state. The crisis was prompted by the dismal performance of the state in Sub-Saharan Africa, statist failures in the Soviet Block, and deteriorations elsewhere. The crisis was particularly acute in developing countries, although there was vigorous questioning of the limits of state action even in the industrialized countries. These concerns led to the notion of the state's governance capacity. As Leila Frischtak put it, "The extended scope of governmental intervention in developing countries is usually accompanied by a short supply of governance capacity--understood as the ability to coordinate the aggregation of diverging interests and thus promote policy that can credibly be taken to represent the public interest. Capacity is essential to engage the support and compliance of society to governmental decisions, and, of course, to make policies sustainable over time. Economic reform requires the politically difficult proposition that the scope of governmental intervention be reduced, which in itself hinges on expanded governance capacity"[2].

Earlier, in the sixties, Gunnar Myrdal had noted the distinction between "soft" states and "hard" states[3]. Hard states set priorities and carry them out because actual administration is on the basis of rational bureaucratic principles associated with Max Weber. In the soft state, administrators habitually circumvent laws and regulations, officials and politicians often collude to thwart implementation of public policies, and

corruption is rampant. In the soft state political accountability of the rulers to the people, the accountability of the bureaucrat to his/her boss, the law and the people, and the rule of law which enables individuals or groups to seek redressal against each other or the state, all get eroded. The state is therefore, perceived as "not working."

Several distinctive efforts have been made to make the state "work"[4]. One response to the soft, ill-governed state has been to try and harden it in the ways Western democracies have attempted. These include more transparent systems with clear procedures and criteria for public decision making; more public information, especially regarding subsidies and budgetary allocations; more transparent personnel management in government, with clear, objective, and well-publicized criteria for appointing, promoting, and terminating the services of personnel; mechanisms for ensuring contract performance; rational regulations governing market transactions; exclusive and protected property rights; insulation of civil service from political influence; clear rules for obtaining government approvals for business activities with minimal discretionary authority to officials, etc.

A second response to misgovernance has been fragmentation of much of the state into smaller, semi-autonomous agencies or bodies that have each a clear mandate, accountability for performance on clearly spelt out indicators, and a chief executive selected on the basis of competence for the job. These arrangements are buttressed by the units having to face competition in the market place, and having to fend for themselves rather than rely on state funding. This is the route taken by a number of Commonwealth countries following Britain's lead.

A third response has been, or can be, to strengthen political management through a fairer representational system, attempts to control electoral costs, state funding of political parties and elections, training for political executives, more stringent weeding out of corrupt or criminal politicians from electoral contests, stronger political commitment to economic growth and social justice, fostering of consociational, associational, deliberative, and direct democracy, and so forth.

The response to misgovernance discussed in this paper is that of slimming the state through privatization, that is, through transfer of some of the enterprises, services, and regulatory responsibilities of the state to the private corporate sector and other non-governmental bodies. As the World Bank put it in its 1991 World Development Report, "The agenda for reform that has emerged .... calls for governments to intervene less in certain areas and more in others--for the state to let markets work where they can, and to step in promptly and effectively where they cannot. In many countries this calls for a stronger orientation toward the market and a more focused and efficient public sector role. History suggests that this is the surest path to faster growth in productivity, rising incomes, and sustained economic development"[5]. In this report, the World Bank identified several interventions that it felt were essential if economies were to achieve their potential: "An abbreviated list of indispensable interventions would include the maintenance of law and order, the provision of public goods, investments in human capital, the construction and repair of physical infrastructure, and the protection of the environment"[6]. On other hand, the World Bank emphasized the importance of privatization: "Privatization is necessary and highly desirable, even though difficult and time-consuming. It is not to be undertaken as an end in itself, but as a means to an end: to use resources more efficiently"[7]. To this end the World Bank Group had, by 1992, supported a vast privatization programme involving 180 Bank operations, 50 International Finance Corporation advisory support and investment operations in privatized firms, and three MIGA (Multilateral Investment Guaranty Agency) projects insuring investments associated with privatization[8]. As the Bank put it, "The primary role of the World Bank in privatization is to help establish a policy environment in which ownership change will produce efficiency gains that expand production and employment and enhance welfare over the long run"[9]. In the pursuit of this noble cause, the World Bank has not been above twisting the tails of client states that hesitated to plunge into privatization. Nor has it been above dressing figures to make its points. For instance, in highlighting that large resources go to supporting SOEs that could be better spent on health or education, the Bank's 1995 Bureaucrats in Business Report showed the Indian central government as transferring over 5 times its expenditure on health or education to SOEs[10]. But it neglected to point out that in India the central government took only marginal responsibility for education and health, the primary responsibility under the constitution being with the states. The bulk of state

expenditure as much perhaps as 80%, was therefore incurred by them. Nor did it disclose that the bulk of the transfers to SOEs by the central government were for investments in such sectors crucial to growth as oil, petrochemicals, power, machinery, and transportation, not to fund losses (the central SOEs have been profitable overall in almost all years after 1960).

Privatization and Ideology

The interest in privatization has partly been ideological in origin and partly pragmatic. Believers in the capitalistic market economy and the power of the invisible hand in promoting economic growth tend to frown upon the state owning enterprises, which are often monopolistic, and upon the "socialistic" ideology underpinning this ownership. The US, the UK, the IMF, and the World Bank, at least in part, have pressed for privatization on ideological grounds, presumably to weaken the forces of socialism and collectivism and to make space for individualism and "free" enterprise. As the World Bank put it in its report on privatization, "The principal objectives of the World Bank Group are the promotion of economic development and the reduction of poverty; an efficient private sector makes essential contributions to the attainment of these goals. Among the means available to promote the development of the private sector is the privatization of state-owned enterprises. Privatization, when correctly conceived and implemented, fosters efficiency, encourages investment and thus new growth and employment, and frees public resources for investment in infrastructure and social programs"[11]. Presumably therefore, the World Bank does not believe that the public sector can make an essential contribution to economic development and poverty alleviation. The OECD has also pushed hard privatization in developed economies because of its faith in competition and aversion to monopolies, especially government monopolies[12]. The USAID, agency of the US in the business of giving developmental assistance to poor countries, has also strongly favoured privatization, and has not been averse to make aid conditional upon a programme of privatization[13].

As against this ideological stance, there are those that point to some inconvenient facts. As Alice Amsden put it, in the context of the "cold bath" type precipitate form of structural adjustment and privatization pushed hard in the former Soviet Block by the

West and by international financial insititutions: "No nation has ever built a modern industry under the conditions currently imposed in Eastern Europe. The world's fastest growing economies for the last three decades--Japan, South Korea and Taiwan--have tended to follow dirigiste economic policies almost diametrically opposite to those commended to post-socialist Europe. The reconstruction of Western Europe after World War II likewise included a heavy dose of public ownership, capital controls and other instruments of economic planning that are anathema in the World Bank's current recipe book. The economies of Anglo-Saxon nations with the greatest enthusiasm for the cold bath--the United States and the United Kingdom--have stagnated relative to West European and Asian economies with more interventionist states"[14]. Thus, if lessons are to be drawn from the world's fastest growing economies rather than the slow growth Western economies, a mixed economy of state owned enterprises (SOEs) and private enterprises may be preferable for developing countries to one of exclusive reliance on the private sector.

Pragmatism and Privatization

There are seemingly powerful practical reasons for slimming the state through privatization. The main reason advanced has been that state-owned enterprises (SOEs) are prone to making losses. This may put an intolerable burden on the finances of the state, and pre-empt credit and other resources that should flow to the (presumably) more efficient private sector. As the World Bank put it, "While many SOEs have been productive and profitable, a large number have been economically inefficient, incurred heavy financial losses, and absorbed disproportionate shares of domestic credit. Of particular concern to governments is the burden that loss making SOEs place on hard pressed public budgets"[15]. For example, in 1989 losses of Argentine SOEs were 9% of GDP; in Poland in 1989, government transfers and subsidies to SOEs amounted to more than 9% of GDP; in China in 1991, about a third of SOEs, and in Tanzania in the 1980s nearly half of 350 SOEs, were operating at a loss; loss making in Guinea SOEs absorbed 90% of domestic bank credit while contributing only 25% to GDP. Although efforts were made in the 1970s and 1980s, often with World Bank help, to improve the functioning of SOEs, the reform programmes in the opinion of the World Bank, were no solution: "Many of these reform

programs had positive results. But experience reveals that they were difficult to implement, and even harder to sustain, in both industrialized--for example, in New Zealand and Japan--and developing countries"[16].

The losses of SOEs as an indicator of inefficiency, may, however, be exaggerated. Some of the losses are because SOEs, as extensions of the state, are expected to pursue the public interest--e.g. operate "uneconomical" railway or air routes; price their outputs at below cost in the public interest (such as grossly undercharge passengers of bus services, or underprice life-saving drugs); or put up their plants in poor infrastructure areas to stimulate the development of backward regions, and thus incur extra costs; or operate as model employers and provide model facilities to employees beyond what the private sector generally provides, etc. These are social costs that a civilized society often must bear; privatization may not necessarily reduce these costs, but merely transfer most of them to the state, thus overstating the profits of privatized units.

There are also other weighty practical reasons for privatization. Many countries have been suffering from chronic fiscal deficits that fuel inflation. Privatization is one way for the state to generate fiscal relief. Mexico, for instance, generated over $ 8 billion during 1980-1991 from large scale privatization that reduced its fiscal deficits and also provided funds to the state to meet its external debt obligations[17]. Privatization can also be resorted to for removing state monopolies and making the economy more competitive, for example by breaking up a state monopoly and privatizing some or all of its parts. Such acts can be part of a larger competition policy.

