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40 YEARS OF PRIVATISATION- WHAT'S NEXT?

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Abstract

Privatisation was hailed as the saviour for the ailing public enterprises when it was first introduced in the early eighties. It was argued that privatisation would bring efficiency to the public enterprises. Efficiency would therefore result in increased profitability. It was argued that this can be achieved because privatisation would instil the private sector behaviour into the conduct of the public enterprises. This was used as the main argument to promote privatisation despite the lack of theoretical support for it. Apart from that, it was also argued that privatisation would reduce the size of government by reducing the size of public sector employees as well as promoting the private sector involvement in the economy. Nonetheless, when privatisation was then introduced, many of the enterprises that became the first target of privatisation were profitable public enterprises especially the public utilities. However, after almost four decades, it is clear that such is not the case. Many of the privatised enterprises, despite retaining the monopoly power, failed to produce the desired results. Apart from that, all these economic arguments disguised the political reasons behind the introduction of privatisation especially the need and desire of the government to curb and limit the power of the trade union. This is especially true when assessing the privatisation policy in the UK. This paper therefore seeks to address some of the issues surrounding the privatisation programs and share some cases of success and failures of the privatisation policy drawing examples both in Malaysia as well as abroad.

Keywords: Privatisation, efficiency, ownership.

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1. Introduction

Privatisation remains one of the controversial policies even after 40 years of its introduction not least because its introduction was not entirely based on genuine economics arguments (Kay & Thompson, 1982). The spectre of privatisation is hurting both Australia and New Zealand, and especially politically (Davidson, 2014). By many accounts, Margaret Thatcher, the then conservative government's Prime Minister of Britain introduced privatisation as an attempt to curb the power of the labour unions (Forsyth, 1997) who had paralysed the British economy in the 1970s through continuous strikes. However, Johnson and Shleifer (2004) has showed that privatisation has worn off since the 1980s and this is a general feeling of caution.

Privatisation involves transforming a formerly public enterprise into a private entity. This can take several forms such as denationalisation, deregulation and sale contract (Kay & Thompson, 1982). As Vickers and Yarrow (1991) pointed out, the objectives of privatisation were to improve efficiency, reduce public sector borrowing requirements, reduce government involvement in enterprise decision making, ease the problem of public sector pay determination, widen share ownership, encourage employee share ownership and gain political advantage. Parker (2004a) noted that the "flotation of state enterprises did help to expand share ownership in Britain. The percentage of adults holding shares rose during the 1980s, from around 7 % to 25%" (p. 10). In totality, the privatisation policy has become the means by which the public enterprises were transferred to the private sector. However, countries are still experimenting with ways of transferring management without transferring ownership (Shirley, 1992).

2. Problem Statement

Many of the economics arguments put forth in support of privatisation centres on the efficiency arguments. Yet, efficiency is not synonymous with ownership whereas privatisation involves the transfer of ownership from the public sector to the private entity. Eluded in the government's stated motives of privatisation was the fact that the public enterprises were established in the first place to meet certain and often specific objectives, such as providing rail services, or postal services, which otherwise cannot be fulfilled by the private sector, at least not during the time they were set-up.

Malaysia was among the earliest nation to adopt the privatisation policy. The move was mooted in 1983. However, not until 1985 did a Privatisation Master Plan introduced. 40 years later, it still receives public scrutiny due to the failures of some of the undertakings which ultimately forced the government to the rescue. Notable among this is the failure of Malaysia Airlines. The Privatisation Master Plan stated that the objectives of privatisation in Malaysia are: to relieve the financial and administrative burden of the government, to improve efficiency and productivity, to facilitate economic growth, to reduce the size and presence of the public sector in the economy, and to achieve the national economic policy target (of the New Economic Policy).

3. Research Questions

What are the major issues pertaining to the privatisation exercises that raised considerable attention from either the policy perspectives as well as the public scrutiny?

4. Purpose of the Study

This paper attempt to highlight major issues pertaining to the privatisation exercises that raised considerable attention from either the policy perspectives as well as the public scrutiny. This paper shall address some of the problem that led to these failures and at the same time highlights the contributing factors that contributed to its successes. In Section 2, we discuss the theoretical perspectives of privatisation. Section 3 highlights the new arguments in support of privatisation. Following this, we discuss current progress of the privatisation policy. The conclusion follows in Section 7.

