Privatization: Theory and Lessons from the UK and South Africa

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Privatization has involved the restructuring of capital across its many dimensions. Neo-liberalism might present itself as the withdrawal of the state in favour of the market, but it is more appropriate to view such developments in the current period of capitalism as incorporating state economic intervention rather than as its negation.

In this paper I will draw two central conclusions from the experience of UK and South Africa. First, given the multiplicity of factors in any privatization, it is erroneous to seek a general theory or explanation. Each sector of the economy in terms of its finance, markets, international position, technological prospects, political context, etc. is very different from another. Second, by the same token, at a systemic level, the role played by privatization will be very different from one country to another depending upon the particular structure and dynamic of the economy irrespective of any tendencies towards "globalization". (*JEL* Classification: H30)

I. Introduction

Privatization is now well-established as a policy and practice throughout the world[1] In the UK, one of the countries focused upon

*Department of Economics, School of Oriental and African Studies, University of London. Paper presented to the Fifth *Seoul Journal of Economics* International Symposium. Thanks to John Sender for comments during drafting, and to participants in the COSATU Workshop for comments on a much larger, Fine (1997a), from which this is in part drawn. I have benefitted from comments at the conference, especially by discussant Daehwan Kim.

[1]Throughout this paper, privatisation will usually refer to denationalization, the focus of the discussion, without necessarily suggesting the lack of

[**Seoul Journal of Economics** 1997, Vol. 10, No. 4]

later, the value of privatized assets on the British stock exchange has reached over £100 billion,[2] as much as 14% of the value of the share value of domestic companies.[3] Privatization has included state corporations previously covering electricity, gas, water, airlines, airports, cars, steel, coal and telecommunications. Progress in South Africa, the second case study considered below, has been much more limited in view of the ANC's opposition to privatization before being elected to government in April, 1994. Now, it has extremely extensive plans for the so-called restructuring of state assets. Nonetheless, privatization has not been as all-conquering as its media hype might suggest. The World Bank (1995) has bemoaned the limited extent of privatization in developing countries and the lack of success where it has occurred. It has even confessed that its pressure for privatization may have been premature given the absence of the necessary political and economic pre-conditions for privatization to be adopted and to be successful.[4]

These last reservations aside, why has privatization come so rapidly to such prominence? The first and most popular explanation is usually offered in terms of the rise of particularly aggressive right-wing laissez-faire governments, such as those attached to Thatcherism and Reaganism, together with a more general shift in the balance between market and state as neo-liberal perspectives have gained ground at the expense of Keynesian/welfarism. From a materialist perspective, however, such arguments cannot be endowed with priority. For, although the rise of neo–liberalism has undoubtedly tempered the rhythm and extent of privatization, the question remains open why it should have triumphed in the form of such policies and why they should have proven acceptable to the "captains of industry".[5] The political and ideological support for privatization

importance of other forms of privatization such as deregulation and the contracting out of public services.

[2]See Helm and Jenkinson (1997) who come to a figure of £80 billion for July, 1992, and add a further £20 billion for subsequent stock movement.

[3]See Hayri and Yilmaz (1997).

[4]As Fontaine and Geronimi (1995, p.147) report, informal talks with World Bank representatives on privatization have confirmed that there is a "great deal of (concealed) disappointment on this issue". For a critique of the World Bank's position, see Fine (1997b).

[5]Indeed, the evidence is that the Thatcher government more of less stumbled upon the policy of denationalisation in its second term of office in the mid-eighties, looking for a way to continue the populist policy of selling

inevitably follows and sustains its adoption.

More secure grounds for explaining the emergence of privatization are to be found in the shifting conditions under which the accumulation of capital has been occurring. First, within production, the restructuring of capital has been marked by two crucial developments. On the one hand, although not new, the internationalization of production(and "globalization" more generally) has posed challenges to state-owned companies which are confined to domestic ownership alone. Across a number of industries, joint ventures between different firms have proved essential with the result that state-owned companies have only been viable on the basis of participation, however fully, with private capital. On the other hand, especially in the wake of new technology and reinforcing the previous factor, traditional divisions between the various sectors of the economy have been broken down, most notably in telecommunications, office equipment and data processing for example, so that the division between the public and the private sector has necessarily been withdrawn given that the public sector used to be confined to a number of demarcated areas of activity.[6]

Second, globalization and new technology has possibly had more impact upon the financial sectors than on any others. Consequently, putting it in very loose and informal terms, the volume and range of financial services that have been made available have given rise to a wealth of "idle capital" that makes itself busy by privatization which is in the first instance, after all, simply the financial process of transferring ownership from the public to the private sector. In down to earth terms, such idle capital is most noticeable in the proliferation of competing financial consultancies, desperate to gain existing privatization business and to promote more.