The Privatization Tide

The world has seen a tide of privatization after 1980[18]. By 1993, well over 3000 privatization transactions, each of over $ 50000, were made, involving some $ 270 billion. Nearly two-thirds by value were in the industrialized countries. Among the developing countries, the major privatizations (by value) were in Latin American countries (57%), followed far behind by Asia (21%), Eastern Europe and Central Asia (19%), and Africa (3%). In terms of numbers of transactions, the tempo got stepped up

after 1987 in the developing countries, with about 5 times more privatizations during 1988-93 as compared to 1980-87. As against almost no privatizations during 1980-87, there were nearly 1100 privatizations in Eastern Europe and Central Asia during 1988-93, half of the total number for all developing countries. Africa, which had got off to a brisk start during 1980-87, did not maintain pace during 1988-93, and in Asia, too, there was some decelaration. As the World Bank bemoaned, "Bureaucrats are still in business. Despite a growing consensus that governments perform less well than the private sector in a host of activities, and despite more than a decade of divestiture efforts in developing countries supported by the World Bank and other development institutions, state-owned enterprises (SOEs) account for nearly as large a share of economic activity in the developing world today as they did twenty years ago"[19].

Besides the privatization of relatively large enterprises, there have been privatizations in the tens of thousands of small enterprises in the former socialist countries of Eastern Europe[20]. For instance, in the former Czechoslovakia, some 70000 properties expropriated by the state between 1955 and 1961 were restored to their original owners, and some 100000 small state-owned businesses were auctioned off, while this method was used to dispose off some 37000 small businesses owned by the state in Russia. Thousands more were privatized under employee buyout schemes and forced liquidations.

In Eastern Europe, privatization of larger state-owned enterprises was attempted by a novel means: distribution of vouchers to citizens, each for a certain face value, which entitled them to purchase shares in the state-owned enterprises of their choice[21]. Privatization has been attempted by many other means also, some of the more popular ones being sale to a foreign party or to a joint venture with a foreign partner, and privatization through a management buy-out. Published cases of privatizations in Eastern Europe so far have not reported any striking improvement in performance. Besides, massive loss of employment may be a frequent outcome. For instance, Tonsil in Poland laid off about 16% workers in a year after privatization, and Exbud, also in Poland, slashed its workforce by 50%[22] Given the rapid rate of privatization in the former Soviet Block, and the latter's disastrous economic decline after the mid-eighties, sustained for over a decade, it is hard to attribute any performance success to the

privatization effort. In Eastern Europe, privatization appears to have been an almost entirely doctrinal misadventure, based on the dubious theory that state ownership is incompatible with democracy and a market economy. These countries over-relied on World Bank--IMF-US advice and paid insufficient attention to the existence of vibrant mixed economies in East and South Asia in the eighties that were also democratic, like Japan. South Korea and India.,

Given the scale of privatization and ambiguities related to its consequences, it makes sense to examine what so far have been the research findings relevant to the privatization of SOEs.

Empirical Studies Relevant to Privatization of SOEs

The World Bank has cited a few studies in support of the putative benefits of privatization[23]. In one non-Bank study of 41 firms in 15 countries that were partially or fully privatized, mostly in high and middle income countries, the sample as a whole improved its financial performance and internal efficiency and slightly increased its workforce thanks to higher capital expenditures. Unfortunately, information on price rises, layoffs, dumping of socially useful but unprofitable activities and so on has not been provided. In another study commissioned by the World Bank, of 12 privatized companies from a mix of developed and developing countries. productivity went up in 7 out of 12 companies. and did not decline in the other five. Many of the companies expanded and diversified. In 9 out of 12 cases. workers "benefitted" although in many cases there were layoffs. Workers increased their pay only in 2 out of the 12 cases. Buyers of the firms made money, but the other stake-holders--labour, consumers and government--also apparently gained[24]. Again. information on price increases, divestiture of socially beneficial activities, or quantum of layoffs is not provided. In a World Bank study of management contracts given to private parties for managing 20 SOEs in 11 countries, it was found that profitability and productivity improved in 13 of the cases, while in the remaining 7 there was decline in one or both criteria of effectiveness[25]. The World Bank also claimed. in an examination of the regulatory contracts for privately owned but government regulated telephone utilities in 7 countries. that such contracts "usually improved performance, resulting in more rapid

network expansion, increased labor productivity, and higher returns on net worth"[26]. Interestingly however, the two countries with the least private ownership of the telecom sector. Malaysia and Venezuela, had the best performance in terms of waiting time for phone!

The alleged superiority of private over public enterprises, and the alleged improvement in the performance of privatized enterprises has, however, been contested. The World Bank itself has reported a study of 28 privatized firms in Guinea of which only 4 operated profitably, 2 close to break-even point, 9 "never resumed operations after sale," and 13 were "operating in difficulty"[27]. In a comparison of technical efficiency in a study of public and private sector enterprises in least developed economies, R. Millward detected no difference, given the same scale of operations[28]. In a comparison of jute and textile mills in Bangladesh under public and private sector control, as well as of industrial firms operating in the two sectors in Tunisia, Nellis and Kikeri also detected no difference in efficiency[29]. In a study of public versus private sector sugar and textile, and of pre versus post privatization performance of 3 vegetable oil enterprises, all in Sudan, Ali Musa concluded as follows: "The analysis of the economic efficiency of the sugar industry revealed no superiority of the private sugar company over its counterparts in the public sector .... Similar conclusions were reached on company managerial efficiency in the sugar and textile industries :... privatization of the three vegetable oil companies brought no significant gains in their economic and managerial efficiences"[30]. Pradip Khandwalla provided 13 examples of sick SOEs that were turned around without privatization, at least two of which were sick private sector enterprises that were nationalized and turned around under government ownership[31]. The increased market capitalization of privatized companies in the UK has been explained, not in terms of genuine efficiency gains from private management, but in terms of effective restructruing prior to privatization, underpricing of shares offered to the public, and increased profits achieved by increasing prices, selling off assets, reducing manpower, and divestiture of some services: "At any time, if they had abandoned their commitments to social responsibility ... the former public corporations could have recorded higher profits in this manner"[32].

Interestingly, there are several examples of SOEs that greatly improved their performance while under public ownership during their preparation for privatization. An example is that of Japanese National Railways (JNR), Japan's, possibly the world's. largest SOE, which recorded huge losses between 1964 and 1986[33]. JNR lost annually some $ 7 billion in the mid-seventies and around $ 10 billion in the mid-80s. During 1964 to 1986 JNR received government subsidies of $ 57 billion and its long-term debt reached a staggering $ 286 billion. Apparently, it had 200000 surplus employees on its pay roll, and as an SOE, the company had to invest in unprofitable, remote routes. In 1982, a government committee report called for a dismemberment and eventual privatization of JNR. In 1987 JNR was reorganized into seven smaller, profit oriented SOEs. The total employment was cut from 358000 in 1983 to 191000 in 1990, and long-term debt of $ 197 billion was reassigned to JNR Settlement Corporation. The successors of JNR were made free to diversify into other businesses, and parliamentary approval for their budgets was dispensed with. The seven companies as a group turned around from an annual operating loss of over $ 4 billion in 1986 to a profit, in 1990, of $ 3.6 billion without raising passenger and freight rates, and quality of service improved. British Steel and Jaguar Motors in the early eighties are some other examples of SOEs whose performance improved spectacularly before privatization[34]. These cases suggest that if SOEs are given reasonable autonomy, a dynamic professional management, and a commercial mandate, they may be able to show a much better performance even during public ownership. This is also suggested by the performance of Australian SOEs after an attempt at reform in the late eighties.

Public enterprises have played an important role in Australia's economy[35]. In 1991-92 they accounted for 10% of the GDP. Some had considerable monopoly power. Telecom and Australian Post accounted for around 90% of the workers in the telecom industry. The government began a series of public enterprise reforms in 1987. Its guiding principles were:

1. Promote competition, wherever possible, as an incentive to increase efficiency.

2. Regulatory arrangements should facilitate competitiveness, exports, and technological change.

3. Improvements in efficiency should be shared with customers through such arrangements as price ceilings and service quality targets.

4. Public enterprises should benchmark with the world's best operating practices.

5. Prices should cover full costs, including costs of negative externalities such as pollution.

6. Any activities explicitly in the public interest or any social justice requirements should be separately funded by the government.

The reforms provided much greater operating autonomy to public enterprises. Their boards became much more accountable for performance and in turn got much more autonomy in the areas of industrial relations, superannuation, and purchasing. The board was expected to develop the enterprise's business strategy, oversee the management, achieve financial targets, pay dividends, meet the government's mandated social obligations, etc. Each enterprise was expected to furnish its corporate plan to the government and negotiate targetted profitability, growth, dividend, pricing, service quality, etc., which then were used subsequently to evaluate its performance. The government in turn provided a clear statement of its objectives for the enterprise. Also the line, earlier blurred, between commercial, regulatory and public policy activities was demarcated: regulation and public policy formulation were not within the province of the public enterprises.

Reportedly, in the four years 1987-1991, labour productivity in the 50 major public enterprises rose at about 10% per annum. Against dividend and interest payments to the government of A $ 170 m. in 1988, these payments rose to A $ 5200 m. in 1993. Domestic call rates charged by the telecom public enterprise were 13% lower in real terms in 1993 compared to 1990 and international rates were 25% lower. Between 1987 and 1993 average domestic air fares charged by Australian public enterprises dropped by 24% in real terms. Telecom exports in 1991 were over a half a billion Australian dollars.

Australia was no aberration. In India, after liberalization of the economy was initiated in a big way in 1991, and despite increased domestic competition and scaling down of import duties from an average of 150% in 1991 to 50% in 1995 (with further reductions in 1996 and 1997), public enterprises responded well to liberalization, deregulation, and threat to their survival. The total revenues of the two hundred plus SOEs attached to the central government increased from Rs.1200 billion in 1991-92 to Rs.1600 billion in 1994-95, and what is more interesting, the overall net margin on sales more than doubled, from 2% to 4.2%[36].

