The Scope of Privatization

Lecture 1

4 February 2025

Objectives of Course

- What is privatization and why did privatization emerge (which economic and political factors influenced its rise)?
- What are the key reasons for state ownership?
- What were the main goals of privatization?
- What were the main challenges and outcomes of privatization?
- How has privatization affected government revenues and capital markets?
- Which sectors and regions have contributed the most to privatization?

The Scope of Privatization

- Pivotal events in economic history often pass with almost surreal normalcy, only rarely evoking the drama of decisive battles or the excitement of great political moments.

- Nonetheless, economic events can impact human affairs just as decisively.

- The past quarter-century has undoubtedly witnessed its share of fundamental political change and high military drama.

- However, a strong case can be made that the economic changes that the world has experienced since 1979 are even more profound than the political changes that ended communist rule in central and eastern Europe.

The Scope of Privatization

1. Economic changes since 1979 have been deeply transformative, even more than major political shifts like the end of communism in Eastern Europe.

2. While often unnoticed, economic events significantly shape the behavior of economic actors just as much as political or military events.

The Scope of Privatization

- The political and economic policy of privatization, broadly defined as the deliberate sale by a government of state-owned enterprises (SOEs) or assets to private economic agents, has been one of the most important and visible aspects of this global trend toward greater reliance on markets to allocate resources.
- Privatization has not only dramatically reduced the state's direct role in producing goods and services but has also massively increased the size and efficiency of the world's capital markets and fueled an unprecedented increase in the number of people who own corporate shares.

The Scope of Privatization

1. **Definition:** Privatization is the process where the government sells state-owned enterprises (SOEs) or assets to private entities, shifting economic activities from public to private control.
2. **Role of the State:** This process reduces the government intervention in producing goods and services, expands capital markets, improves efficiency, and increases the number of private shareholders.

The Scope of Privatization

- To understand how and why privatization emerged when it did, we begin our narrative with a brief history of the rise and fall of state ownership in the modern era.
- After this, we seek to answer a series of basic questions:
  - How much privatization has occurred?
  - Why have so many countries adopted privatization programs?
  - What are the costs and benefits of state versus public ownership, both theoretically and in actual practice?
  - How do governments privatize state-owned enterprises?
  - Most importantly, has privatization worked?

The Scope of Privatization

1. Privatization emerged as a response to the rise and fall of state ownership, influenced by economic challenges and policy shifts over time.

2. Key questions include: Why do governments privatize? What are the benefits and drawbacks of privatization? How is it implemented? And, most importantly, has it been successful?

Reasons for State Ownership

- State ownership of a given business activity or organization can arise for five reasons:
  1. State ownership can be a natural extension of royal power in feudal or tribal societies.
  2. State ownership can emerge as a means to commercialize complex, vital, and expensive new technologies. This rationale became prominent during the late nineteenth and early twentieth centuries as the technologies spawned by the Industrial Revolution multiplied in scale and import.
  3. States often nationalize failing private businesses to preserve employment, continue producing essential goods and services, or both. This can occur either on an ad hoc basis, for an individual company, or in response to a systemic economic crisis such as the Great Depression.
  4. Ideological motivations, extreme political factionalism, allowing ruling groups to consolidate control over economic assets.At one extreme, communist governments considered private ownership of land or enterprise to be inherently exploitative and thus prohibited private

Reasons for State Ownership

1. **Historical Power:** In feudal and tribal societies, state ownership was an extension of royal authority.
2. **Economic and Technological Development:** Governments took ownership to commercialize important and costly new technologies, especially during the Industrial Revolution.
3. **Crisis Management:** States nationalized failing private businesses to protect jobs and essential services, especially during economic crises in the Great Depression.
4. **Ideology and Political Control:** Some governments, especially communist regimes, opposed private ownership, while others used state control to consolidate political power.

The Rise of Privatization in Developed Countries

- Most people associate modern privatization programs with Margaret Thatcher's Conservative government in Great Britain in 1979.
- However, Germany under Konrad Adenauer initiated the first large-scale "denationalization" by selling Volkswagen shares in 1961.
- In 1980s, Thatcher's government introduced large-scale privatization, which became a model for other countries.
- Privatization significantly increased the number of shareholders and capital market efficiency.

The Rise of Privatization in Developed Countries

1. Privatization gained global attention in the 1980s with Margaret Thatcher's government in Britain, but Germany had already started selling state-owned assets, for instance the shares of Volkswagen, in 1961.

2. These privatization efforts expanded capital markets, increased efficiency, and encouraged more people to become shareholders.

The Rise of Privatization in Developing Countries

- Another reason for government ownership, often through nationalization, was a historical resentment of the foreigners who had owned many of the largest firms in these countries.
- Extreme political factionalism, mentioned above as an explanation for state ownership, was a distressingly frequent motive in developing countries for nationalizing existing private businesses or starting new SOEs from scratch.

The Rise of Privatization in Developing Countries

1. **Historical Resentment:** Many developing countries nationalized large firms that were previously owned by foreign entities, aiming to regain economic control.
2. **Political Factors:** Political divisions often led governments to take over businesses, either by nationalizing private firms or creating state-owned enterprises.

The Aims of Privatization

- Margaret Thatcher first introduced privatization efforts in Britain in the 1980s.
- The objectives of the British Government's privatization program included:
  1. Raising revenue for the state.
  2. Promoting economic efficiency.
  3. Reducing government interference in the economy.
  4. Promoting wider share ownership.
  5. Providing the opportunity to introduce competition.
  6. Subjecting state-owned enterprises (SOEs) to market discipline.