Third, privatization has been an important way in which the relations between capital and labour have been reorganized. In part, this reflects the advantage to be taken by capitalists from the forms of restructuring mentioned in the previous paragraphs, in conjunction with shifts in management techniques associated with new technology with the greater potential, for example, for subcont-

off public housing. See Brittan (1986) and discussion in Fine (1990).

[6]For mainstream analysis, such factors are recognised in terms of the economies of scale and scope. In these terms, privatization can be justified in terms of the erosion of natural monopolies through technical change. For a critique of the notion of natural monopolies, see Fine (1989 and 1990).

racting. In part, it also draws upon the shifting balances between capital and labour in the labour markets, as economies have experienced very high levels of unemployment and women and youth have served as a latent reserve army of unemployed. In short, privatization and so-called labour market flexibility have been intimately related to one another.[7]

In short, privatization has involved the restructuring of capital across its many dimensions. As argued elsewhere in the context of privatization but of more general relevance,[8] neo-liberalism might present itself as the withdrawal of the state in favour of the market, but it is more appropriate to view such developments in the current period of capitalism as incorporating state economic intervention rather than as its negation. What is privatized and how represents the state's continuing intervention within the economy, favouring certain capitals at the expense of others and mediating between capital and labour in economic, political and ideological arenas.

II. Mainstream Approaches

Against this background, it is useful to begin this paper with a review of the orthodox literature on privatization. Corresponding to the wave of privatization, there has been a wealth of theoretical and empirical research – for example, more than 3,000 articles in academic journals over the past four years, and these articles are compl- emented by any number of books and government and consultancy reports. The academic literature has been concerned with the motives for, and the methods and consequences of privatization, together with the problems posed by post-privatization regulation. Like other developments in mainstream economic theory, the discipline found itself confronted with an empirical issue and reality which it was particularly unsuited to handle. Undeterred, the response has been characterised by two features. First, the issue of privatization has been interpreted within the existing fashions of the discipline. This has involved the new microeconomics and industrial economics around transactions costs, property rights and informational imperfections and asymmetries. Second, the literature has

[7]For a critical assessment of the notion of flexibility in labour markets, see Fine (1998, Chapter 4).

[8]See especially Fine and Poletti (1992).

tailed upon empirical developments as they have arisen in sequence with the progress of privatization itself—what to privatize, how to privatize, and how to regulate. From a position of a wide gap between its theory and material realities, the orthodox literature on privatization has been directed at a moving target as privatization has proceeded. But it is instructive in shedding light on the realities of privatization to examine how orthodox theory has evolved even if its distance from practice remains significant.

The literature on privatization, including analytical and policy frameworks for assessing it in practice, is dominated by what has been termed a "new synthesis" in economic thinking.[9] The analysis has evolved in the specific context of privatization in developed countries, although it is taken to be of general applicability across both developing economies and those in transition.

The new synthesis is marked by a number of general features. First, as already observed, it emerged initially, and all the key elements were put in place, prior to privatization being considered of relevance to developing countries and those in transition. As was proudly and perversely proclaimed at the time, privatization was the UK's most successful export, a boast tempered by the corresponding continuing deindustrialisation of the most severe Kind and disastrous performance in UK manufacturing exports. In short, privatization theory is a response, sometimes critical, to Thatcherism and is marked by its contextual origins. Second, the privatization literature followed in the wake of the privatization process as it evolved. Considerations of the economics of regulation only appeared at a later date, after the terms of the debate over the merits of public and private ownership had already been settled. Third, by the same token, the literature has only just begun to be informed by the consequences of privatization in practice, otherwise depending upon limited experience sectorally, comparatively and over time. Fourth, whilst, as emphasized, a response to particular economic and political circumstances, the theory of privatization has also been heavily influenced by particular fashionable developments that have been taking place in economic theory, even though these have nothing as such to do with privatization, merely serving as a convenient and fashionable illustration for the theory. For a variety or

[9]The term is taken from Fine (1989 and 1990) where the arguments in this section are developed in depth.

reasons, economic theory has been preoccu- pied with issues of asymmetric and incomplete information and the costs of transactions within a market system. Privatization proved a natural application, even though such factors are far from being its sole nor most important determinants.

