State and analyse the arguments for the privatisation of public corporations

Privatisation is the transfer of the partial or complete control of a state activity and related assets to a private investor or investors. According to Steve. Hanke privatisation can take place in a variety of forms such as

1) Contracting out
2) Partnership in the ownership, control, management of enterprises by the public and private sectors with various ownership structures
3) Total divestment and marketization of public enterprises thus turning the whole organization over to the private sector

A public enterprise is defined by CARICAD studies as " an institution either wholly owned by Government or in which Government owns a majority share, that sells goods and services in the market and has its own management entrusted with the task of running the organization."[1]

There are many strong arguments for the privatisation of public corporations which can be studied in four categories of Economic, Ideological and Political and Organizational. Before these arguments are discussed it is critical to give a brief overview of the emergence of privatisation in the world. In developed and developing countries, privatisation is one of the most revolutionary innovations in the recent history of economic policy. The policy of privatisation of public enterprises has been adopted and implemented variably at the global

[1] Caribbean Centre for Management Administration. *Report on Management of Public Enterprises in the Caribbean*. pg 2.

level since the 1980s. The British Prime Minister, Margaret Thatcher and U.S President, Ronald Reagan were the two political leaders behind this global policy movement. According to A. Farazmund, " they both came to power with an agenda to reverse the growth of their governments and their administrative welfare states which were begun in the 1930s". [2] By the 1970s most capitalist nations and all socialist governments had experienced a major failure in their corporate and government leadership with a growing rate of national debt and budget deficits. Both groups of nations were unable to continue the trend and were forced to adopt major changes which included reorganization, reform, structural adjustment and the privatisation of public enterprises.

Public enterprises are established for many reasons such as provision of social goods and services which the private sector fails to provide; control of key resources such as water and oil and also to enable economic stabilization with the provision of employment. However, many of these Public Enterprises are privatised for many reasons. Privatisation is seen as a means to increase output, improve quality and reduce unit costs. It is believed that privatisation will curb the growth of public spending and raise cash to reduce government debt.

The arguments for the privatisation of public corporations are discussed in more detail below.

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[2] Ali. Farazmund, *Public Enterprise Management*. London: Greenwood Press. pg 18

Economic

Although some state owned enterprises have been productive and profitable, a large number of them have been economically inefficient, incurring heavy financial losses. "The sugar industry in Barbados made considerable losses in 1988 and 1989 despite being heavily subsidized by the Barbados government."[3] "The Guyana Mining Enterprise (Guymine), which produces bauxite, recorded losses for both 1988 and 1989."[4] In St.Lucia, Antigua and Grenada, the transport authorities all recorded losses. Privatised firms exhibit higher profits than public enterprises, faster growth and greater cost containment. Privatisation also facilitates the obtaining of new foreign loans and debt release, reduction of deficits and high inflation rates. Privatisation leads to open, competitive economies that produce higher incomes and more permanent jobs. A recent study conducted on fully or partially privatised firms in Jamaica revealed that "once privatised, the firms increased returns on sales, assets and equity."[5] In June 1987, over 70% of the Caribbean Cement Company in Jamaica was purchased through a share offer. The Cement Company has shown a "27% increase in production and 67% increase in

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[3] Caribbean Centre for Management Administration. *Report on Management of Public Enterprises in the Caribbean*. pg 27.

[4] Caribbean Centre for Management Administration. *Report on Management of Public Enterprises in the Caribbean*. pg 28.

[5] S.Kikeri, J.Nellis and M.Shirley, *Privatization: The Lessons of Experience*. Washington: The World Bank. pg 29.

profits for 1987".[6] In the United Kingdom, the British Telecommunications was privatised and as a result it reaped greater profits.

<u>Ideological and Political</u>

Reasons for privatisation can also be examined under the categories of ideological and political. The Jamaican experience is a prime example of this and will be discussed below. In 1992, a change of the Jamaican government was made from the free-market oriented Jamaica Labour Party (JLP) to the socialist Peoples' National Party (PNP). This new government brought a new strategy and an official transition was made to a new policy based on public sector ownership. The PNP had more of a nationalistic ideology in their decision-making and the private sector was therefore viewed as being inadequate for realising the economic objectives of the country to expand income and employment opportunities. Under its industrialisation plan the government had nationalized a major foreign owned bank, Barclays and the cement manufacturing plant. "By October 1980, public ownership had extended to the areas of transportation, communications, agricultural and land development, tourism, housing and trading."[7]

However the aggressive expansion of the public sector failed to achieve its stated objectives. In October 1980, the JLP was reinstated by

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[6] A.Ott and K.Hartley, Privatization *and Economic Efficiency*. Vermont: Edward Elgar Publishing Ltd. pg 79.
[7] A.Ott and K.Hartley. *Privatization and Economic Efficiency*. Vermont: Edward Elgar Publishing Ltd. pg 27.