Even in Britain, changes in the government-SOE relationship in the eighties yielded good results. Mrs. Thatcher's government "tightened the financial constraints imposed on the public corporations and sought to introduce more market-oriented managements.... the consequence was a signficant improvement in productivity performance".[37] For 10 SOEs that were not privatized until the mid-eighties, their productivity (output per head) increased on an average by 4.6% per annum between 1978-1985, versus 2.6% for 1968-1978. As benchmarks, UK manufacturing productivity rose at the rate of 2.7% per annum during 1968-1978, and 3% during 1978-1985[38].

It is clear that there is no overwhelming evidence in favour of superior enterprise-level performance after privatization; some gains are common, but are equally commonly offset by some losses. Besides, these gains can be achieved even without privatization by appropriate changes in the control environment of SOEs. And yet privatization can have another practical advantage: where a state suffers from severe fiscal deficit, or indebtedness, it can help reduce this fiscal deficit or indebtedness and thereby improve the financial condition of the state. Proceeds from the sale of about 700 SOEs in five chronically fiscally deficit Latin American countries exceeded $ 18 billion, and amounted to 8% of their foreign debt in 1990; in Mexico, fiscal support to SOEs declined by 50% between 1982 and 1988[39]. The British government realized a mouth watering 80 billion dollars from its privatization of some 46 SOEs between 1981 and 1991[40]. Also, in countries with many urgent developmental tasks, it makes sense for the state to sell off those of its enterprises that have no significant social welfare or

developmental function, and re-channel proceeds to developmental tasks. If a reasonable safety net is created to offset the hardships of the all-too-common layoffs and divestitures following privatization, then privatization can become politically much more palatable. The state can readily and fruitfully dispose off its textiles companies, hotels, airlines, shipping companies, food production firms, car and cycle making enterprises, collieries, power plants, and so forth. It can invest the proceeds in such priority tasks as research and development to support exports-led growth, the development of sustainable energy resources, pollution control, setting up or subsidization of long gestation plants, improvement and expansion of transport, communications, ports. energy, road facilities, basic health and education, poverty alleviation, etc. But care must be taken that the new owners are professional managers with financial integrity and a sense of corporate social responsibility.

Once suitable SOEs have been identified for privatization, the strategy suggested by the World Bank makes sense[41]. If the country is market friendly and has a high capacity to regulate enterprises effectively, and the enterprise is operating in a competitive market, privatize immediately. If the enterprise, however, is not operating in a competitive market, first create an appropriate regulatory mechanism to control monopoly power and then sell. Many developing countries have low regulation capacity and also market unfriendly economies. In such conditions, a competitive SOE may best be disposed off after creating a more market friendly environment (e.g. through deregulation); and an SOE with considerable monopoly power may be privatized not only after deregulation and installation of an effective regulatory arrangement for controlling the misuse of monopoly power, but initially may require privatization of only management (e.g. through a management contract), and only later this may be followed by an outright sale.

As important as strategic considerations in privatization may be the actual management of privatization. Badly managed privatization may have a number of adverse consequences, such as poor price realization by the state, accusations of underhand dealings by the privatization authority, lack of viability of privatized units. transfer of privatized units to incompetent or unscrupulous private management, grave

compromising of the public interest. etc. Several case studies illustrate the motives, management, and consequences of flawed as well as successful privatization.

Cases of Privatization in Industrialized Countries

Britain led the Western world in nationalization after the second world war under a Labour government and in privatization of SOEs after 1979 under a Conservative government. The major privatization objectives of Mrs. Thatcher appear to have been both ideological and pragmatic. The ideological objective seemed to be to roll back the "inefficient" state, widen share ownership (popular capitalism), and reduce government involvement in enterprise decision making (greater free enterprise). The pragmatic objectives seemed to be improvement of economic efficiency through greater competition and autonomy, reduction in public sector borrowing, making pay determination easier in the public sector, encouragement of employee share ownership to reduce conflict of interest between management and employees, and political mileage. British Telecom offers a good example of British management of privatization.

British Telecom (BT):[42]

British Telecom a utility, was privatized in November 1984 with a public offer of 50.2% of BT's equity. The Telecommunications Act was enacted earlier in 1984 by which BT's prices after privatization were to be regulated by the so-called RPI-X formula (RPI means the retail price index, and X for BT was 3, so that prices could change at a rate of 3 percentage points lower than the rate of inflation). BT was not to have any additional private sector competition (beyond Mercury) until 1990. Besides, cable companies were to offer telephone services only through an agreement with BT or Mercury. Nor was BT permitted to have unrestricted resale facility. BT was to operate subject to regulation by the Office of Telecommunications (Oftel). BT was to operate as a licensee of the state for a 25-year period. The license conditions could be varied by BT with the approval of Oftel, and in the event of a dispute the latter would be referred to the Monopolies and Mergers Commission for adjudication. While the rates

for local calls, trunk calls, and line rentals were regulated, rates for international calls, pay phone calls, rentals for equipment at the customer's premises, telex, mobile radio, etc. were not regulated. The unregulated items could, however, be scrutinized by Oftel for reasonableness in pricing, and Oftel could refer the matter to the Monopolies and Mergers Commission. The regulations were to be reviewed 5 years after privatization. Thus, the regulatory structure was in place before BT's privatization.

There was some criticism of the issue price of BT's shares, as indeed of several other British privatizations. The issue price was 130 pence, payable 50 pence on application. The opening price on stock exchanges was 93 pence, indicating a seriously underpriced offer. Indeed, the underpricing averaged 60% for six major privatizations (BT, British Gas, British Airways, Rolls Royce, British Airports Authority, and Trustee Saving Bank), resulting in a loss to the government of nearly 3000 million pounds ($ 4.5 billion)[43].

As part of the British Government's policy of encouraging employee share participation, some 220000, 96% of the employees of BT, got free shares. Over 180000 of these employees bought shares on a matching scheme in which the employee got an offer of 2 shares free of charge for each share purchased by the employee upto a maximum of 77 shares; 62000 bought shares under a priority offer; and 80000 employees took up options in 1985 under an employee share save scheme in which the employee agreed to a monthly deduction from the wage packet for an option to purchase shares at a pre-determined price later on[44].

In 1985, BT launched Cellnet to offer cellular radio services, as a joint venture with Securicor, and in competition with Racal-Vodaphone. It increased rental and local call charges substantially, and reduced many trunk call charges, and repeated these price changes in 1986. In 1986, BT acquired a majority stake in Mitel, a Canadian producer of PABX equipment. There was some criticism of the services provided by BT after privatization[45].

BT was not a malfunctioning utility prior to privatization. Its privatization was partly for ideological reasons and partly to liquidate a large government investment for other uses

such as debt reduction. It was not clear whether privatization of BT resulted in any significant increase in efficiency. There apparently was a large loss to the state from underpricing the public issue but significant gains from share ownership for employees and those members of the public that applied for BT shares. BT did, apparently, show some entrepreneurship after privatization, in the form of new ventures. It raised prices for some of its regulated products and lowered them for others, presumably in response to demand conditions. The privatization of BT was a huge capital market transaction, and the privatization through a public offer of shares was possible because of the highly developed and large British capital market.

Canadair:[46]

Canadair was privatized in a very different way than BT. Canadair was a Canadian SOE which came into existence in 1976 when it was acquired by the Canadian government from General Dynamics, a US multinational, to stave off bankruptcy. It produced an executive jet aircraft called the Challenger, and a water bomber to combat forest fires. After acquisition the government invested the huge sum of C $ 7000 million for the continual development of the Challenger. Canadair was considered a "weak performer." In 1984 the Canadian government decided to privatize Canadair. It followed an interesting divestiture process:

1. The Canadian Development Investment Corporation (CDIC) was entrusted the management of Canadair privatization. It assembled a consortium of 3 investment firms, one each from Canada, the US, and the UK, to advise CDIC.

2. World-wide search was made to identify and interest potential buyers with a history of sound management, adequate financial strength, and technological skills for the maintenance and development of a dynamic aerospace manufacturing sector in the private sector in Canada, especially in Quebec (where Canadair plants were located).

3. 150 potentially interested parties were contacted world-wide, and bids were invited from those that indicated sufficient financial capability. After reviewing the

preliminary proposals, 6 parties were asked to make formal presentations in mid-1986 to the CDIC Board. Two were judged to be superior to the rest, namely Bombardier and Canadian Aerospace Technologies, and both were asked to upgrade their proposals. Finally, Bombardier was selected by CDIC and its proposal was approved by the Ministerial Task Force on Privatization. Bombardier was a profitable Quebec-based producer of snowmobile and other transportation equipment, with sales of half-a-billion Canadian dollars, and a reputation for innovative, entrepreneurial management. It had no previous experience of aircraft manufacturing.

4. Bombardier acquired Canadair for C $ 120 million in cash, and agreed to pay C $ 173 million more for the estimated future royalty loss to the government. In return the government took over all debt of Canadair, and the assets Bombardier took over included C $ 100 million in cash. Thus, Bombardier acquired the assets of the company practically free of cost. It paid nothing at all for the government's expenditure of C $ 7000 million for further development of the Challenger aircraft. There was another curious feature. The Canadian government got class A shares worth C $ 100 million, to be cancelled, dollar for dollar, provided the $ 100 million in cash with Canadair on privatization was spent by Canadair in its aerospace business (rather than be siphoned off by Bombardier), and class B shares of C $ 50 million that would be cancelled dollar for dollar, on Canadair investing the money in research and development or on winning new export business.

Canadair's SOE incarnation was because of a private sector failure and the Canadian government's resolve to have an indigenous aircraft manufacturing capability. Even the privatization was planned to serve this purpose. Whatever the fate of Canadair after privatization, the latter appears to have been an elaborate charade for a giveaway to a local indigenous business group. Although 150 potential buyers were contacted, ultimately the SOE was handed over, practically free of cost, to a Quebec company not even in the aircraft manufacturing business! A management contract to a reputed aircraft manufacturer might have been a much cheaper (for the government) option. Possibly, political considerations may have played an important role in this privatization.

