PRIVATISATION AND THE ROLE OF PUBLIC AND PRIVATE INSTITUTIONS IN RESTRUCTURING PROGRAMMES

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Privatisation and restructuring have been at the centre of national reform programmes in the industrial countries as well as developing and transitional economies. The economic rationale is overwhelmingly one of increased efficiency, encouraging the growth of private sector enterprises and reducing the role of the state.

The first section briefly discusses the causes of market failure and presents arguments for and against government intervention. The next reviews the three main approaches to privatisation; the transfer of ownership by sale of assets or by restitution, the introduction of a competitive environment following deregulation or liberalisation, and a system of contracting out the provision of goods and services in a public and private partnership. The necessity of subsequent restructuring and welfare provision is stressed in an outline of the factors necessary for privatisation to be successful.

The next section emphasises the importance of socially responsible restructuring and the involvement of stakeholders. The main groups, government, the new managers/owners and employees are specifically noted, although the stakeholders concerned go far beyond these to the community as a whole, and particularly the poor and disadvantaged who may be most in need of a social safety net. Other factors noted are the distributional effects and the governance implications of a dispersed or concentrated ownership structure, following a transfer of assets in the wake of a privatisation.

Finally, the problems associated with impact assessment are presented. These are mainly a function of the lengthy process of a major privatisation and the widespread effects across the economy. The need for a sufficient institutional and regulatory framework is emphasised and the post-privatisation evaluation will reflect how adequate these are.
1. THE ECONOMIC AND POLITICAL CASE FOR PRIVATISATION

1.1 Introduction

Privatisation has become a popular panacea for solving the organisational problems of LDC governments by reducing the role of the state and encouraging the growth of the private sector enterprises. However, privatisation takes a number of forms and has been approached in various ways during the move away from state control to other forms of ownership in developing and industrialised countries.

Any debate on the boundaries of privatisation raises the question as to how far can privatisation be taken, that is, where the boundaries are. One view is that everything can be privatised, except where there are important externalities, such as national defence. Historically, private provision of key services has been widespread, particularly in the form of the contracting out of services. But wars and economic depression during the last century prompted a rise in levels of regulation and nationalisation. More recent privatisations are a reversal of this in an attempt to achieve higher levels of efficiency.

However, it is important to note that privatisation is a political process and has important economic and social implications that not only affect enterprise performance, but also social welfare and stability. The social effects have to be considered in any impact assessment, particularly those related to employment, social safety net measures, social privatisation that results from the extension of share ownership to small investors and employees, and the role of public utilities and services in economic and social development. It is therefore important that the framework for evaluating policy developments, including all forms of privatisation, is clearly set in advance. Clearly, the crucial question is how should success be measured? If privatisation is part of an integrated policy framework, critical questions about priorities should emerge that reflect both technical analysis and value judgements about the tradeoffs between objectives. Practical judgement should inform decisions. For example, to treat inefficient and patronage-ridden public industrial enterprises and an under-funded government health system with an excellent record equally, in the case of Sri Lanka for example, is clearly wrong. Also, the Malaysian enthusiasm for privatisation seems to extend far beyond public enterprises into such public services as health and education and leave unanswered a large number of efficiency and distribution questions, not least relationships between ethnic groups.

1.2 Why is privatisation necessary?

The major objective of privatisation is to improve economic efficiency, competitiveness and sustainability of the whole private sector of an economy. The World Bank has noted that the return on equity invested in public sector enterprises is around one third that in the private sector. Thus, mobilising capital for investment will modernise the private sector and free up resources by reducing the financial
burden of loss-making public sector enterprises to more socially beneficial projects such as health and education. Important, too, is the removal of enterprises from the political arena.

1.3 Market failure versus government failure

The 1991 World Development Report considers the interaction between governments and markets, stressing the fact that the two should not be considered to be substitutes. For although competitive markets are the best way yet found for efficiently organizing the production and distribution of goods and services, the state must provide an appropriate institutional framework and must step in where markets prove inadequate or fail altogether. There is also a complementarity aspect of markets being encouraged to work and judicious intervention by the government in cases of failure.

It is important to examine the causes and consequences of market failure. However, firstly, it is useful briefly to consider the sense in which markets are supposed to be efficient, since the best way to understand market failure is to begin by understanding market success. Adam Smith argued that as each individual pursued their own self-interest, in a market economy, they would also serve the common good. The implications of this is that the following exist: (1) there are enough markets, and (2) all consumers and producers behave competitively. Therefore, if markets are complete, so that no transactions are missed, and if there are so many buyers and sellers that none can alone influence prices, then the market outcome will be efficient. Then resources will be fully employed, they will be correctly allocated to productive enterprises and the correct combination of goods and services will be produced, meaning the combination that will maximise the welfare of consumers, given the initial distribution of resource ownership, and hence incomes.