5. Research Methods

This paper address some of the issues surrounding the privatisation programs and share some cases of success and failures of the privatisation policy drawing examples both in Malaysia as well as abroad.

6. Findings

6.1. The Debunked Arguments

Many of the initial objections of privatisation, notably Kay and Thompson (1982), was due to the fact that the policy lacked the theoretical arguments to support it. As pointed out by Parker (2004b), unlike their European counterparts, there has never been any official documents on the privatisation policy in the UK, apart from the Conservative Party manifesto. Privatisation, in general terms, refers to the shifting of governmental functions, responsibilities, and sometimes ownership, in whole or in part, to the private sector (Tang, 2017).

In fact, as pointed by Vickers and Yarrow (1991), in two out of three types of privatisation activities carried out, namely the privatisation of public competitive firms and the privatisation of state-owned enterprises with substantial monopoly power, the government exerted controls through regulation. In some cases, this control is overly restrictive or vague (Tang, 2017). Consequently, this also means that the privatised enterprises are not totally free from the government control. Among the reason why this arises is because privatisation was sold on an implausible argument especially with regards to the inefficiency of the public enterprises.

The argument for efficiency is equally difficult to judge in an industry dominated by a loss-making public-service obligation and suffering (Gibb, Lowndes, & Charlton, 1996).

The privatised public enterprises were either loss-making or were profitable. Yes, it is plausible that privatising loss-making public enterprises will reduce, if not eliminate, the financial burden of the government. The same argument cannot be used in the case of profitable public enterprises. By privatising profitable public enterprises, the government lose the revenue generating resources.

There are two major aspect of the privatisation that need to be understood. First, privatisation was offered as a way to increase efficiency of the public enterprises. Consequently, this involves the transfer of ownership from the public sector to the private sector. Hence, efficiency and ownership became the inter-twined issues when discussing the privatisation policy.

Students of economics would know that efficiency is defined in two ways i.e. productive efficiency where price is equal to the minimum average cost (P=AC) and allocative efficiency where price equals to

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marginal cost (P=MC). Both can only be achieved by a perfectly competitive firm. This firm structure itself highlights the fact that competition is an important determinant of efficiency and will therefore determine also the efficiency of the firms after privatisation. Yet many, if not all, of the privatised public enterprises retains their monopoly status after privatisation. In some cases, notably in the case of British Airport Authority (BAA), privatisation only involves the conversion of public assets into a regulated private monopoly (Tang, 2017). In many developing countries, the market itself were generally 'underdeveloped and are highly uncompetitive' (Nhema, 2015) to allow competition to play its role in enhancing efficiency. This refers to both the product market as well as the capital market. This limitation is recognised by UNDP-GCSPE (2015) when they argued that "no model of ownership (public, private, or mixed) is intrinsically more efficient than the others, but there are efficiency differences within certain service sectors and specific contexts" and that the literatures that compare efficiency between private and public lack rigors. This can be clearly seen when we discuss the performance of privatisation programs in the next section.

This concept of efficiency became a thorny issue when comparing the enterprises before privatisation and after privatisation. No doubt, many of these enterprises became profitable after privatisation. However, as pointed by Parker (2004b), although profit is a useful measure of productive efficiency in competitive markets, its use in imperfectly competitive conditions is problematic because profits may reflect higher prices rather than more efficient production practices. Hence, those profitable privatised enterprises may have enjoyed profitability because of higher price and not because of increased efficiency.

Privatisation was also pursued on the premise that the private sector has the inherent incentives to run the business efficiently because of the profit objectives. Thus, the transfer of public enterprises onto the private hand became eminent. Yet again this argument failed to recognise that, those public enterprises were established in the first place, not for profit objective but to provide goods and services that the private sector failed to produce (i.e. public goods) due to higher start-up cost and other issues related to market failure. In addition, since those public enterprises were under the government control despite the fact that they were the off-budget agencies, there were many restrictions imposed on them. In the UK for examples, these public enterprises were faced with restrictions imposed by the Public Sector Borrowing Requirements (PSBR) which means that their ability to borrow money to finance their activities are restricted. In such cases, the below average performances of these public enterprises are not to result of their operation but because of the restriction imposed by the government itself. According to Nhema (2015), privatisation therefore can be envisaged as a method of insulating enterprises from the disastrous public policy interventions by the government.