Finally, irrespective of the applicability of the new synthesis to developed countries, the application of its analytical and policy framework to the radically different circumstances to be found in developing countries and economies in transition is most questionable. Indeed, it can be argued that the more pronounced changes and policy goals in such countries would have provided a sounder footing on which to formulate a theory of privatization, since the issues and consequences involved present themselves more clearly and cannot be overlooked. Anticipating what is to follow, the significance of the definition, redistribution and use of property rights emerges particularly sharply in the context of economies in transition, but they are also of importance in developing countries even if conveniently overlooked.

In short, the privatization literature suffers from the limitations of its analytical and empirical origins which, in principle, ought to have restricted its scope of application. This has not been so in practice and, partly and explicitly driven by a pro-market ideology despite its humble analytical foundations and origins, the momentum behind privatization has swept much before it. Ideally, it would be best to wipe the analytical slate clean and start again. A start is made here by a critical assessment of the key components of the new synthesis.

It can in part be seen as a reaction against the earlier tradition of "old" public sector economics. This was itself firmly based upon the notion of market failures. These fall into two types – the supposedly "natural" or given as opposed to the "artificial" or those created by economic agents. The first refers to conditions in production and/or consumption which lead to inefficiency in the context of a perfectly competitive, i.e. price-taking, economy. These might include economies of scale (natural monopoly) and externalities. In addition, the private sector might be considered to be naturally unsatisfactory if it provides an inequitable distribution of income or if it encourages or discourages consumption of goods that are considered undesirable of desirable, respectively, what are termed demerit (alcohol to be taxed for example) or merit (education to be subsidized) goods. In this way, the economic theory of market imperfections provided the rationale for public sector intervention, for which public ownership was one extreme form relative to subsidies and taxes for example. In addition, having identified the role for the public sector, it was more or less presumed that the benevolent welfare state would effortlessly implement the policies necessary both to rectify inefficie- ncy and to meet social goals. On the other hand, artificial market failure arises out of the uncompetitive behaviour of economic agents, especially firms. In this case, the idea is that prices will be unduly high and the market restricted, providing a role for the state to control prices.

The old public sector economics was very much a product of the Keynesian and welfarist ideology of the post-war boom. The new synthesis is a response to the collapse of that boom, and the issue that emerged in the late 1970s of public versus private ownership. Whilst the old tradition was particularly ill-suited to address the question of ownership, simply presuming the state would do what the market would not, the new synthesis continues to be marked by emphasis on how to deal with potential market failure. Interestingly, the ways in which it has evolved can be seen as pulling in opposite directions in terms of conclusions about the relative merits of forms of public and private ownership. On the one hand, the scope of market failure has been considerably widened. It now includes issues such as how property rights are defined and utilized, informational imperfections and asymmetries, and the effects of transactions costs. The recognition of these additional market failures might be expected to enhance the potential role of the state in sorting them out. On the other hand, however, the state itself is placed under closer scrutiny. It is no longer presumed that the solution to a market failure can be safely left to be remedied by benevolent intervention, partly because the state may not be benevolent, in so far as it reflects and incorporates the actions of officials and others with interests of their own, and partly because the state may have neither the knowledge nor the capacity more generally to implement what is required of it. In short, the new synthesis accepts, and even extends, the framework of market failure but also questions whether the state is able and willing to provide a corrective improvement. Complementing market failure is its *alter ego* in the form of regulatory failure. It cannot be presumed that the state will put right what the market gets wrong. It is a matter of a trade-off between the two.[10]

[10]As Jasinski and Yarrow (1996, p. 43) conclude from their four volume

III. The New Synthesis of New Political Economy, New Institutional Economics, and Neo-Austrian Economics

The first point about the new synthesis, then is that it supplements the old public sector economics and, in doing so, it draws upon three separate and broader types of literature.[11] One is derived from the new political economy which emphasizes the role and realm of the state as revolving around rent-seeking. In this view, the state's interventions not only distort the economy away from the conditions of beneficial perfect competition, they also encourage agents to incur the wasteful, and possibly illegal, expenditure of resources to gain such an advantage. Now, in this form, the notion of rent-seeking has a precise meaning and also a precise calculus of effects under given conditions – those of perfect competition and partial equilibrium. For, it is a static theory of distortion from market-led economic efficiency, with the added wrinkle that the inefficiencies are compounded by the costs of obtaining and sustaining them. However, and this is of more general significance for other parts of the literature, the notion of rent-seeking has readily taken on a life of its own, often divorced from its origins and limited sphere of applicability. Any economic intervention by the state, in a wide variety of circumstances, has become viewed as potentially a counter-productive policy response of an invitation to rent-seeking behaviour.