The Rumasa Group, Spain[47]:

Rumasa was set up as a small private company in 1961, and grew into a large holding company of 800 enterprises employing about 45000, including 20 banks with 100 subsidiaries and 130 other companies with 350 subsidiaries. Headlong growth, poor financial health, and shady practices induced the government to take over the group in 1983 to stave off bankruptcy of the Rumasa banks and the threat this posed to Spain's banking system. The businesses were expropriated without compensation and placed under the management of Patrimonio, a large SOE conglomerate operating in the tabacco and telephone sectors. Upon investigation many underground operations of Rumasa came to light and around 400 of the 800 enterprises appeared to be just front companies. The government takeover was slated to be a temporary affair, the idea being to reprivatize Rumasa enterprises after cleaning up operations.

Upon expropriation, the government proceeded to liquidate or merge some 400 "shell" companies. Rumasa Reprivatization Unit was established to oversee a transparent divestiture of Rumasa businesses with representation of the civil service, the private sector, and the Rumasa group. An action programme, involving financing of privatization, valuation of companies for sale, identification of potential buyers, development of options in industrial relations related issues, etc. was chalked up. A US consultant-cum-broker was hired, and with the latter's help a sales prospectus was prepared for each company. Bids were received and evaluated by Patrimonio's committees under the consultant's supervision. The evaluated bids were sent to the Rumasa Privatization Unit; which then forwarded its selections to the government for ratification.

Within 2 years, out of the 400 companies that had not been liquidated earlier, 226 had been sold and 152 had been returned to the original owners at a cost to the government of $ 3700 million for settling debts, employment terminations, etc., a sum that was raised by the issue of long-term debt at 9.5% interest. Most of the Rumasa companies were bought by foreign companies or by consortia with foreign participation. In return, the government appears to have realized chicken feed - around $ 150 million. It looks like everyone, including the original unscrupulous owners, the foreign

consultant, the employees, the creditors. and the domestic and foreign buyers gained, the only loser being the government of Spain representing the interests of the people of Spain. An annual recurring charge upwards of $ 350 million was bartered by the government for a one time receipt under $ 150 million!

Commonwealth Bank of Australia (CBA)[48]:

CBA was partially privatized initially to the extent of 30% of its equity in 1990, and later, in 1993, by a further 19%. The case is interesting because this partial privatization was effected by a Labour government in Australia opposed to privatization in general and dependent on an apex labour union (Australian Council of Trade Unions) for political support. It was partially privatized despite the Commonwealth Bank Officers Association being against any privatization of CBA. The manner the partial privatization was effected provides some interesting insights into the political management of privatization in a hostile environment.

The CBA, established in 1911 as an SOE, was widely perceived to be a bank operating in the public interest. It was dividend paying; and it lent to those areas considered too risky by private institutions, such as to rural producers and small businessmen. It was also a major lender for housing, a major lender to local and quasi-governmental bodies, lent at concessional rates to charitable institutions, and to welfare recipients.

The partial privatization was effected to raise funds for the A $ 1.6 billion take over of the State Bank of Victoria, which had made a huge loss of A $ 2.7 billion. The privatization was "marketed" as a means for bailing out the State Bank of Victoria, which otherwise might have had to be liquidated or sold off to a private party. "Concessions," however, were made to those opposed to privatization, namely the Australian Labour Party, the Australian Council of Trade Unions, and the Commonwealth Bank Officers' Association. These included acceptance of such conditions as retention of majority holding by the government, limiting individual shareholdings to not more than 5%, no sales of shares to domestic and foreign banks or other foreigners, the creation of an attractive employee shareholding scheme, and no forced compulsory retrenchment.

The four cases of privatization of British Telecom. Canadair, the Rumasa Group, and the Commonwealth Bank of Australia indicate the variety of motives and considerations underlying privatizations in developed economies. Improving the efficiency of an SOE may often be a relatively unimportant consideration. The reasons range from the doctrinaire ("roll back the state" and people's capitalism) as in the case of British Telecom, to unburdening the state without reliquishing strategic state objectives as in the case of Canadair, to sorting out a mess made by the private owners through a so-called expropriation without compensation and then a return to the original owners of the now unencumbered and laundered assets, as in the case of the Rumasa Group, to bailing out a sick SOE through politically smart operations, and partial privatization without sacrificing the public interest aspect of SOE, as in the case of the Commonwealth Bank of Australia. These cases indicate that privatization is often far from an act motivated by strictly economic considerations; it is, in many cases, a very political, very tactical act, and not always aimed at the public interest.

Cases of Privatization in Third World Countries

Privatization is more difficult in developing countries than in developed countries because the private sector is less developed in developing countries and state interference is usually high. Thus, it is not easy to find suitable buyers, and if one is found, the buyer may not have as free a hand in management as he or she might have in a developed economy. Several cases of privatization in developing countries offer interesting insights and lessons.

The Guyana Telecommunications Company (GTC)[49]:

Guyana in South America ran into horrendous external indebtedness; by 1989 total foreign debt was almost 7 times the total exports and 6 times the GDP. The government defaulted on its debt servicing obligations. This coincided with a period of declining GDP, so that output in 1988 was about two-thirds in 1976, and many skilled and educated Guyanese emigrated. This in turn made it difficult for the government to manage public enterprises. Under pressure from the World Bank and IMF, the

government embarked on a structural adjustment programme of deregulation, liberalization, infrastructural and administrative reconstruction, and privatization.

Guyana Telecommunications Company (GTC) was a government monopoly provider of telecom services in Guyana. Although profitable, it was plagued by obsolete technology, run down equipment, with only about 65% of the access lines in working condition. The completion rate for international calls (that is, for getting through to the number called) was 20% or less. Customer satisfaction was very low because of long delays in getting booked calls and a two-year waiting period for getting a telephone. GTC apparently was also overmanned, with many untrained workers. Salaries were lower than in the private sector. Employee morale was low and theft and bribing were common. The bulk of the company's profits, which were substantial at 13% and 25% on revenues (before tax) were not allowed to reinvested, and instead were transferred to the government.

GTC was privatized by sale of shares, in accordance with the recommendations of a divestment committee. Foreign-based telecom companies made preliminary proposals for buying the company, and Atlantic Tele-Network (ATN) was invited to submit a bid and a detailed business plan. In 1990, the GTC was dissolved, and its assets and liabilities were transferred to the Guyana Telephone and Telegraph Company (GT&T), which was given a license to operate telecom services in Guyana. In 1991 ATN paid $ 16.5 million for 80% of the shares in GT&T and agreed to assume $ 4 million worth of foreign currency liabilities. ATN was also required, under the deal, to implement an expansion plan to improve telecom services in Guyana. It was to add 2000 access lines over 3 years, provide service on demand in some areas, improve call completion rate to 60% for calls to and from the US, the UK. and Canada, improve billing accuracy, complete digitalization and extend service to rural areas, etc. GT&T was prohibited from increasing rates for 3 years except to compensate for inflation and devaluation. Against this, the government guaranteed at least 15% return on GT&T's rate base after January 1994.

GT&T was a board managed company with 5 ATN and 2 government directors. After ATN took over management, much restructuring and slimming was done. Five groups

were formed, of operations. administration and support services, finance, public communications and relations. and expansion/engineering. Each group in turn had several departments. After a 3-month review of the existing organization. administrative tools. and personnel files. a personnel reorganization was carried out in which 500 out of 1100 lost their jobs. The package offered to the employees was a 90% pay hike to those that were retained and compensation equal to 22 months salary for those who were made redundant. A majority of lower level employees, particularly supervisors and operative staff, had to go. The company embarked on its planned expansion. It, however, ran into problems with the telecom regulatory authority over tariff increase to compensate for Guyanese devaluation, and the matter went to the courts. There was also some public resentment over the steep increase in tariffs on international calls.

Several benefits accrued after privatization: a doubling of the working lines in service in less than 2 years; installation of over 100 public telephone booths; an improvement in the call completion rates in some areas from less than 20% to over 50%; drastic reduction in telephone facility awaiting rectification from 5000 in Georgetown to about a tenth in October 1991: introduction of cellular service, etc. Compared to 1989, in 1992 operating expenses as a percentage of revenues had declined from 91% to 53%, net profit margin climbed from 13% to 47%. The privatization apeared on the whole to be successful. But it also resulted in a key public utility passing to a foreign company.

National Commercial Bank, Jamaica[50]:

In the 1980s. a new conservative government attributed low economic growth of Jamaica to the size of the government sector. Under pressure from the US and IMF, it embarked on a programme of deregulation, divestment, and reduction in government expenditure. As part of this policy the National Commercial Bank (NCB) was privatized in end 1986. This privatization was not quite a thumping success; but it illustrates some interesting aspects of privatization management.

NCB was Jamaica's largest commercial bank. and it was privatized in three phases between end 1986 and February 1992. In the first phase the government sold off 51%

of its holdings to the public for $ 16.5 million. In the second phase, in 1991 the government reduced its non-voting shares by about 20% by selling 6 million shares to NCB Trust and Merchant Bank Limited, the trustee for the NCB Employee Share Scheme. This increased the holdings of the employees from 3% to 10.5%. In 1992, despite first announcing that it would dispose off its remaining holdings (about 39%) by public issue, the government sold it off to Jamaica M & N Investments Limited, a syndicate owned by Jamaica Mutual Life Assurance Society and Jamaica National Building Society with a combined "membership" (life-policy holders plus savings and mortgage members) of 400000. A condition was attached to this sale whereby the syndicate had to sell at least 8.3% of the shares acquired to the public. The syndicate had controlling interest in two other banks, and with its 42% stake in NCB, the syndicate and the companies it controlled had 48% market share in commercial banking. Thus, while the initial divestment was highly visible and transparent, the last divestment was not, and resulted in substantial increase in effective market concentration.