In general, the economic arguments that privatisation could lead to efficiency have been debunked (see for example, Kay & Thompson, 1982; Vickers & Yarrow, 1991; Shirley, 1992). However, it should be highlighted that this argument failed to recognise the fact that the private sector's managers are governed by a different set of incentives and disciplines that are different from their public sector's counterparts (Kay & Thompson, 1982). Shirley (1992) has also argued that the arguments that privatisation creates additional public resources is in fact illusory.

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6.2. The Political Economy of Privatisation

It is no coincidental that the privatisation policy was introduced and adopted at the same time as the demise of the Keynesian activism policy. The Keynesian economic philosophy of the sixties and seventies resulted in the expansion of government involvements in the economic activities. The increased number of state-owned enterprises (SOEs) and nationalisation was the result of this. The main objectives behind the establishment of these state-owned enterprises were to provide the so-called public goods and services (Rees, 1984). However, Rees (1984) also argued that the main problems with these SOEs are that "the objectives which public enterprises are set are poorly defined, complex, unstable, and tend to increase cost levels and reduce profits" and that "failures occur in the monitoring and control of public enterprises, which allows those within them to operate in their own interest, implying high costs and low profitability" (p. 19).

These SOEs were run not as profit-oriented entities. Apart from that they were headed by bureaucrats. Profit were not their motives and the bureaucrats are not paid based on their financial balance-sheet performance. Boubakri, Cosset, and Guedhami (2004) also argued that the managers of these SOEs are not exposed to the market mechanisms' pressure such as the stock market, the product market and the managerial labour market, unlike their private sector counterparts and in addition, they were not evaluated on how much profits they made but according to whether they deliver the task assigned to them i.e. in providing the public goods and services. The utility function of these bureaucrats differs significantly from their private-sector counterparts (Niskanen, 1971) who were driven by profit motives. If that were the case, why not the government set profit as the sole objectives of these public enterprises.

The privatisation involves the selling-off of public enterprises to the private sectors. Financially, two immediate benefits can be enjoyed by the government from privatisation: proceed from the sale increase the revenue of the government and at the same time, it reduces the government expenditures. However, this sale is only a one-off increase in government revenues; in subsequent years it constitutes a revenue loss. There is no prove that government expenditures decrease dramatically post-privatisation.

It goes without saying that the pursuit of privatisation is to advance the philosophy of the free market economy, i.e. minimal government. This has become the decree and the political mantra of the 1980an, or specifically post-Keynesian era. One obvious evidence is the involvement by the Adam Smith Institute in the proposal to privatise the British Rail. Authored by Kenneth Irvine, the Institute published the Right Lines (1987) and Track to the Future (1988). Graham and Silke (2017) called this as the dominance of neo-liberal discourse and the death of public goods which rose into dominance following the collapsed on Keynesianism and the resurgence of economic laissez-faire liberalism. But, as many sceptics pointed out, when the economy is in nose-dive, the government is urgently called upon to the rescue, as was the case during the 2007 financial crises.

One element of privatisation that are often neglected though appears in many policy papers is its effect on broadening the share ownership that resulted from the privatisation programs (OECD, 2018). In Malaysia, this was indeed one of the target of privatisation – at least based on the official objectives set by the Privatisation Master Plan, 1985. In the UK, expanding the domestic shareholder base was also cited as the reason for the push towards privatisation (Her Majesty Treasury, n.d). In some instances, the shares issued as part of the privatisation exercises are reserved for the employees of the privatised entities.

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6.3. New Justification – The Corporate Governance

New justification has emerged in support of privatisation policy. According to Shirley (1992) this new justifications are based on the arguments that privatisation should further three goals: (1) improving the use of public resources, (2) improving operating efficiency, and (3) improving dynamic efficiency. The main aim of privatisation as promoted by the World Bank is therefore to help developing countries to increase efficiency and cost effectiveness (Shirley, 1992). Obviously, efficiency is no longer confined to the economic definition of efficiency (the allocative efficiency and the distributive efficiency), but rather revolves around the new concept of operating efficiency and dynamic efficiency. The later, according to Shirley (1992), concern the privatisation of property rights which led to new investment, or innovation which would provide the stakeholders with a clear interest with regards to the funds invested. Tan (2012) argued that a "clearly designated property rights reduce the chain of command between principal and agent and also provide owners with incentives to monitor the performance of managers" (p. 45).