The conditions required for markets to achieve these objectives are discussed in the Applications Guidance Note on Regulation for Enterprise Development. In addition, efficient markets also depend on assuming perfect information, as the provision of information is itself subject to market failure. Monopoly control of information leads to market failure, just as much as monopoly over resources. It is clear too, that achieving fully competitive markets is difficult, so it is the nature and extent of the imperfection that is important. Interventions by government may also be justified where resources are not fully employed, or the efficient market outcome is unacceptable on distributional grounds. Therefore, although this too is closely linked to regulation and enterprise development, it is so central to privatisation and restructuring, and in particular the nature of a necessary government response, that both market and government failure are briefly included here.

a) Market failure

Markets fail for two main reasons. The first is where there are market structures that are at odds with perfect competition, because there are too few participants in the market. The second is that markets may not exist, or they may be incomplete or
fragmented; this allows transactions to have non-market spillover effects or externalities. Externalities result when the production or consumption activities of one economic group impinge on those of another and the effect is not resolved by the price system. All of these problems are likely to be more severe at lower levels of development. Furthermore, although monopoly and externalities are conceptually separate, they tend to interact to cause market failure. Since monopoly and spillovers lead to inefficient outcomes, both result in a misallocation of resources.

b) The case for government intervention

It is widely accepted that to maximize social welfare, public intervention is necessary in cases where markets fail. An economy with perfectly competitive input and output markets, and with no unpriced externalities, is supposed to achieve equilibrium. However, in developing countries in general, and Sub-Saharan Africa in particular, establishing the case for market failure is hardly necessary as in these economies market failure remains pervasive. Where markets are incomplete or non-existent, the role of the public sector must be expected to be greater than in economies where markets are well developed. Since the development process involves the establishment of institutions such as markets, a general principle follows - the lower the level of development, the greater is the pervasiveness of market failure, and thus the greater the need for public intervention.

c) The reaction against public provision

There are arguments that suggest that government should not intervene in the economy as a matter of general principle, of which just two should be mentioned here:

- **Ideological objections.** Those who believe that individual liberty is dependent on the preservation of market capitalism, which is threatened by state intervention, oppose government intervention in any form. Similarly, those with a normative belief in *laissez-faire* hold that it is wrong to entrust the control of resources to government officials no matter what social objectives they may be pursuing. That is, the government may not be benign.

- **Positive objections.** This is based on the premise that personal incentives are always the best motivation. The belief in the efficiency of market capitalism leads to anti-statism, and the argument that governments always dissipate the gains from the division of labour because they pursue their own self-interest. Rent-seeking is the norm and the state is an agent that is exceptionally difficult to monitor and control and is thus an inefficient means of pursuing any objective.

d) Government failure.

Market failure is a necessary but not a sufficient condition for government intervention since this assumes that existing imperfect institutional arrangements can be compared with an ideal norm. The appropriate comparative institutions approach compares the
existing arrangements with an alternative real set of arrangements, raising the possibility that government failure may lead to a less efficient outcome than market failure. Outcomes from government intervention include a lack of incentives, corruption, discrimination and rent seeking. Furthermore, there is no reason for the state to do better than the private sector where information deficiencies are the cause of market failure, unless the government has access to superior information.

e) The arguments against public intervention: Application to SSA

The extent of government failure in SSA is well established. It is not difficult to cite examples of chronic over-staffing of public institutions, which have grown alarmingly fast and yet produce less. Staff costs leave no surplus from inadequate budgets for carrying out projects, and support facilities are lacking. Rapid increases in staff due to political pressures to provide jobs, have resulted in quality declining as fast as numbers have increased. In addition, the lack of incentives is a serious problem.

In many countries the public sector is disproportionately large. Rather than attempting to assist in the development of market institutions, government policies have been antagonistic to private activity and have stifled what existed. Private enterprise has been actively discouraged as nearly every perceived problem has prompted a new government intervention.

Structural adjustment lending and conditionality in programme aid have led to changes in the public-private balance in many countries. This may be temporary, as compliance has been the result of coercion, rather than because governments have changed their ideologies, or dealt with corruption. Institutional changes, that take time, may be necessary for a better balance between public and private activities to be achieved. Other forms of joint ownership, such as cooperatives or alliances of various kinds may be useful in some cases. The organisation of small enterprises that form a cooperative, sometimes prompted by an initiative from an established private company, provides a means of skills and technical transfers that can be very productive. One example of this is a co-operative in South Africa that has linked the brewers to local farmers in South Africa.