The privatization was not exactly a success. During 1981-86, real revenue of NCB had grown at an average rate of 21%. It grew at only 2% during 1987-92, despite the faster growth of the financial sector in the post-divestment period. The bank's assets growth also was only 4% per annum in real terms in the post-divestment period compared to 10% in the pre-divestment period. Indeed, loans declined by 4% per annum in the post-divestment period compared to a 10% per annum growth in the pre-divestment period; deposits increased by 2% per annum compared to 11% per annum before privatization, in part because of decline in interest rates in 1988. However, profit growth rate was nearly double during post-privatization as compared to the pre-privatization period, although overall return on equity was just about the same. Instead of concentrating on the domestic banking sector, after privatization the bank focused more on diversification, expansion into international markets and new activities to earn foreign exchange so that non-interest income increased from 18% of total income pre-divestment to 28% in 1992 and 1993. There was a sharp increase in capital expenditure, particularly in computerized, integrated retail banking. An employee survey by a consultancy firm indicated that by and large the employees felt that divestment facilitated decentralization and encouraged more involvement in decision

making at lower levels. Total employment rose by about 25% between 1987 and 1992; per employee revenues declined by about 10%. Clearly in the case of NBC, privatization did not significantly improve the performance of the bank that was already performing reasonably level, and increased monopoly power in banking.

Privatization and peopleization of bus transport in Sri Lanka[51]:

In Sri Lanka, road transport was nationalized in 1958 and was controlled by the Ceylon Transport Board (CTB) until 1978. Thereafter the CTB was dissolved and nine Regional Transport Boards (RTBs) and one central coordinating organization, the Sri Lanka Central Transport Board (SLCTB) were formed to operate under the Ministry of Transport Boards. In 1979 the government permitted private operators to run regular services. In 1987 there were 10000 registered private buses and 7500 government buses but the latter carried 60% of the traffic. There was a sharp curtailment of bus services towards the end of eighties because of Tamil militancy, and in 1989 there was a virtual collapse of bus transport. Besides, over the years, the government bus services had got overmanned; some 30% of the services, mostly in the rural areas, were uneconomic; fleet maintenance, especially preventive maintenance, was poor; there was large scale misappropriation of collections; fares for rural areas, school children, and students were heavily subsidized: the unions, with political links to the ruling party, flouted discipline and efficient work; there was politicization of management; productivity was hampered by over 120 days of paid leave (including weekly days off), which increased payroll by 33% to compensate for leave: and there was absenteeism.

Following acute dissatisfaction with the bus services, the government considered a new transport policy in 1989 involving "peopleization" of some bus depots (equal sharing of ownership of RTB--operated depots between employees and government) and privatization of the rest, with a generous voluntary retirement scheme for surplus staff.

In 1990 peopleization was initiated, with depot employees allotted 50% of the shares free and the remaining 50% being held by financial institutions in trust, pending transfer to employees after 3 to 5 years. Each depot was managed by a board of 7 directors.

Four of these, including the managing director, were appointed by the government from out of the senior employees; two were elected by the employees; and one was nominated by the depot's bank. A voluntary retirement scheme was introduced in 1990 as a prelude to peopleization, but apparently had negative consequences: the more skilled and capable employees, including managers, engineers, drivers, etc. who could get alternative employment left, while there was no appreciable reduction in surplus lower level unskilled staff.

In spite of peopleization, several constraints remained. The earlier controls in setting fares remained; fleets remained run-down, resulting in only 70% operations; only a part of the cost of highly subsidized season tickets was reimbursed by the government, and season tickets could not be withdrawn because of political reasons; paid holidays could not be reduced though competing private operators did not give even the weekly paid holiday; overtime had to be paid for operations beyond office hours although the private operators paid no overtime; vehicle running times exceeding 12 hours had to be covered by two crews, unlike in the private sector; and buses had to operate during night hours even though this was unprofitable. There was no visible success from peopleization. Clearly, privatizing in the form of peopleization had changed ownership; but without the devolution of appropriate autonomy, there was no improvement in performance.

The World Bank has been pushing privatization in developing countries. Its slogan is that ownership matters, and private ownership is inherently more efficient than public ownership[52]. On the other hand, socialists claim that socialized ownership is inherently more productive than private ownership because there is no exploitation of the workers by the owners. These are largely empty slogans with scant, if any, support from ground realities in the developing countries. In the three cases of privatization considered, one each from Guyana, Jamaica, and Sri Lanka, privatization was successful only in Guyana, possibly because the performance of the public enterprise was awful and the transfer was to a high quality management. In the Jamaican case, privatization was of a reasonably well functioning public sector corporation, and it was done for ideological rather than pragmatic reasons. Not only performance did not improve, there may have been some backsliding, and increased market concentration in banking was an

additional adverse consequence. In the Sri Lanka case, a socialistic privatization was attempted without a change in autonomy and quality of management.

These three cases suggest that privatization should not be attempted for ideological reasons as a gesture to the dubious doctrine of the inherent superiority of a particular form of ownership, but for pragmatic reasons that have to do with a genuine possibility of improvement in management of a badly performing public enterprise; or for releasing the state's resources for more pressing alternative uses. And if privatization is pursued then (a) it is vital to ensure a qualitatively excellent new management, and (b) it is vital to give the new management far greater measure of operating autonomy than before. Certainly, where a strong public interest is involved in a service or productive facility being privatized, the public interest can be guarded, as in the case of Guyana, by including certain caveats in the privatization agreement and by enforcing their adherence. There may even be a regulatory authority to prevent abuse. But beyond these mechanisms there must be considerable operating freedom, especially in the areas of capital budgeting and employment practices. A further lesson may be that if excess manpower has to be shed, while the compensation to those losing their jobs must be fair and attractive, the decision of who should go should rest with management, not employees. Otherwise, as in the Sri Lanka case, the capable may leave and the enterprise may get saddled with "excess baggage."

One more case of privatization, of the Malaysian Airlines System, provides an interesting example of how the state can reap large benefits from partially privatizing a well-performing public enterprise.

Malaysian Airlines System (MAS)[53]:

Malaysia initiated a partial privatization policy in the eighties as part of the Malaysia Incorporated concept of the Mahathir government. The basic idea was of close cooperation between the government and the private sector for rapid industrial development. As part of the policy of privatization, the government issued guidelines on privatization. The main objectives of privatization were to reduce the financial burden on the government of operating SOEs; promotion of competition to realize

greater efficiency; stimulation of entrepreneurship for faster growth; and containment of the state's monopoly power and bureaucratic control. A Privatization Committee was set up, assisted by a secretariat. In accordance with the Bumiputra policy of increasing the share holdings of indigenous Malaysians, certain percentage of shares of privatized companies were to be reserved for SOEs set up to promote the Bumiputra policy. Further, the privatization policy was to ensure that no one party was to have absolute majority of the company's share capital. Foreign ownership was restricted to no more than 30%. The personnel policy was to ensure that no employees lost in any way the benefits they enjoyed as government employees, and the employees would have to be absorbed into privatized firms under terms at least as good as those they enjoyed earlier. The Malaysian Airlines (MAS) privatization was a good example of the application of Malaysia's privatization policy

MAS was Malaysia's national airlines. Formed as a private sector company, the government acquired majority holding in 1966. As of March 31, 1985, MAS operated 34 aircrafts valued at around $ 400 million. It employed nearly 17000 employees. Barring 1981-82, the company had been profitable from 1975-76 to 1984-85, with net profits on sales of 8% and 10% in 1983-84 and 1984-85. The government decided in 1985 to offer a part of its holdings to the public for sale, and MAS decided to make a substantial issue at the same time. Before these issues, however, a revaluation of the assets was made in 1984, and a 3 for 1 bonus issue was made, 90% of the beneficiary being the Government of Malaysia.

The public issue was at 80% above par, and a third was reserved for Bumiputra insitutions. A sixth was reserved for employees of MAS. Just about half of the shares were offered to Malaysian citizens and institutions. A limit of 10% of total equity per shareholder was imposed. The government kept a golden share which enabled it to speak at meetings of shareholders. More important, it gave the right to appoint 6 members of the board, including the chairman and the managing director. These public issues reduced the Malaysian government's holding from 90% to 62%, and later, after further divestiture, to 42%.

The major beneficiary of the privatization was the government. It issued to itself a hefty number of bonus shares before privatization. It got for MAS much infusion of private capital without relinquishing control of the company. It created a stake in the company for the employees and extended the shareholdings of Bumiputra institutions. Financially, it not only got M $ 63 million for putting up 35 million shares to the public, but since the market price of MAS shares reached M $ 3, it very significantly increased the market value of it holdings. At the same time, the government gave a clear signal that MAS was to operate on commercial principles by having its shares traded on stock exchanges. The employees, too, gained. No one was laid off, and thanks to their shareholding, they became partners in prosperity.

Alternative Modes and Management of Privatization of SOEs:

Dennis Rondinelli has listed a large number of alternative ways of privatization of SOEs[54]:

1. Restitution and reprivatization of enterprises nationalized or expropriated earlier by the state. This has been a common form of privatization of many small businesses in the former Soviet Block countries. In former Czeloslovakia, for instance, some 70000 properties expropriated by the state between 1955 and 1961 were restored to their original owners.

2. Auction, another common means of privatizing small businesses earlier expropriated by the state. In Russia, some 37000 small businesses owned by the state were auctioned off, and in the former Czecheslovakia, nearly 100000.

3. Direct sales of state enterprises or their properties to private investors. Argentina for instance, sold off plants producing more than half of the country's electrical power to consortia of foreign and domestic private investors. Germany set up the Treuhandanstalt, an agency for privatizing 12500 state companies of the former East Germany, and by 1992 had arranged the sales of over 8000 of these.

4. Stock offerings, involving the public sale of shares of SOEs through a stock exchange or offers to specific private investment groups.