The new institutional economics has also contributed to the new synthesis. Its starting point is to explain the division between market and non-market institutions, especially the internal organization of the firm as opposed to its external market relations.[12] At its core lies the notion that market transactions are not costless and that the

collection of articles on privatization:

> Very roughly, privatization can be viewed as a means of reducing the impacts of both monitoring failures and government failures at the risk of increasing the effects of market failures.

For a conventional account of privatization theory, see also Vickers and Yarrow (1988). Clarke (1993) reviews the UK experience, arguing that it is far from a blueprint for other countries to follow, pro-market dogma to the contrary.

[11]See Rowthorn and Chang (1995).

[12]For presentations and assessments of the new institutional economics in the context of development, see Harris et al (eds) (1995). For a critical assessment in the context of labour markets, see Fine (1998, Chapter 4).

capacity of economic agents to uncover and incorporate all potentially relevant information is bounded. Consequently, non-market institutional forms will emerge as well as customary and collective, rather than individualistic, optimizing behaviour. Moreover, these are not, as such, evidence of inefficiency. Thus, non-market institutions, such as the state itself but also the internal organization of large corporations, are inevitably the spontaneous consequence of the inadequacies of exclusive reliance upon the market alone. As in the case of rent-seeking, the new institutional economics has produced a terminology of its own, even if more technical and less focused. It is deployed widely and freely.

Central is the notion of principal-agent problems (in which there are problems monitoring those with whom one contracts because they have better knowledge than you over what they are doing and with what effects). There are also problems of the definition and nature of property rights, and how the broader legal and other institutional environments interacts with the generation and receipt of information. Like the new political economy, however, even if the latter marches under its limited banner of rent-seeking, the new institutional economics is essentially a static theory, even if of allocation of activity within and between market and non-market institutions. This does not prevent it from being applied in a much wider range of circumstances as if this were a simple corollary. In this way, for example, increasingly in the most recent literature, the historical evolution of institutions is seen as a dynamic interaction between institutions that generate property relations, information and corresponding contracts, and vice-versa.

This brings the new institutional economics into common ground with the neo-Austrian school of economics which differs from the other two influsences on the new synthesis in that it is primarily concerned with the dynamics of the market economy in the context of an uncertain and changing world. In this respect, there is an antipathy to the notion of equilibrium and to the formal mathematical modelling that often characteries the new political economy and the new institutional economics. Instead, emphasis is placed upon the greater potential for decentralized decisionmaking. Individual economic agents are better placed both to generate and deploy new resources and information themselves and to do the same with that generated by others. Within the neo-Austrian tradition, the market is taken to be the most appropriate institutional form in which to accommodate such creation and diffusion of innovation and change. More important, however, is that the issue is raised in the neo-Austrian literature of how economic agents create and respond to a dynamic world of change and uncertainty irrespective of whether the market is favoured or not.

As a first point about the new synthesis, then, it is able to draw upon three separate, new or revitalized traditions. Each of these has itself developed in peculiar ways, from relatively narrow analytical origins. Taken together, especially in informal discourse, there is considerable licence to move seamlessly between a variety of concepts as if they were rigorously and coherently founded and integrated – which they are not. Further, there tends to be a presumption that these new analytical developments have shifted the balance in favour of the market and against the state – because of rent-seeking, the spontaneous formation of appropriate institutions, and the individual economic agent best knowing and responding to change.[13] Finally, with the exception of the neo-Austrians, the focus of the old public sector economics, with its emphasis on market failure, remains central – even if supplemented by notions of regulatory failure. To a large extent, this justifies the conclusion that ownership as such does not matter as opposed to the conditions of competition and regulation governing that ownership. But, if a choice has to be made on ownership, then the new influences on the synthesis have shifted the balance in favour of the market and privatization.