1.4 Methods and Rationale

There are three main types of privatisation, and the approach taken to privatisation is a function both of the organisation or enterprise concerned and the level of institutional development in place in the country where it occurs.

The first is a transfer of state owned enterprises operating in a competitive market to private ownership.
In coal mining, as in all extractive industries, operations are continually restructured as older mines, exhausted or uneconomic, are replaced by new capacity. In the UK, the means to bring about the restructuring of hard coal mining included the closure of surplus capacity and measures to increase efficiency and competitiveness. These actions were underpinned by political initiatives to promote restructuring, such as reductions in operations subsidies and finance for new investment. Labour relations strategies were also adopted to complement the restructuring objectives.

The defeat of the 1985 miners’ strike led to an acceleration in the rate of restructuring in British coal mining. In 1988, the National Coal Board was given a new corporate identity as British Coal and the government initiated a privatisation programme. Between 1985 and 1992, all but 51 out of 169 collieries were closed and employment fell from 171,400 to 42,560, a contraction of 75%, while a reduction in output from 88.4 MT to 66 MT represented a contraction of only 25%. Subsequently, labour productivity rose from 2.72 to 6.20 tonnes per person per shift, later rising to 12 tonnes due to further improvements by the end of 1994.

Operational restructuring, in association with technological restructuring and restructuring of work organisation, was the source of productivity growth. As less productive capacity was closed and output from modern mines expanded, the industry’s average performance improved. The implementation of new technologies increased the rate of production and reduced labour requirements through automation, work organisation was altered and work was intensified through surveillance and new incentive pay arrangements.

State initiatives to promote restructuring have been complemented by employer strategies of restructuring the labour process and labour relations. For the new British Coal, operational restructuring depended on a range of tactics designed to deconstruct the established institutions of industrial relations, leading to the removal of the National Union of Mineworkers (NUM) and the introduction of the Union of Democratic Mineworkers IUDM, the only group with whom management would negotiate. The mineworkers conciliation scheme was terminated on 31 May 1986 and replaced by a new joint reconciliation procedure designed to internalise the divisions between the two unions. The Coal Industry Act 1987 provided for representation by the UDM, and a conciliation procedure agreed on 20 February 1987. (See Box 8 in the next section on Socially Responsible Restructuring below).


There are a number of options in this case. In the industrialised countries where capital markets are well established, this can be achieved by the sale of all or part of
the equity of the enterprise. This took place in the UK in the telecommunications sector and the utilities, gas, electricity and water and also coal during the 1980s and 1990s, where the aim was to raise economic efficiency by:

i) removing the ‘soft budget’ constraint of taxpayer support and improving the discipline of the market;

ii) providing incentives for managers;

iii) imposing a profit-based objective in place of a rather ill-defined public interest criteria; and

iv) removing any political involvement in management.

The rationale for this type of privatisation is considered to be a response to institutional failings of public ownership and the weakness of the state in its role as a principal of corporate governance.

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**Box 2**

**The 'Shock Therapy' Approach to Privatisation in the Former Soviet Union (FSU)**

Governments in the FSU, and in the west, were anxious that industrial privatisation and reform of product markets should be irreversible, which required some compromise. Since political democratisation was given a high priority, the survival of the government depended on the popularity of the reforms, and this required careful consideration of employees and their families in state owned enterprises, particularly industry and agriculture. Managers and employees within these industries showed a high degree of solidarity and a mistrust of the state. Thus, senior managers had a veto over reforms and in Belarus and Ukraine reforms were delayed and the first wage of voucher auctions cancelled.

In Russia, the outcome was a two-stage privatisation to facilitate the states withdrawal from industry. The first stage (1992-94) involved the mass privatisation of state-owned enterprises with low stock market values, essentially the whole of the manufacturing industry, with the exception of firms in the defence sector. This was a centralised programme which gave citizens in general, and enterprise managers in particular, the opportunity to acquire controlling stakes, resulting in ‘manager-controlled, employee-owned’ firms. Outsiders could also own these shares, but generally encountered hostile reactions from incumbents, who considered them to be asset strippers and excluded them from exerting any influence. Later studies that show no subsequent performance gains, are largely due to privatisation but with little progress in restructuring, and hence no improvement in performance.

The second privatisation stage (1995-96) in the FSU comprised of piecemeal privatisation of valuable firms engaged in the production of raw materials, mostly oil, gas, metals, etc and utilities such as energy and communications. Here, the
Privatisation of this kind has been achieved very differently in developing and transitional economies. During the past decade or so, the transitional countries have implemented economic reforms with the intention of transforming a distorted economy, generally due to protection and/or widespread state control of production, into a market-oriented and hopefully more efficient one. In the former socialist states, privatisation was specifically designed to replace supervision by the state with more appropriate decentralised mechanisms aimed at enhancing efficiency and producing goods for world markets.