5. Liquidation of a state enterprise with a view to selling off its plants, equipments, lands, buildings, etc. to different buyers. Poland liquidated about 540 SOEs employing over 175000 workers between 1990 and 1992, and the assets were bought not only by outside investors but also by managers and employees.

6. Employee management buyout, involving the sale, partial or whole, of an enterprise to its employees. In Russia some 6500 state companies were identified for sale of 51% of shares to employees. In South Korea, a law required reservation of a certain percentage of shares for employees in the event of privatization.

7. Public distribution of shares through lotteries, coupon sales, more or less free distribution of vouchers to citizens to enable them to obtain shares in SOEs, etc. The idea is to promote widespread public ownership in privatized companies and develop public support for privatization. In South Korea, the government offered upto 75% of the shares in some of the most profitable SOEs to low income groups at prices below market prices. Mongolia issued free vouchers to its citizens for acquiring shares of SOEs. Similar voucher schemes were used in several East European countries and Russia.

8. Demonopolization, in which former state owned monopolies are broken up and privatized.

9. Public-private partnerships, involving joint ventures between government and private enterprises in providing services, developing infrastructure, etc.; build-operate-transfer projects under which private parties build and operate a facility for a specified number of years and then transfer it to the government at the end of this period; joint investment by government and private parties, etc. For instance, in Venezuela, the government, a US bank, and an Italian bank formed a joint

venture with equity participation to build a methanol plant, and China approved several joint ventures between foreign parties and its SOEs.

There is no evidence that there is any one most effective form of privatization in terms of performance improvement. Different special circumstances are likely to influence the choice of the preferred mode. Much depends also on such factors as availability of effective private sector managements, for, privatization without transfer to an effective management may worsen the situation, as appears to have been the case in the former Soviet Block countries.

Drawing on the experiences of privatization in many countries, Rondinelli has suggested the following guidelines for effective privatization:

1. Clearly identify the objectives of privatization and set realistic goals. Is the primary goal budgetary relief, for instance, or promotion of competition, or increase in efficiency, or an ideological gesture? Select the appropriate privatization method in terms of the objective(s).

2. Create an effective privatization agency. "Privatization is a complicated procedure that requires an agency or organization with the resources, authority and skilled personnel to implement the process professionally and with a minimum of bureaucratic delay. Experience indicates that the most effective means of managing the privatization process is by centralizing responsibilities for policy-making in a single ministry or agency," such as the ministry of finance or industry. "At the same time, responsibility for implementation should be decentralized to banks, financial institutions or management consulting firms, or to the managers of state enterprises themselves, with appropriate supervision by the national privatization agency"[55].

3. Select appropriate methods for privatization. "Experience with privatization over the past decade has clearly shown that no single method is the most appropriate for divesting governments of all SOEs or for eliciting the participation of the private sector in all economic activities"[56]. A large number of considerations need to be

kept in mind, including some unique characteristics of the society in question. For instance, restitution makes sense in countries in which there has been a history of expropriation of small units; in countries with a large public sector but not many SOEs, such as the US, contracting out makes sense; in countries with large capital markets, public offerings of shares make sense, in countries that earlier set-up many SOEs to promote industrialization, sales or management contracts make sense, and so forth.

4. Develop clear and transparent procedures, such as specifying selection criteria for evaluating bids, clearly defined competitive bidding procedures, disclosure of purchase price and buyer, specification of who is responsible for what, and proper monitoring and supervision of the privatization programme.

5. Develop and apply appropriate assessment and valuation methods. The SOE sought to be privatized needs to be realistically valued in terms of its earning potential, and an appropriate method of assessing it must be used, such as liquidation value, or discounted cash flow, or replacement value, etc. Auctions, competitive bids, and share offerings may be helpful in establishing a realistic value.

6. Allow for restructuring, liquidation or bankruptcy of SOEs that cannot be sold. If the first, suitable organization and managerial changes need to be made, and debt may have to be restructured and the product portfolio reorganized.

7. Establish and implement equitable bidding and contracting procedures, so that the public perceive them as fair and transparent. Thus, clear criteria need to be developed for qualifying participants, evaluating bids, and dealing with liabilities.

8. Enact appropriate legal reforms, such as vis-à-vis labour laws, trade policies, credit regulations. wage and price controls, property rights, so as to create a congenial institutional environment for privatized units to operate effectively.

9. Strengthen private sector management capability, such as by extensive contracting with the private sector for them to supply goods and services provided by public agencies.

10. Protect current employees, such as by contracting out to employees' organizations the provision of some services; by creating employees' share ownership plans; by preference to re-hiring laid off employees; by ensuring that the private employers provide fair wages and appropriate working conditions, etc.

11. Allay fears that the poorest groups will be excluded or neglected as customers, by, for example, requiring cross subsidization in the case of privatized utilities. Voucher schemes for the poor that enable low income families to buy services from the market can also be useful.

12. Redefine the roles of government and of public employees in a market-oriented economy, such as the government remaining the financier, authorizer, and overseer of "public" goods and services but relying on the private sector for delivery of these goods and services.

Privatization of Public Services

Privatization of SOEs has hogged much more attention than the privatization of public services because the former is more drammatic and visible. But the extent of privatization of public services may be greater in magnitude than the privatization of SOEs. In the US alone, an estimated $ 300 billion worth of public services have been contracted out[57]. Besides, while the evidence for the success of SOE privatization, in terms of greater efficiency of the SOE, is still quite sketchy and mixed, there is substantially greater evidence that privatization of public services "pays" and improves service quality. A study of public services provided by the state of Florida in the US indicated that privatization could save the state between $ 500 million to $ 1200 million a year out of a total $ 6.3 billion budget[58]. A survey in Japan of contracted out public services indicated that around 80% of the respondents felt that efficiency had gone up, 51% that costs had declined, and 57% that service quality had improved[59].

Privatization of various municipal services in Britain appeared to have led to substantial savings[60]. In Richmond, Canada, the cost per household of refuse collection declined from C $ 53 before privatization to C $ 32 after privatization, primarily because refuse collection per member of the collection crew rose by nearly 70%[61].

A very large range of public services can be privatized[62]. These include physical environment and public works related services, such as utility meter reading and maintenance, utility billing, solid waste collection and disposal, tree trimming and planting, and cemetery maintenance: transportation related services such as road repair and cleaning, parking lot operation, streetlight operation, airport operation, bus system operation and maintenance, traffic signal installation and maintenance, and maintenance of emergency and other vehicles; public safety related services like fire prevention/control, crime prevention/patrolling, emergency medical services, ambulance service, traffic control, and vehicle towing; health related and human services like operation and maintenance of hospitals and day care centres, public health, child welfare, addiction treatment programmes, public housing, sanitary inspection, and insects/rodents/animals control; cultural and recreation related services like parks and gardens, libraries, museums, auditoria and convention centres, recreation centres etc.; support services like estate maintenance and security, payroll, local tax assessment, billing, and bill processing, data processing, legal services, secretarial services, personnel services, and provision of public information to citizens; and economic environment improvement related services like downtown and industrial area improvement, housing and urban development, and employment opportunity documentation and development.

There are many alternative ways of privatizing public services[63]. Contracting-out is a most common method. In this method the government retains control over the activity, continues to finance it, but delegates its operation for compensation to one or more private parties. There are several options in contracting: several contractees to induce competition or a single contractee to build a long term relationship; commercial versus non-commercial contractee(s). Contracting-out in the US may be most common in the areas of environment maintenance, public works, and transportation services[64]. It may be least common in the area of recreational and cultural services.

Franchise arrangement is another common form of privatization. In this arrangement the government grants a private party authority to provide a particular service within a particular area. The users secure the service for a fee directly from the franchisee, but commonly the government monitors health, safety, price, quality, and service-level parameters. Franchisees may be charged a fee to cover these monitoring costs.

Provision of grants and subsidies to private bodies to carry on a desirable public activity that otherwise the government would provide. Grants and subsidies are often provided when measuring a service or anticipating its demand or its quality is difficult for the government. Common areas for subsidy/grant are public safety, health, recreation and cultural services. Sometimes subsidies/grants are provided on a matching basis or for earmarked expenditures.

Vouchers are a relatively new way of privatization. Potential users of public services are given redeemable vouchers which they can use to get services from any one of a set of alternative recognized providers. The suppliers get reimbursed by the government against the surrender of vouchers. This way, eligible citizens, such as the elderly, have a choice as to where they may obtain a service, and this induces competition between alternative suppliers.

Voluntary service is another form of privatization, where individuals, groups, or institutions are recruited for honorary public service. In the US, this mode is used fairly commonly in the provision of various public-safety services like fire prevention, emergency medical help, ambulance, crime prevention and patrol, traffic control, etc. Training of volunteers may be necessary before they are entrusted duties.

Service-shedding or divestiture is another relatively uncommon method of privatization. This occurs when a service is discontinued by the government or handed over entirely to the private sector. Service shedding to commercial private firms occurs somewhat frequently in public works, public utilities, transportation, health services, support services, sanitary services, etc.

A 1982 survey of public services in nearly 1800 local governments in the US indicated that privatization had increased in several public service categories[65]. Privatization was more likely of services that provided "private" types of goods/services (as distinct from "public" goods/services which by their nature are open to use by all and their utilization by some do not diminish their utilization by others, such as a public park or a television channel), or of public services with high degree of public dissatisfaction, or of services for which a large number of alternative private suppliers are available.