Privatisation has also been suggested as a way to improve corporate governance. The state-owned enterprises were considered to have a weak corporate governance which contributed to their weak performances (Johnson & Shleifer, 2004). They argued that the effectiveness of privatisation is greater when corporate governance works well. This relates to the principal-agent theory. Private sector managers are governed by a different set of rules as opposed to the public sector bureaucrats that run the public enterprises. In many parts of Asia and other developing countries, privatization was accompanied by other economic reforms, such as trade and other capital market liberalization (Boubakri et al., 2004) which strengthen the corporate governance of the privatised companies. However, Dyck (2001) pointed out that the difference between corporate structures of established firms and the privatised enterprises is that the later have not yet been tested. Furthermore, Dyck (2001) also argued that the structures of the privatised enterprises are devised by political actors.

Johnson and Shleifer (2004) has argued that privatised firms with weak corporate governance have demonstrated weak corporate governance. Damagingly, they also argued that in many countries, the judiciary cannot counted on to enforce contracts between investors and firms.

6.4. The Unpopular Policy

As soon as Prime Minister Margaret Thatcher and President Ronald Reagan adopted the privatisation programs in the early eighties, the World Bank has embraced it as the way forward for the economic relationship between the private and the public sector. As mentioned earlier, this is in no way uncoincidental especially when considering that it took place in tandem with the demise of Keynesian economy and the rise of neo-liberal thought either in the form of the New Classical Macroeconomics or the monetarist economics whose philosophy was based on market economy. The debate between market economy and government involvement in the economic activities was tenacious in early 1980s (Wolf, 1993), spearheaded by Friedman on one hand and Galbraith on the other.

A few aspects of the privatisation policy have made it as an unpopular policy, and still are, in light of some recent development. First, when countries rushed to undertake privatisation, many of the earlier enterprises targeted were the profitable ones. In Malaysia, these include the Telekom Malaysia (telecommunication), Tenaga Nasional (electricity supply), and even the Malaysia Airlines. Adam and

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Cavendish (1995) show that in 1980 for example, 61 percent of the state-owe enterprises which were the candidates for privatisation then, was indeed profitable. Vickers and Yarrow (1991) painted the same pictures in the case of public enterprises in UK. They showed that the Electricity Council, British Gas, British Rail, British Airways, British Aerospace, National Bus, British National Oil Corporation as well as British Airports Authority were all making profits in 1978-1979. Later on, these ventures failed, such as in the case of British Rail and Malaysia Airlines.

On many fronts, privatisation has been successful in transforming the privatised enterprises into a profitable entity. However, there are also many cases of rolled-back and failures, and in this later case, the consequences are catastrophic. Hall and Lobina (2006) documented the failure of the privatisation of water services in a few countries including China, India, Vietnam, Turkey and Zimbabwe. They concluded that the evidence debunks one of the most important myths concerning water privatisation, namely that private finance will play an important role in delivering progress towards the water and sanitation MDG. Furthermore, they argued that "emphasis on the private sector over the past 15 years has had a negative impact on progress towards water and sanitation MDG" especially among the poor communities on the world.

In the US, the privatisation of airports has face with some serious challenges. According to Tang (2017), the US Congress has established the Airports Privatisation Pilot Program in (APPP) 1996. However, the program only managed to complete the privatisation process of only two US commercial services airports because airports privatisation is unattractive due to the likely higher financing costs and the loss of financial grants from the federal Airports Improvement Program (AIP). Privatisation was pursued to provide a ready source of funding for airports (Donnet & Keast, 2011). They also argued that the airport privatisation pays less attention to the need of the airport as gateways to the region and domestic hub for fostering economic growth, but instead focused more on ownership structure and agenda of control. In some cases, the "major obstacle to securing investment is the prospect that those delegated with decision making power will not use that authority to deliver what was promised but will instead divert the returns for their own benefit" (Dyck, 2001, p. 77).