The reform process has generally involved restructuring and privatisation of enterprises, with the expectation of attracting increased foreign investment. But here, the input markets, including labour, and the output markets were all part of the privatisation programme. The actual mechanisms varied between countries, in part reflecting the degree to which the population approved of the reforms. In some cases the mass privatisation of state owned enterprises by a centralised voucher system gave individuals, and the enterprises themselves, the opportunity to acquire controlling stakes. However, while this transferred ownership out of the state sector, there was no guarantee that progress would be made toward enterprise restructuring.

Secondly, liberalisation or deregulation is a form of privatisation. This allows activities that were previously restricted to the public sector to be undertaken by others. The removal of restrictions on market entry increases the role of competition and private enterprises that are successful are an example of privatisation, although the ownership of assets has not actually been transferred.

Box 3 Privatisation by Transfer of Ownership and by Deregulation: Chile

Deregulation, liberalisation and privatisation have been major elements in Chilean economic policy since 1973, reversing a long-term trend. Since 1973, Chile has undergone four major privatisation efforts. During 1975-9, 259 expropriated enterprises were returned to their legal owners. Since the private sector did not pay to get the corporations back, it received them as they were operating at the time of the transfer, mostly with limited working capital, an oversupply of labour and no significant investment. By 1983, more than fifty had either failed, or been sold. A more competitive environment was brought about by deregulation and changes in the tariff structure which reduced effective protection in some sectors.

Between 1975-9, the private sector bought enterprises and assets from the government, comprising largely firms in the commercial and industrial sectors as well
as banks. The transfer of ownership was done through auction. However, although all bidders were required to provide detailed reports of their financial position, this was not monitored or enforced and, since accounting procedures did not call for consolidated balance sheets, it was an easy process to indebt a third company and transfer the funds to the company that was being auctioned. Many commentators also suggest that the capital markets could have coped better if privatisation of financial institutions had been postponed until the full effects of deregulation were seen or after a major reform in the financial sector had been established.

From 1985 to 1986, privatisation aimed to diffuse ownership among the wider population and a capitalisation of the enterprises being sold. During this time regulatory legislation governing financial institutions, including banks, mutual funds and financial intermediaries, was introduced specifically designed to avoid the negative effects of property concentration and of links between financial and industrial enterprises that had occurred in the past. Success in the operation of private pension funds provided optimism that appropriate regulation could minimise the negative effects of widespread financial crises.

The final tranche of privatisations occurred between 1986-88 and was to continue the programme of diffusion of control, although the approach was to transfer ownership by small package sales to private investors and to private pension funds and workers. This was the only phase that included workers in the final distribution.


Finally, privatisation can be in the form of contracting out of service provision. This is not a novel concept, for example, in the early 20th century, on average only 10% of GDP was produced by the state. Nowadays, it is common for government to retain overall responsibility for supplying the service while the operational aspects of provision is franchised to the private sector. The leasing of public assets to the private sector is an example of this type of privatisation.
Box 4 Public/Private Partnerships

- There are a number of ways to introduce the private sector into State Owned Enterprises without full privatisation.
- Management contracts, or concessions are essentially procurement methods with no transfer of assets. New private sector investors take responsibility for investing in new assets and/or the delivery of a flow of services from new assets or existing assets.
- Due to competitive pressures and more effective asset management, the private sector are expected to be able to provide services, more efficiently than the state.
- Efficiency gains are expected to come from a better handling of design, construction and operating risk.
- The impact depends on the extent to which commercial risks are transferred from the state to the private sector. However, if political and regulatory risks are perceived to be high by the private sector, then the net gains from the partnership may be limited.
- Contracts must be written such that risk is transferred to the private sector and there is no compensation, protection or favourable terms, for example, credit availability at preferential rates.
- In many examples in developing countries lack of competition in the markets and poor negotiating power, with the perception of high regulatory and political risk, result in a high cost of capital that outweighs any efficiency gains from introducing the private sector. The net benefits of a partnership with the private sector compared with the alternatives of lower cost public sector financing are limited.
- In developing countries the choice may be between low cost World Bank financing versus high cost private financing, especially for infrastructure projects. Here the benefits of privatisation are not obvious.
- The underlying principle of public/private partnerships is to transfer risk to the entity best placed to manage it. Risk should not be transferred for its own sake. Governments or consumers may pay for inappropriately transferred risk, for example, regulatory risk, through higher services charges or safety concerns.

Source: Taken from DFID, Reform of State-Owned Enterprises, (2000).