Privatization of public services is not without its risks. It may run afoul of the law; or the parties providing privatized services may fail financially, or fail to provide good services, or fail to comply with regulations. There may also be bribery and corruption involved in private parties procuring government service contracts. Public employees may oppose privatization because of the fear of losing jobs. These potential negatives can be addressed in many ways. For example, there must be transparency in the award of contracts, and fairly detailed specification of contract conditions relating to price, quality, safety aspects, etc. Customers' panels for public services may quickly cue the government to bad services or malpractices. Job loss by public employees may be minimized by having the private contractee give first preference in hiring to public employees made redundant by privatization, or by making hiring a certain percentage of these mandatory, by attractive separation terms, or by making redundant employees the suppliers of privatized services, etc. Stringent penalties for malpractice or violation of contract specifications can also be helpful. Special incentives could be provided for superior contract performance, and for superior customer satisfaction with the service provided. Careful legal drafting may be required in privatization contracts, including specification of redressal mechanisms in the event of dispute.

Privatization of Governance Functions

A society consists of many governance systems or governments. Some of these constitute the state; others are in the private domain. As Corinne Gilb has indicated, "A private government is the government of a business or industrial corporation, a bank or other financial institution, a trade association, church, or any other limited purpose organization"[66]. Each of these governments in its limited sphere and to a limited extent

"translates values and policy into enforceable law and institutionalized, organized action, that authoritatively allocates resources"[67]. Thus, a corporation has its charter and makes policies consistent with this charter as well as with the core values of the corporation's major stakeholders. These policies and rules constitute the enforceable legal system of the corporation which guides management actions and resource allocation. Actions that contravene this "law" are punishable within the powers of the firm's governance system, such as through withholding of promotion or termination of service. These private governments have varying degrees of social legitimacy. The state could use those private governments with relatively high social legitimacy to offload some of its governance functions. For instance, associations of organizations of a class can have significant social legitimacy as governance systems for matters pertaining to these organizations. Such an association, say the drug manufacturers association may monitor and adjudicate upon issues of unethical competition between its members. An institution of chartered or public accountants may give rulings on matters of propriety or matters of acceptable accounting practice. Associations of business schools may decide accreditation criteria and debar or expel schools that do not meet these standards. An apex cooperative society may enforce certain standards and norms in all member societies. The governance legitimacy of these bodies can be used by the state to transfer some of its governance functions to them vis-a-vis the class of organizations they "govern." For instance, it may officially delegate to them certification, licensing, or adjudication rights pertaining to these organizations, or reorganize certain classes of regulatory actions performed by the apex bodies, so that the state no longer needs to perform these certification, licensing, adjudicatory, or regulatory functions for these classes of organizations (or individuals). There may also be possibilities for replacing governmental regulatory bodies by elected bodies. In New Zealand, for instance, beginning in 1988, local education boards appointed by the government were abolished and their functions were transferred to elected boards[68]. Thus, devolution of governance functions to non-state bodies or legal recognition to those functions that are being performed are both rich possibilities for slimming the state.

Such privatization of governance is becoming somewhat commonplace in many societies. For instance, in Britain and India, the state relies on the institute of chartered

accountants to frame acceptable accounting principles and practices and more or less requires that companies abide by them. It does so by requiring companies to obtain from chartered accountants--and only accountants who are members of the institute--a certificate as to whether or not their accounts have incorporated acceptable accounting principles and practices to show a true and fair picture of the company's financial health and performance. The state often recognizes certain private bodies in good standing to certify compliance with some regulation or another. For instance, the state may rely on the bankers' certificate that an importer has complied with all the formalities required for release of foreign exchange to pay for imports; confer on an association of vehicle owners the right to issue driving licenses or certificates that emissions are within permissible limits. Even some individuals, such as notaries and justices of peace, are vested with such powers as powers of attestation.

With time a modernizing society's private institutions tend, through trial and error processes, to develop formal or informal codes of conduct and conduct monitoring and code enforcing capability. Such institutionalization is more likely in open, democratic societies because of contestation and relatively easy access to information. Although not part of the state, these institutions begin to resemble the state and may, therefore, be said to be governments. So long as these governments remain democratic, maintain due process and the rule of law within their mandates, they can function as arms of the state without being part of the state. There are instances of such institutions exercising nearly sovereign powers. The East India Company, with a charter from the British crown, could legitimately maintain armies, make war, annex territories, and rule these territories[69]. While such nearly sovereign powers may be both unfeasible and undesirable today, there still can be substantial devolution of the state's governmance functions to effectively performing, democratic, socially well-regarded institutions.

Such devolution is useful for a number of reasons. First, it reduces somewhat the onerous burdens of the state and also therefore its expenses. Second, it harnesses sector-specific expertise in the private sector that the state either does not possess or can acquire only at great cost. Third, it increases the legitimacy of regulations by having them administered by private bodies in good social standing. Fourth, it reinforces self-

regulation and participation of people in governance. Fifth, the intimate knowledge of the private body about the devolved matters is likely to translate into more effective regulation. Sixth, it can cut down on corrupt practices in the government's regulatory agencies. Seventh, if these institutions are administered democratically, contestation, accountability, and internal and external monitoring would tend to eliminate favouritism, underhand dealings, etc. The risk of devolution is of inappropriate execution, corruption, and erosion of public accountability. That risk can be contained by some steps. For instance, the private body with devolved authority may be required to be administered democratically, with a largely elected managing committee and elected office bearers. Representation of various stakeholders, such as employees, customers, the state itself, and eminent professionals in the management apparatus of these bodies may be mandated, so that the regulatory functions are fair to all stakeholders. Their charters for devolved authority may be for limited periods, and renewable only subject to a review of performance. Training may be provided to the functionaries of these bodies related to the devolved responsibility.

Some potentially major areas of devolution are certification, licensing, and justice. A wide range of certifications can be devolved to appropriate community bodies: births, deaths, marriages, caste or religious or community affiliation, domicile, property maintenance, etc. Local associations of business can be enabled to issue certifications concerning compliance with fair employment practices, pollution control requirements, records maintenance requirements, safety and hygiene requirements, grievance redressal procedures, etc. Consumer interest protection bodies can be delegated certification of safety and quality for specific classes of locally produced or distributed items like restaurant food, and cooked food, fruits, or vegetables sold by vendors.

Licensing is another high potential area for privatization to appropriate institutions. In contemporary societies, licenses are often required for all sorts of activities: drive a vehicle; set up shop; construct a factory; start certain types of practices that require a high order of training, such as medical practice; sell alcoholic beverages, drugs, and other products whose distribution needs to be regulated in the public interest; deal in foreign exchange; operate as a broker on a stock exchange; start a company; start a bank or an insurance firm; make public issues of capital; enter into a joint venture with a

foreign party, etc. etc. Many of these licenses and approvals can be delegated to appropriate institutions. For instance. if there is a local shopkeepers' association. it can handle applications for license to start a shop. The local branch of a medical council can handle applications for license to start medical practice. Drug dealers' association, if there is one, can handle licensing applications for starting a pharmacy. The relevant industry associations can handle licensing applications for setting up factories. Such devolution may not only be cost effective, it may also strengthen what some have called associational democracy, that is, democracy at the levels of the institutions, associations, and groups in society[70].

Justice is a third interesting area of (limited) privatization. In many democratic countries professing rule of law. justice is so often delayed or is so expensive at times as to constitute denial. In India, one estimate is that some 6 million cases are pending in the courts[71]. Lok adalats or people's courts have mushroomed to speed up justice[72]. A lok adalat is constituted when one or a few highly regarded individuals are requested by the community to constitute a court. Those desirous of bringing a dispute to it have to make a prior agreement to abide by the decision of the lok adalat. Thousands of disputes have been very speedily resolved in this fashion. disputes that otherwise might not have been resolved by the courts for years, and might have financially ruined the parties in the bargain.

Disputes headed for the law courts can be cut down by several private initiatives. Many employer-employee disputes can be prevented form reaching law courts by instituting fair grievance redressal procedures within organizations. More can be prevented by fair employment practices. Industry or trade associations can develop codes of fair management practices and grievance procedures for widespread adoption by member organizations.

Slimming through Deregulation

States enact regulations for a large variety of public purposes such as prevention or reduction of market failures, public safety, control of "profiteering," containment of monopolization and exploitation by "monopolies," conservation of scarce resources like

foreign exchange, effective macroeconomic management through credit control, ensuring the health of vital sectors like the financial sector and capital markets, guiding investment into high priority sectors, prevention of "unfair" competition, enforcement of conservationist measures, pollution control, containment of discrimination against the "disadvantaged," and so forth. Many of these are well-intentioned, and many may indeed have beneficial consequences. For instance, losses in the "tightly supervised" banking sector in Malaysia during the banking crisis of 1985-86 were only 2.4% of deposits versus 40% of deposits for the lightly supervised non-bank co-operatives[73]. Even the World Bank, a strong votary of deregulation, has acknowledge the need for regulation in the sectors of utilities, environment, and finance[74]. But many regulations may also impose costs, sometimes unanticipated costs, such as corruption, poor public service, unconscionable delays, increased transactions costs, inequity, inefficiency, outright theft of public property, and so forth. In statist economies, therefore, there is considerable scope for slimming the state and making it more effective through deregulation. Even in non-statist societies, regulations that may have made sense at one stage of economic or social development may not do so at another stage. For example, pollution control through stringent government regulations may be called for at a time when industry is flagrantly polluting the environment. But once responsible behaviour regarding pollution gets institutionalized, the machinery of pollution regulation may need to be dismantled or attenuated, and regulation can even move from state regulation to self-regulation by industry itself. Similarly, some form of foreign exchange control may make sense during extended periods of balance of payments difficulties, as Britain experienced in the fifties and sixties, but this control may need to go once the balance of payments get stablized.

Poor countries do tend to regulate more, possibly because of immature private sectors and the attractiveness of statist economic development. Of 39 countries that were classified by the World Bank in its World Development Report 1997 as low income and lower-middle income countries, 32 scored 4 or 5 on regulation, a component of the conservative Heritage Foundation's index of Economic Freedom for 1995, while of 20 countries that were classified as upper-middle and high income coutnries, as many as 18 had regulation scores of only 1 or 2[75]. But that may not mean, as the Heritage Foundation believes, that regulation necessarily depresses the growth rate significantly.