a landslide victory as the government of Jamaica. The size of the government and the policies pursued in the 1970s were regarded by the JLP as the main constraints on economic growth and development. The new government therefore assumed power in October 1980 to reduce the role of the public sector through deregulation, divestment of public enterprises and reduction of government expenditures. The JLP manifesto had stated the intention to "create a market system of economics… to shift unnecessary public enterprises to the private sector so as to remove the burden of finance from Government."[8]

This new political venture was also greatly welcomed by the IMF and the Reagan Administration in the U.S.A. It was viewed that the future of the Jamaican economy greatly depended on reduced government involvement and renewed private sector influence. Some examples of the privatisation measures are stated below. In December 1986, 51% of the equity in the National Commercial Bank (NCB) was publicly offered for sale. In 1987, 71% of the Cement Company's shareholding was publicly sold. Also the street cleaning and garbage collection has been contracted out to private companies. In the agricultural sector, the public sector holdings in the banana industry have been privatised. The Jamaican government's ideological position conceptualises development in an economy in which the private sector is seen as an engine of growth. The government sees the role of the public sector to provide the

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[8] V.V.Ramanadham, *Privitisation in developing countries*. London: Routlege. pg. 386.

infrastructural framework to facilitate the efficient operation of the private sector.

<u>Organizational Issues</u>

The fourth argument for the privatisation of public corporations is organizational issues. Organization is the foundation of sound management. It involves the "deployment of the required resources; financial material and human and the determination of the rules which will govern the relationships among the various parties involved in the exercise."[9] The private sector has been able to flourish in this organizational context as the poor performance of public enterprises is reflected by administrative/political constraints. This inadequate performance of PEs in developing countries is due in part to ineffective processes of co-ordination, planning and control of both within the national system and within enterprises.

In terms of capital resources, PEs in developing countries are scarce in real financial resources and tend to rely on commercial bank overdrafts for operating capital and to replace operating losses. As with the case of Air Jamaica and BWIA, government usually has to deal with losses and purchase equipment for these PEs. Inadequate capital resources also result in the inadequacy of accommodation for the public sector. Accommodation is perceived as a management tool for the promotion of productivity of the physical and human assets of the organisation. The

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[9] Caribbean Centre for Management Administration. *Report on Management of Public Enterprises in the Caribbean*. pg 38.

private sector is viewed as luxurious in terms of accommodation because of the better working conditions and adequate flow of capital in this sector.

Another organizational issue which plagues the Public enterprise is good management. The most important precondition of success is the provision of adequate management and the private sector again wins the battle. Most PEs fail because of the poor selection of an experienced and knowledgeable Board of Directors and a capable Chief Executive of impeccable integrity. This management inefficiency of PEs can also be linked to the career path for management levels in PEs. In the private sector there is greater opportunity for reaching the top of the organizational structure and thus achieving job satisfaction. On the other hand with the public enterprise there is a high level of uncertainty of job security as political changes at election can change Directors of the enterprise and also make redundant top level managers and others within the organizational structure. The promising careers of these individuals are therefore brought to an abrupt end.

Privitisation is also advantageous because of its operational autonomy. The day-to-day operations of the private sector are based on management decisions and not by the bureaucratic chain of government. Most PEs fail because they are controlled with interference from government. “Any attempt by a Minister to control the day to day activities of a Public enterprise not only produces confusion but removes the responsibility of the management for its success."[10]

Private sectors have established clear operational objectives such as profit requirements, human resources, financial resource utilisation, productivity and quality and social responsibility. On the other hand, management in PEs have vague, fluctuating and often conflicting objectives.

The reader must also be aware of the arguments against privatisation. It must be noted public enterprises still have a purpose in society. A PE gives the state control over monopoly power and profits in those areas where monopoly is unavoidable. For example, utilities such as water and electricity. Most opponents of privatisation indicate that privatisation is not always the answer as it corrupts the marketplace. Economic efficiency is concerned with the utilisation of scarce resources. Most private sectors reach certain levels of economic efficiency but they incur social and externality costs such as pollution and unemployment compensation. The government also incurs infrastructure costs. Also, privatisation does not necessarily mean that goods and services will be provided more cheaply or efficiently by the private sector than by the public sector.

[10] Caribbean Centre for Management Administration. *Report on Management of Public Enterprises in the Caribbean*. pg 22.

Public sectors play key roles in the development of countries but they manifest many problems as they are slow at developing and introducing new technologies and they are subject to over-frequent and damaging political intervention. Privatisation seems to offer a means of ridding the state of the financial burden of loss-making activities, while at the same time spreading share ownership. Privatisation when correctly conceived and implemented fosters efficiency, encourages investment, new growth and employment and frees public resources for investment in infrastructure and social programmes.

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