However, in all cases, privatisation implies a readjustment in the roles of government and the private sector in economic and social development. Thus, it needs to be carried out in a way that can ensure success and widespread support. In some cases it has played a role as an instrument of systemic change and therefore when the states shifts its responsibilities to the private sector it has to assume new responsibilities as a regulator of privatised monopolies, as a guardian to ensure fair competition and as provider of social protection.
1.5 Conditions for successful privatisation

Regardless of the reasons for privatisation or the methods used to transfer ownership, a number of factors can contribute to the likelihood of its success. Clearly, it is rare to find all of these conditions met at any one time, particularly in developing or transitional economies. The vital factor is the role of government in creating an enabling environment for privatisation. Where this is lacking, too rapid a privatisation programme may be detrimental to the economy as a whole, and may be very hard to reverse, and so needs to progress slowly and carefully.

Box 5 Factors to Enhance Successful Privatisation

1. A strong and growing economy with a viable private sector. This facilitates the absorption of redundant workers and considerably reduces the social costs involved. A period of economic crisis is not favourable to successful privatization.

2. Well-functioning legal and administrative institutions. To attract private capital, there must be adequate enforcement of laws covering private property rights, contracts and enterprises, as well as reasonable and fair taxation. There must also be regulation of financial markets, competition and monopolies.

3. An infrastructure offering companies adequate communications, transportation and utilities. These services must be available at internationally competitive prices to allow successful competition.

4. An effective system of corporate governance. Some control is needed to ensure that the new owners respect the terms of the privatization sale; an effective system of governance is also needed to complement the skills and experience of the new management team.

5. A social safety net which protects redundant workers in the event of dismissal. This should include separation indemnities, unemployment insurance, assistance in re-employment and retraining.

6. Participation and involvement of all stakeholders in the process of privatization. It is even more important than in straightforward restructuring to find acceptable ways to gain the support of unions and workers, of communities that could be affected, and of the public at large.

Source: ILO, Socially Responsible Enterprise Restructuring, working paper - forthcoming
1.6 Summing Up

State owned enterprises are an important part of the public sector in many developing countries, producing an average of 11% of GDP in all developing countries and 14% in the poorest (1995 figures). Privatisation of these enterprises is important for a number of reasons. Firstly, it removes the burden to the state in the form of subsidies and releases the funds for basic public services, such as health and education. Secondly, many state owned enterprises are operationally inefficient, and thirdly, provided the necessary institutional infrastructure and regulatory frameworks are put in place, it sets a standard of good practice that will encourage and support private enterprise in other areas of the economy.

Summary: Methods of Privatisation

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<th>Terms of Asset Transfer</th>
<th>To whom Property Rights are Transferred:</th>
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<tr>
<td></td>
<td>Existing Managers and Workers</td>
</tr>
<tr>
<td>Sale</td>
<td>Employee-Management Buy-Out</td>
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<td>Free Distribution</td>
<td>Spontaneous Privatisation</td>
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2. SOCIALLY RESPONSIBLE RESTRUCTURING

Regulation, increased competition and new relationships between the state and the private sector all combine to create an environment of change and restructuring, and may involve whole national economies or just a single industry or group. But while this presents many opportunities for increased efficiency, there are a number of communities, groups and individuals that will be affected. Restructuring can therefore be the source of anxiety and social problems and in any impact assessment it is important to identify who the stakeholders are, what the likely effects will be, and how the privatisation process can minimise any negative outcomes.

While there is a clear requirement for firms to maximise profits for their shareholders, an economic model based solely on the separation of the role of business and government simply does not work because of the separation of ownership and management, government involvement in the economy and industry involvement in the political process. One alternative concept is that of a contractual obligation that corporations have towards society. Because society is set up in such a way that firms can develop and use both natural and human resources, there exists an implicit contract or covenant between the firm and society. The legitimacy of the demand that firms exercise social responsibility is based upon this relationship (see below Box 6). Indeed, through the political process, society imposes regulations upon business if it does not act responsibly and if it fails to strike a reasonable balance between the interests of different stakeholder groups.

Box 6 The Socially Responsible Enterprise:

- Rewards shareholders with a reasonable return over time
- Is customer focused
- Considers employees as its most important asset; provides meaningful work, fair wages and benefits; ensures their employability; and provides an enabling work environment.
- Contributes to the prosperity and social cohesion of the communities in which it operates;
- Applies the golden rule - do unto others as you would have them do unto you - to its business partners – suppliers, alliances, franchisees, etc
- Practices eco-efficiency and environmental sustainability.