Regulatedness and growth rate seem to be more or less uncorrelated. Highly regulated as well as lowly regulated economies had fairly close percentages (45% versus 47%) of countries with negative or low growth rate upto 2% per annum. Similarly highly regulated as well as much less regulated economies had similar percentages (55% vs. 53%) of countries with growth rates above 2%. China. Vietnam, Mozambique, and Indonesia, all four highly regulated economies, had annual growth rates exceeding 7%, while Singapore, Malaysia, and Chile, all three with relatively low levels of regulation, also grew at 7% plus. Similarly, several highly regulated economies recorded negative growth rates; but so did several low regulation countries.

Regulation, or rather, excessive regulation, can, however, extract large social costs. Regulation appeared to be strongly correlated with the extent of black market in the economy, another component of the Index of Economic Freedom. For instance, of the 101 countries for which the Index was computed in 1995, the least regulated 28 countries (with scores of 1 or 2 on the 5-point regulation scale) scored an average of 2.5 on the extent of black market; while the most regulated 38 countries (with regulation scores of 4 or 5) scored an average of 4.3 on black market (black market scale went from 1 = less than 10% black market economy to 5 = over 30% black market economy)[76]. Black markets reward the unscrupulous and thereby distort incomes in their favour, corrode public administration, and reduce tax revenues. Wealth from black market operations tends to be used up in hoarding and conspicuous consumption, or ends up in Swiss bank accounts, rather than be used in productive, income generating investments.

Every regulation involves not just benefits but also costs, and sometimes the cost-benefit ratio becomes quite adverse. Consequently, there can sometimes be striking benefits form deregulation. Reportedly, deregulation in airlines, railways, trucking, telecommunications, and cable television in the US yielded an estimated $ 40 billion in welfare gains to consumers and producers, not to mention savings in administrative costs to the state; and in Argentina, liberalization of harbour terminals in Buenos Aires resulted in 80% reduction in fees[77]. In Chile, after deregulation in the telecom sector, several new providers of telecom services entered the fray, and the price of long-distance dialing dropped by half[78].

Deregulation or no regulation are no panaceas, however. The costs of inadequate or inappropriate deregulation can be horrendous. In a recent World Bank study, over 100 instances of bank insolvency in 90 economies during 1970-1994 were identified, entailing losses to governments exceeding 3% of GDP in 23 out of 30 countries for which data were available[79]. The largest losses were in developed countries. In the US, the savings and loan debacle of the 1980s following deregulation of this sector cost $ 180 billion to clean up, and in Japan in the mid-nineties, unbridled financing of real estate speculation by banks resulted in nonperforming bank assets of $ 400 billion. Latin American economies also encountered horrendous haemorrhages; Argentina's losses from banking scandals in the 1980s were over half of its GDP, and Chile's exceeded 40%.

The World Bank has identified two different modes of regulation[80]. One it calls institution-intensive regulation, involving precise and detailed regulations, reliance on bureaucrats and government technocrats to oversee them with considerable discretionary authority, as well as checks and balances to prevent arbitrary behaviour. The second it calls institution-light regulation. involving simplification of rules, use of contracts, transparency, extensive public information, use of incentives, decentralization, monitoring by people's organizations, arbitration machinery for resolving disputes, etc. The World Bank has advised three principles that should govern the response of the state to demands for regulation:

> "First, different ways of regulating having different costs and benefits, which countries should assess explicitly before proceeding. Second, this assessment should also incorporate the administrative dimension: some forms of regulation are intensive in their requirements for information whereas others require much less (or much more easily monitorable) information; likewise, some regulatory approaches depend on command-and-control, others more on market-like mechanisms. In general. information-light and market-like approaches are easier to implement, and often at least as efficient. Third, states differ markedly both in their institutional capabilities and in the structure

> of their economies. Their approaches to regulation should reflect these differences"[81].

Regulations tend to be self-perpetuating because they tend to create power centers and vested interests. Regulations give the regulator the power to impose costs on regulatees for actual or alleged non-compliance, which then may confer on the regulator the power to extort rents from the regulatee. To prevent or minimize this, governments resort to checks and balances. A corrupt system may arise in which there is a rent sharing nexus between unscrupulous regulatees, corrupt regulators, and corrupt supervisors of regulators. Thus, special efforts need to be made to eliminate inappropriate regulations, efforts that are likely to be vigorously resisted by vested interests.

Springcleaning has been attempted in many different ways. One innovative effort has been reported from Mexico[82]. A high level "deregulation czar" was appointed by the president in 1988, who reported directly to the president and the council of ministers. Businessmen in Mexico had access to this official, and they could complain about irksome rules and regulations. The czar's office was mandated to investigate these matters, in particular find out the rationale for such rules and their relationship with other regulations. The office had to take the view within 45 days as to whether a rule should be retained or not. If it did not, then the rule was automatically annulled. This innovation appears to have worked, mainly because of very high level political support, tough penalties for officials that failed to implement the czar's rulings, the time limit, the availability of expert staff to the czar, and the czar's credibility won by fair hearing and impartiality towards the weak as well as the strong.

The British government has effectively used the businessmen's deregulation task force device to identify regulations for removal or modification. Seven such task forces appointed in 1993 made over 600 proposals for deregulation, of which just about 60% were accepted by 1995[83]. As additional measures, an eighth task force was appointed to propose deregulations concerning charities and the voluntary sector Another interesting development was legislation that required estimates to be made of what any new regulatory legislation may cost business in implementing it. Further, in 1992 the

prime minister instructed all departments to review all their regulations to identify those that could be simplified or eliminated. Several hundred regulations were identified for amendment or repeal[84]. In Canada in 1992, the government initiated a department-by-department examination of existing regulations, and this examination mandated that every regulation that was retained was publicly justified in terms of the benefits of the regulation outweighing the costs, and further, that the regulation was structured in such a way as to maximize gains to beneficiaries in relation to the costs to the government, business, and citizens[85]. In New Zealand, sweeping deregulation was ushered in by a Labour Party government in the mid-eighties that was convinced that New Zealand was over-regulated and this hampered its competitiveness. The deregulation drive resulted in the removal of wage and price controls, controls over interest rates, controls over capital movement, restraints on competition in the banking sector, restraints on competition in sectors like telecommunications, energy, and transport, and restraints on employer-employee bargaining[86]. It also abolished licensing that applied to many professions and trades.

Responding as governments continuously do to a barrage of problems and crises, and concerned as they are with the defensibility of their actions, there is a nearly irresistible pressure on governments to make regulations. To remain vital and responsive, however, governments must be equally energetic in periodically eliminating or modifying regulations that cost much more than their benefits. "Exnovation," or this sort of periodical springcleaning needs to be institutionalized. Without strong political support this sort of springcleaning is unlikely. Also, incentives must be created for bureaucracies to curb their regulation-breeding tendency. If bureaucracies are assessed on how their citizen "clients" perceive them, and if rewards are tied to improvement in perceptions, perhaps many bureaucracies may be motivated to eliminate unnecessary and irksome regulations. Further, if savings from deregulation are allowed to be spent by the bureaucracy in discretionary activities, there may be a further incentive to deregulate. Publicly specifying the longevity of every regulation, so that the regulation ceases automatically to be in force on the expiry of its specified life, unless explicitly renewed before this, may also help in depleting unnecessary regulations.

Concluding Comments

The state's governing capacity is not some static quantity. It can be raised, but over time. It can be raised by appropriately redesigning both its political system and also its bureaucratic system. But these changes take time. In the short-run, however, the state's governing capacity can be a constraint on what the state can do effectively. Some fine tuning of the state's portfolio of activities can reduce the gap between what the state can do well and what the state is doing. That fine tuning is a pragmatic enterprise, not an ideology-driven wholesale retreat into a laissez-faire state. Opportunities for fine tuning are afforded by the selective and appropriate privatization of state-owned enterprises, public services and the state's governance functions, and by selective and appropriate deregulation. Privatization of state-owned enterprises provides an additional bonus in the form of generating for the state large financial resources that can be invested in high priority areas like infrastructure improvement, health, education, R and D, etc. Privatization of public services can enhance citizens' satisfaction with public services and lower costs to the state, but public accountability and public purpose need to be protected by appropriate mechanisms, and the issue of manpower rendered surplus through privatization has to be tackled imaginatively. As a society's skill capital and the capabilities of its various associational institutions increase it should be possible to transfer increasing amounts of the state's governance functions to private bodies, but here again, privatization must be done with suitable safeguards lest the public interest suffer. Such privatization may yield an unexpected bonus in the form of strengthening the institutions to which devolutions of governance functions are made. Selective deregulation in over-regulated states is desirable to reduce transactions costs, corruption, and black marketing. Equally, of course, appropriate regulation in laissez-faire oriented states, or in key but unregulated sectors is desirable to prevent large scandals and scams, and speculation spurred collapses. Publicly deliberated, consensus-based, expert analysis underpinned strategies of privatization and deregulation (or appropriate regulation) are more likely to yield good results than doctrinaire, unilateral, or externally imposed strategies. If privatization and deregulation are managed effectively, a bonus is an enhancement in the state's governance capacity because scarce financial and managerial resources are released to improve

the operation of those activities not privatized or deregulated. The state is able to recharge its batteries.

One final point. Privatization is a useful way not only of spreading governance skills and governance responsibilities in a society, an outcome that strengthens participative democracy; it is also a useful way of tapping managerial talent outside the state. As a society matures, a great deal of managerial competence begins to accummulate in the various private institutions of the society. Normally it is used for furthering private interests. Privatization enables the state to tap this large, growing pool of resourcefulness, competence, and creativity for public purposes. This facilitates the diffusion of public purpose to private institutions and managers, so that what emerges is a creative fusion of public purpose and private initiative and efficiency. Utilizing this pool and enriching it can only speed the ascent to state and societal excellence.

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