IV. Market Failure, Competition, and Industrial Economics and Policy

A second central point to the new synthesis is that there is a core section of the economy that is best left to the market and only to be subject to the interventions of the state in order to enhance competition, especially through easing regulations, for example, that inhibit ease of entry to a particular sector. This has been termed the quantity theory of competition[14] – the idea that a sector is more competitive if there are more competitors and that more of such

[13]In the context of industrial policy, Chang (1994) has shown decisively that this is not so. See also Tittenbrun (1996) for an analytical and empirical critique of the various positions adopted in favour of privatization.

[14]See Weeks (1981).

competition is beneficial. However, this can only be shown to be true within orthodox neoclassical economics under the most highly restrictive assumptions such as absence of externalities, decreasing returns to scale and partial equilibrium.[15]

In addition, the quantity theory of competition involves a very narrow notion of market competition for product markets, as opposed to the competition in product quality and differentiation, technological progress, access to finance, etc. This leads to a third, more general point concerning the way in which the new synthesis has changed the understanding of what constitutes industrial economics. Previously, the latter incorporated a substantial component of informal and institutional analysis as admirably summarized within the notion of structure-conduct-performance, the SCP approach. This suggested that the structure of an industrial sector, such as the degree of monopolization, would affect the way in which a corporation would conduct its business and, consequently, have an impact upon its own and more general economic performance. It allowed a whole range of factors to be brought into consideration, not least the internal organization of firms and their capacity to innovate and diversify. Now, in deference to mathematical models within industrial economics, the descriptive framework provided by SCP has been rejected for notions of equilibrium in which the anticipated effect of one's own and one's rivals' performance affects the choices of conduct and structure so that a unilinear causal relationship between the three factors is rejected. Modelling techniques have also been expanded to include game theory.

In short, irrespective of the merits of the old industrial economics, the use of the new industrial economics by the new synthesis has narrowed the range of the explanatory factors to be taken into

[15]As Schmalensee (1988, p.677) observes in his centenary survey on industrial economics for the *Economic Journal:*

> Recent theoretical research suggests that market conduct depends in complex ways on a host of factors, and the empirical literature offers few simple robust structural relations on which general policies can be confidently based. Moreover, formal models of imperfect competition rarely generate unambiguous conclusions. In such models, feasible policy options usually involve movements *towards* but not *to* perfect competition, so that welfare analysis involves second-best comparisons amongst distorted equilibria. In particular, there is no guarantee that making markets 'more competitive' will generally enhance welfare, particularly if non-price rivalry is intensified.

consideration. They are confined to those that are readily amenable to formal modelling, although these models can become extremely sophisticated in terms of strategy and counter–strategy. Here, in conjunction with the previous points, the new synthesis appears to have selected the worst of all possible worlds. For, on the one hand, formal mathematical models do not sustain the simple conclusions concerning the benefits of competition. On the other hand, they involve the exclusion of factors which are known to be crucial to industrial performance. In this light, it is not surprising that the more informal approaches to the issues of rent-seeking, institutions and neo-Austrianism should have gained in prominence more recently, especially in the context of the economies in transition where the changes associated with privatization are so much more dramatic.

Restricting the scope of industrial economics, not surprisingly, leads to the fourth point about the new synthesis – it places a particular focus on what is the scope of industrial policy. Taking a longer view on this issue, it is apparent that the definition of industrial policy is itself highly variable both over time and between countries. This is a consequence of the capacity for almost all economic policies to affect industrial performance and for one or other of these policies to be decisive at one time or set of circumstances as opposed to another. Trade, R&D, skills, finance for industry, vertical integration, small business, provision of infrastructure, etc have all from time to time been seen, rightly or wrongly at the time, as the appropriate focus for industrial policy. For the new synthesis, the focus is far more narrow – confined to competition, regulation (on which see later) and ownership. It follows that, just as crucial factors are neglected, so will be the corresponding policy considerations. This is true of other economic factors, especially where dynamic considerations of change are concerned, as in technological change and the generation of productivity increase and comparative advantage.