These ideas support the view that business has a social as well as an economic mission. This stakeholder model emphasises the responsibility of the firm not only to investors, but also to others who are affected by its decisions and actions.
2.1 The Stakeholders

Box 7 Objectives and stakeholders in privatization

Identifying the stakeholders is of primary importance in ensuring that privatisation will be socially responsible. In practice, the process is often as important as the substance of change to the success of restructuring. This means respecting the values of the enterprise, seeking the involvement of those affected, practising open communications and treating all employees with respect and dignity. Then, the emphasis can be directed towards overall stakeholder value rather than short-term shareholder gains. Box 7 illustrates the privatisation objectives in the inner circle and the groups that will be affected in the outer circle.

The involvement of all major constituents or stakeholders in the privatisation process is crucial. These stakeholders differ, depending on whether a single SOE is being privatised or if it is a mass privatisation. In either case, the government is a key stakeholder and in most cases is the major stakeholder and the principal agent in the privatisation. Government is concerned about the fiscal impact, and the reduction of the public sector borrowing requirement (PSBR). But they are also concerned about the social and political impacts. Prior to privatisation, government is responsible for devising any necessary regulation and for developing labour strategies that secure the support of employees and
provide adequate social provision.

Other stakeholders include the employees - workers, worker representatives (labour unions) and managers. Many will feel increased job insecurity and be very vulnerable. In developing economies this may affect an extended family, while in transition countries many job related benefits, such as health and child-care, will be lost. In addition, the public, both as customers and taxpayers, present managers, potential new owners, bureaucrats, politicians, the business sector, and communities are likely to be affected. In most cases, the objectives and the stakeholders involved in privatisation and restructuring are numerous and complex. Finally, there may be an impact on the environment, which affects all stakeholders, present and future. In many countries, state owned enterprises have been among the major offenders in pollution and excessive resource utilisation. Privatisation is an opportunity to encourage greater environmental responsibility. After privatisation, the regulators can impose penalties and correct any unpriced externalities (see the earlier section on market failure).

Box 8 The Social and Safety Impact of the Restructuring of the UK Coal Industry

Colliery closures have long been recognised as having particularly serious socio-economic effects that are often exacerbated by other characteristics of mono-industrial areas. These include inadequate infrastructure, high youth unemployment, a narrow skills base, and an unattractive and often polluted environment, all of which detract from efforts to attract new investment.

Restructuring and the associated attack on trade union organisation in the British coal industry had a deleterious effect upon working conditions and pay that are still evident in 2001. In the drive for increased productivity, the health and safety regulations in British coal mining were perceived as constraining the achievement of competitiveness. International mining standards were seen as necessary for the privatised industry to attain commercial viability, so the Health and Safety Commission replaced detailed regulations under the Mines and Quarries Act 1954 with a package of legislation entitled The Management and Administration of Safety and Health in Mines. The role of the colliery deputies was shifted from safety towards supervision. The Coal Mines Regulation Act 1908, which limited underground working hours to 7.5 hours was regarded as obstructing the more productive organisation of work, and to facilitate temporal flexibility the Coal Industry Act 1992 was introduced and the 1908 Act repealed. The removal of statutory limitations allowed employers to prescribe longer shifts and the optimal shift length for some collieries in the north-east became in excess of ten hours. This extension in working time inevitably increased accident rates, in addition to the negative health effects of longer periods spent underground. Several of the technical measures designed to promote productivity also had a potentially dangerous effect on health and safety, particularly the introduction of roof-bolting as a principal means of support, single-entry faces, etc.

Compensation payment schemes were implemented, although government policies to develop alternative employment in the coalfield areas have been less successful. In the
UK, 93,434 miners took redundancy under the government schemes between 1988 and 1993. In other countries, similarly high numbers of miners have lost their jobs, for example, in the Czech Republic 11,600 in two years, and in China, Germany, Hungary and India contractions in the industry has caused high levels of unemployment. In Russia, few mine closures have taken place because of the fear of social unrest. In Spain, Poland and the US retraining programmes have been introduced to enable miners to find alternative employment.


2.2 Restructuring in developing and transition economies

High standards of corporate social responsibility as part of a restructuring programme are not always achieved in the industrial countries. However, in developing and transition economies the institutional framework and infrastructure are not always complete. Many governments in these countries have privatised most of their industry and natural resources, although the results in terms of restructuring and economic growth have been very different. For example, in Russia, restructuring did not follow privatisation and as a result, GDP has declined by nearly 40%, fixed investment has declined dramatically and inequality has doubled. In contrast, privatisation in Poland led to and speeded up major restructuring of enterprises. As a result, GDP has increased since the reforms began.