In UK, the major headache of the privatisation program is the rail privatisation. The privatisation of the British Railways in 1992 involved the separation of the British Railways into three separate entities – the rail track (and signalling), the passenger services and the freight services – despite the many suggestions that British Railways should be privatised as a whole some. The passenger services were later-on divided into 25 different franchises. Bowman (2015) argued that the privatisation of British Rail can hardly be called privatisation because of the successive failures of the ventures that forced the government to highly subsidise their operation. In a piece in The NewStatesman, Wolmar (2018) argued that the privatisation of British Rail has nothing to do with making the services better but rather was driven by the ideological fervour of a few Tory MPs. Leyland (2005) claimed that the policy was pursued by an unpopular government. The same argument was put forward by The Guardian that the Conservative party drove through the privatisation of British Rail two decades ago for largely ideological reasons. This follows the forced bail out of StageCoach under the Virgin Group (The Guardian, 2017). Leyland (2005) argued that the problem with British Rail privatisation is that it involved taking one single industry and breaking up into distinct parts.

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In Malaysia, two epic failures of privatisation are the water privatisation and the Malaysia Airlines. This comes despite the many successes in many fronts. Malaysia Airlines was among the few pet projects earmarked for privatisation in Malaysia in the early 1980s. This follows the example of British Airways. The latter was also one of the earliest enterprises identified for privatisation but was only privatised in 1986.

Secondly, in some instances, the motives for privatisation has nothing to do with efficiency but rather "to monetise corporate assets in order to free up funds for other public interest needs" as well as to open them for foreign investment, such as in the case of Lithuania, the Czech Republic, France or to reduce national debts (OECD, 2018). When profitable public enterprises were privatised, the government loses the source of fund that these enterprises could generate. Hence, in many instances, the government would normally and gladly announced the amount collected from the sales of those public enterprises. There is no definitive evidence that the private enterprises are more efficient that the public enterprises.

Thirdly, in many parts of the world, the initial adoption of the privatisation policy was undertaken at haste. The proper environment to support the privatisation policy was not there. Majority of the privatisation exercises in UK was successful because this environment was created in tandem with the implementation of the privatisation policy. One such environment that are crucial is the regulatory framework. The inherent motive behind every private entity is profit. Private enterprises will cut corners, embark on unethical business practices, etc. All these affect the social welfare of the society that may arise because of price increase, the quality of the services, or even the reduction in the quality of the produce of these private entities. A regulatory body (bodies) is therefore needed to oversee these practices. Hence, in UK, these regulatory bodies were set-up to regulate the privatised bodies. Two sets of regulatory bodies were established, first is the specific industry regulatory body such as Office of Telecommunication (OFTEL, now part of OFCOM), Water Services Regulatory Authority (OFWAT) etc., and second the Merger and Monopoly Commission (MMC, now the Competition Commission). Privatisation should be seen as the needed reform to rejuvenate the previously public enterprises. These are the enabling environment that are necessary for the successful implementation of privatisation. In its review of the adoption of privatisation across developing countries, Asia Development Bank (2001) acknowledged the need for aid agencies to support policy reforms, competition, and the presence of the regulatory environment when accessing privatisation effort.

Another aspect of the privatisation policy that make it unpopular is the fact that privatisation led to load-shedding by means of retrenchment, voluntary retirement, or voluntary separation schemes. Gibbs, Lowndes, and Charlton (1996) show that between 1979 until 1988-89, British Rail had shed 70,000 jobs. This was viewed as an effort to reduce the size of government in the economy. But, does that translate towards the reduction of the overall government expenditures, or whether it was displaced by other form of government expenditures

7. Conclusion

The rush towards privatisation can not be seen in isolation from the changing philosophical thought and economic thinking in the 1980s especially with the rise of neo-liberalism and 'demise' of the Keynesian economic thinking. The success of the privatisation policy, to borrow Brittan (1983) depend on the 'fully fledge market condition' in which the privatised enterprises operates. Vital to this condition is the present of competition. In cases where privatisation fails, the condition is not met. In their desire to privatise the provision of public goods, the government failed to ensure the presence of a competitive environment. When the privatised enterprises were successful, some studies have pointed that the success is not very much depend on the efficiency of those enterprises but rather on the higher prices imposed by these enterprises. In such case, there is the welfare loss on the part of the society arises from privatisation.

The failure of some privatisation projects may be due to the fact that there is no standard procedure to oversee the enterprises post-privatisation. According to OECD (2018), few countries have engaged in regular or even topical post-privatisation assessment of outcomes of these privatised enterprises except for France, Japan and Lithuania.

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