The Aims of Privatization

1. **Raising Revenue:** Selling state-owned enterprises (SOEs) provided the government with funds, helping reduce public debt or finance other projects.
2. **Improving Efficiency:** Privatized businesses were expected to operate more efficiently under private management compared to government control.
3. **Reducing Government Control:** The goal was to limit government intervention in the economy and encourage market-driven decision-making.

The Aims of Privatization

4. **Expanding Share Ownership:** Privatization allowed more people, including small investors, to own shares in major companies.
5. **Enhancing Competition:** Introducing competition in previously state-dominated industries aimed to improve service quality and lower costs.
6. **Market Discipline:** Privatized firms had to respond to market forces, making them more accountable and performance-oriented.

Privatization in Britain

- Although the Thatcher government was not the first to implement privatization, it is considered the most historically significant.
- Privatization was not a key campaign promise in 1979, but the Conservative government quickly adopted it.
- Margaret Thatcher used the term *privatization*, which was initially coined by Peter Drucker, replacing the previous term *denationalization*.
- Early privatization efforts faced strong opposition from the Labour Party, which vowed to renationalize companies such as British Aerospace and Cable and Wireless if reelected.

Privatization Spreads Globally

- The perceived success of Britain's privatization program encouraged other countries.
- Conservative Chirac government in France launched major privatization in 1986, selling 22 major companies.
- Privatization spread to Western Europe, Asia, and Latin America.
- Transition economies in Eastern Europe adopted mass privatization strategies after the fall of communism.
- Voucher privatization programs were implemented in many post-Soviet economies but often led to insider control rather than widespread ownership.

Privatization Spreads Globally

1. **Impact of British Privatization:** The success of privatization program in Britain encouraged other developed countries to follow, with France being a key adopter.

2. **Privatization Efforts in France**
   - In 1986, the conservative Chirac government launched a major privatization program, reversing earlier nationalizations by the socialist government.
   - Over 15 months, 22 major companies worth $12 billion were privatized, including large banks nationalized in 1945.
   - When the socialists returned to power in 1988, they halted further privatizations but did not renationalize the already privatized firms.

Privatization spreads to Transition Countries

- After the collapse of communism (1989–1991), former Soviet bloc countries in Central and Eastern Europe started privatizing state-owned enterprises (SOEs).
- The goal was to quickly transition from a command economy to a market-based system, but governments had limited policy choices and faced significant challenges.

1. **Mass Privatization and Its Challenges:** To distribute state assets, governments introduced "mass privatization" programs, giving citizens vouchers to bid for shares in privatized companies.
2. Initially popular, these programs later faced criticism as the best companies ended up under insider control, and many privatized firms failed to perform well.
3. Overall, the results of voucher privatization were mixed, with many cases leading to economic inefficiencies.

Fiscal Impact of Privatization

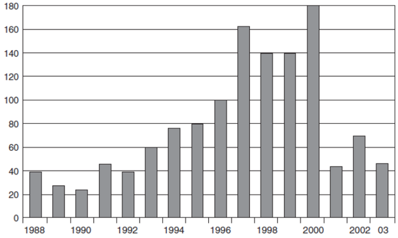

FIGURE 1.2. Worldwide revenues from privatizations, 1988–2003 (US$ billions). Source: *Privatisation International*, as reported in Megginson and Netter (2001), and IFR Thomson database.

Figure: Annual Privatization Revenues (1988–2002)

- Governments generated significant revenues from privatization between 1988 and 2002.
- These revenues helped improve government budgets, particularly in the late 1990s.
- Privatization enhanced stock market capitalization and efficiency, especially outside the United States.
- After 2001, privatization revenues dropped but showed signs of recovery by late 2003.
- Overall, privatization played a key role in strengthening global financial markets.

Sectoral and Regional Trends in Privatization

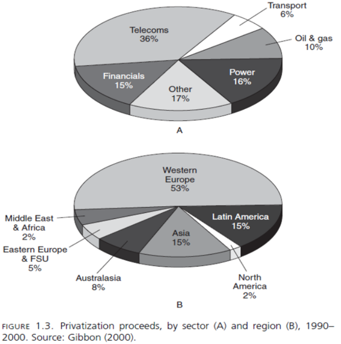

Figure: Privatization by Sector and Region

Sectoral Distribution:

- Between 1990 and 2000, telecommunication led privatization proceeds (36%), followed by power (16%), financial institutions (15%), and oil & gas (10%).
- Utilities (telecom, power, oil, and gas) accounted for 62% of all privatization proceeds, while regulated industries made up 67%.
- Infrastructure sales, including national oil and gas companies, comprised 68% of total revenues.

Sectoral and Regional Trends in Privatization

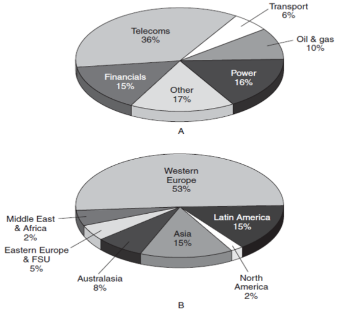

FIGURE 1.3. Privatization proceeds, by sector (A) and region (B), 1990–2000. Source: Gibbon (2000).

Figure: Privatization by Sector and Region

Regional Distribution:

- Western Europe led with 53% of proceeds.
- Asia and Latin America followed, each contributing 15%.