China has experienced rapid growth during the 1980s and early 1990s during the prolonged period of reform. However in terms of market liberalization and privatisation, the policy shift was not as comprehensive as many other countries. Vietnam has linked privatisation with restructuring, achieving greater levels of success than many low income countries whose governments defined their economic policy in terms of central planning, for example, Ethiopia, Angola, Mozambique, Guinea-Bissau, Laos and Cambodia. However, the transition in this group of countries was accompanied by major armed conflicts, with the exception of Laos.

Box 9 Wuhan State Asset Management Company

Several models of the state asset management companies have emerged in China. In most cases including Shanghai and Beijing, asset management companies have been typically converted from old government line bureau or large SOE. Wuhan State Asset Management Company (WAMC) is unique in that it is an integrated holding company encompassing a range of sectors and is more commercially oriented. Due to these unique features, the Wuhan model has received wide attention from other provinces and municipalities.
In June 1994, Wuhan State Asset Administrative Committee was established to take the responsibility for pre-serving and increasing the value of state assets. In August, WAMC was formed to exercise the functions of management and operation of state assets. WAMC was initially given responsibility for 24 companies that were either producers of finished products or in the wholesale/retail trade area. The Wuhan government has subsequently set up three other asset management companies, but they are sector-oriented derivatives of the old industrial sector (machinery and electronics; raw materials; light industry and textiles). The four companies, especially the WAMC, have been deemed successful in managing state assets and the municipal government is planning to transfer its holdings in other enterprises to the asset management companies. There are two ways for WAMC to acquire assets of other companies: property transfer and market purchase. Property transfer means that all or a part of the state assets of some SOE are transferred to WAMC by the authorisation of Wuhan municipal government. Market purchase means that WAMC acquires interests in other enterprises through investment, share purchasing, or M&A.

With respect to the relationship between WAMC and constituent companies and other stakeholders, WAMC manages its constituent companies in three ways including property management; participation in major decisions concerning large investments or bank loans and M&A among the companies under it; and monitoring of company performance, including selection of managers, performance evaluation and compensation, and financial supervision. WAMC carries out its functions and roles as a shareholder in the companies through its participation in shareholders’ meetings, or by participation on the board of directors of the companies where WAMC holds shares. WAMC does not interfere directly in management of constituent companies. In principle, WAMC does not have the responsibility for approving lay-offs, nor does it interfere with other personnel decisions. WAMC does not provide direct loans to its member companies, nor does it provide guarantees against its own assets. Instead it works to “persuade” bank lenders to provide financing. To assist financially weakened companies under its control, WAMC may seek to: a) invite enterprises from outside the group or outside the province to merge or co-operate with the company; b) encourage companies with difficulties to adopt a share-holding form that leads to a change of management and other reforms; c) sign 3-year term management contracts with the managers, to be renewed according to performance; d) sell shares of the weak companies to employees or private companies; or e) encourage changes in product/business lines. In addition, WAMC has provided a number of incentives to the companies under its control, including the introduction of performance-based compensation packages to senior managers and stock options to managers in listed companies.

Source: Ms. Zhang Qi, Deputy Division Chief of the Foreign Economic Relations Department of the Development Research Centre of the State Council of China, with editorial revisions by the author.
2.3 Summing Up

In almost all countries the trend of the last decade or so has been to move away from state owned enterprises or government control of large industries to either purely private ownership or some combination of public-private partnership. In most cases this has been accompanied by restructuring, either before or after privatisation. This has been done most successfully where governments, employers and labour organisations have undertaken the restructuring process in a socially responsible manner. This ensures that different stakeholder interests and social and economic concerns can be taken into account. Thus, socially responsible enterprise restructuring is a strategic issue for the groups concerned.
3. RESTRUCTURING IMPACT ASSESSMENT (RIA)

3.1 Estimating the Costs, Benefits and Risks of Restructuring

This is a difficult area in which to conduct an impact assessment. Firstly, many of the results are very long term. For example, the privatisation of a whole sector, particularly when there is a restructuring programme associated with it, can take several years to complete, as was shown in the UK coal industry case. An early task is to identify the stakeholders (see Box 7), which should be done as part of the restructuring policy decision. In some cases, such as deregulation and liberalisation, the impact on the effectiveness of the new legislative framework on working practices may be measurable at the level of small and medium sized enterprises.

For larger and more radical projects, the cost of the privatisation itself may be high. Many state owned enterprises are heavily indebted, often to the government or other nationally owned enterprises, perhaps the utilities, and have negative value on a debt-inclusive basis. Privatisation though a transfer of ownership may require restructuring prior to the privatisation, which contributes to the cost.

3.2 Assessing the Impact of Privatisation and Restructuring

The method of impact assessment should be a mixture of quantitative analysis, with case studies to examine the effects on the stakeholder groups. Given the range of privatisation programmes, from large state owned utilities to public-private initiatives the approach will vary in each case.

For large state owned enterprises, the appraisal begins before the restructuring or privatisation begins. Since one of the major reasons for privatisation is poor performance and inefficiency, the cause and extent of the inefficiency should be understood. The form of the privatisation will reflect the baseline state of the enterprise, that is, the inefficiencies may be corrected though restructuring prior to the transfer of ownership. The involvement of stakeholders also needs to be assessed, to ensure that the new ownership structure has a clear idea of their responsibilities.

Another reason for the privatisation is to reduce the burden on the state. It is important in an impact assessment to measure the extent of this gain and whether it will be rigorously adhered to. If freeing up of resources is to be achieved, there needs to be assurance that no further subsidies will be provided by government and that the hard budget constraint will be upheld.

Prior to the transfer of ownership, the necessary regulatory framework should be in place, including procedures for monitoring or supervising the restructured enterprise and a firm commitment to ensure compliance with penalties for failure to comply. A further commitment to transparency with respect to regulations is necessary such
that all stakeholders are aware of their need to act within the legal framework. It is also important to be clear about how disputes are to be resolved, whether public hearings will be held, how consumer protection is to be addressed and what will be the impact on informal groups and the poor.

It will be necessary to understand how the proposed privatisation will lead to a real, long-term improvement in performance, that is the nature of the reform and restructuring should be clear. Examining the issue of moral hazard will provide reassurance that the hard budget constraint is understood, while potential for adverse selection and poor governance can be assessed by analysing cross-holding, familial connections between firms and the relationship between owners, managers, investors and employees. Will the new ownership be more or less dispersed, and will bank creditors play an active or passive role in corporate governance?

Assessing the potential for greater competitiveness after privatisation is difficult, partly because the impact of new entrants to the sector may only be expected in the long-term. But some improvement in services or added value for consumers is required.

The success of enterprise restructuring depends on the availability of investment funds and technical expertise. Therefore an impact assessment needs to consider the adequacy of the capital and financial markets and the opportunity cost of funds directed to the new enterprise. If the funding is from domestic sources there is a reallocation, whereas if it is based on a joint venture with a foreign firm, new capital will be introduced. Technical expertise can involve skills training and incentives structures built on changes in performance, although this may require support from donors and outside agencies.

Finally, the social impact should be assessed. The effect on poverty of increased fiscal support, the impact of lower prices and the value of the service provision may be countered by higher unemployment levels and loss of benefits. Quantitative measures of these impacts are necessary to assess the impact on labour and the communities in general.
Box 9  Impact Assessment of Contracting-Out Projects

Baseline Information

- What is the cost of existing Services? This should include direct service provision costs, indirect support costs and the cost of capital. Disaggregated information on different aspects of the service is the most useful.

- Current performance or output. Some information about the quality and quantity of services supplied in the form of quality indicators and output indices.

- Employment, poverty, gender and distributional aspects of the move from directly state operated to contractor operated services.

- Private sector operations: Wages, prices, performance levels, technical competence, competitiveness of markets are all useful.

Monitoring Project Impacts: Key indicators

- Cost of service provision by the contractor.

- Cost of managing the contract.

- Information on how the tendering system functions. This may include: advertising, the search for contractors (how many respond to expression of interest), which staff wrote the specification, the bidding process, whether the contract went to the lowest bidder, how the final decision on choice of contractor was made, non-price factors admitted in tendering, financial guarantees required, reliance on reputation of contractors, evidence of a suppliers' cartel, whether in-house bids are allowed. Was the process free from nepotism, bribery, other possible coercion or evidence of poor governance?

- Contract implementation and management.

- Previous in-house provision.

- Impact on the contractor market.

- Level and quality of output under the control of the private sector contractor.

Source: Taken from DFID, Reform of State-Owned Enterprises, (2000).
3.3 Summing Up

Impact assessment of privatisation should be part of the strategic planning process that leads the privatisation. The answers to the questions raised during the impact assessment are those that support the decision to privatise.

Following privatisation, the main aim of the impact assessment is to determine how well the regulatory structure has been able to establish a competitive environment and whether the expected social impact and the provision made, are sufficient. The privatisation of whole sectors, as with some of the state owned enterprises, is a long-term process. Certainly all stakeholders need to be involved in an impact assessment, as attempting to reform and privatise without adequate political support from government, labour unions and employees, and the general public is unlikely to succeed, and may result in civil unrest.
KEY TEXTS / REFERENCES:

DFID (2000), *Reform of State-Owned Enterprises*


Nellis J (World Bank), (June 1999) *Time to rethink privatisation in transition economies?* in "Finance and Development", IMF