So far, the discussion has primarily been organised around the role of competition. The other side of the coin for the new synthesis is theory and policy where competitive outcomes are not appropriate as for natural monopoly, in the presence of economies of scale and scope. Here, the idea is that there is no possibility of a competitive equilibrium output so that, as best it can, a regulatory body must set prices or limit excessive profits, as well as securing quality and spread of provision to customers. A fifth point on the new synthesis, then, is that it presumes that there is a ready distinction, both conceptually and practically, between artificial and natural monopoly for which there are corresponding industrial policies, namely enhancing competition and regulation, respectively. It is relatively easy to show, however, that the notion of natural monopoly is not sustainable in the sense that it cannot be identified independently of the economic environment in which it operates. Consider, for example, a situation in which wages are driven down. This almost certainly reduces the scope for the economies of scale associated with natural monopoly as small-scale producers become more commercially viable. It might even be argued that driving down wages is a means of promoting the case for privatization and enhanced competition (and vice-versa)! Consequently, natural monopoly cannot be defined independently of the economic conditions in which it is presumed to operate and, moreover, policy itself may change whether an industry is interpreted as a natural monopoly or not.[16]

This leads to a sixth, more general, point about the new synthesis. This is its failure to take broader social and economic conditions into account. This is evident in a number of ways. Property rights are, for example, conceived of very simply as a residual claim to income—whatever profits are left over after costs are paid either go to the state or to a private company according to ownership. Not surprisingly, this tends to lead to the conclusion that ownership as such does not matter except as a secondary issue relative to competition and regulation. But property rights in general and privatization in particular are much more complex. For privatization can involve a decisive shift in the way in which property rights are exercised. Putting it too sharply, the public sector is to a greater of lesser extent subject to a political process which is quite distinct from the market process attached to private property. This is true even if both public and private sectors are subject to competition and regulation. It is much harder for broad-based interests to be represented politically when it comes to the private than to the public sector although, of course, there is no guarantee that political responses and processes within the public sector are always advantageous to the majority. But they do have to be taken into account and are liable to be highly variable and complex.

[16]See Fine (1989 and 1990).

Two different aspects are involved in deepening the approach to the understanding of what constitutes and what is the impact of property rights. Ons, the less fundamental conceptually, concerns the effect of redistributing given property rights. According to longstanding theory from the literature on transactions costs, externalities and the theory of the firm, the redistribution of property rights does not matter for efficiency as long as they are properly defined and owned. This has, however, been shown to be incorrect when there are residual property rights, those aspects of economic life over which it is difficult or too costly to determine precisely within a contract. Then, who has ownership is important, not only, for example, in the power associated with the redistribution of wealth but also for the efficiency with which that wealth is used.[17] This point is readily understandable in the context of South Africa. The presence or not, for example, of racial discrimination in employment practices is very hard to pin down. It would make a difference who owned the companies and how they set about ensuring that managers deal with the potential for racism and other issues that cannot be solely reduced to commercial or contractual conditions and for which there is considerable managerial discretion.

A more fundamental aspect in approaching the issue of property rights is to acknowledge that these might not only have an impact through being redistributed but that their very nature is not fixed but subject to change through how the exercise of property rights is dependent upon economic and social factors. It has been argued, for example, that the impact of privatization is very different according to the culture and institutions through which the state operates.[18] In the UK, there is a relatively weak tradition of the state acceptably and legitimately interfering to regulate private capital in the public interest compared to France. One result is that UK regulation has been perceived to be the responsibility of the regulator, to be personalized rather than a matter of participatory accountability. As Prosser (1995, p.512) puts it:

> Powers have been conferred personally on regulators and the assumption seems to be that if the right people are appointed this is in itself a guarantee of legitimacy.

[17]See Grossman and Hart (1986).
[18]See Prosser (1995).

It follows that what is being privatized depends upon a broader set of considerations than those narrowly defined by a tranche of physical property and set of regulations. What these allow for in practice is highly contingent upon society-specific factors.

A separate way of seeing this aspect of property rights, the neglect of the socioeconomic environment, is the failure of the new synthesis to take into account the specific histories of nationalized industries, their dynamic and their broader social and economic significance. In Britain, for example, the strong popular commitment to the national health service is almost certainly a consequence of the tradition of free and universal provision that it embodies. There has also been a more general commitment to public service, including the ethos of public provision as opposed to pursuit of self-interest, although this is being eroded with the progress of privatization.

This is because privatization has been heavily associated with an ideology, through anti-statism, of "bureaucratic bashing". This places the legitimacy of government into question as well as public service ethics and motivation. To be a state official is potentially to court the reputation for being superfluous, inefficient relative to the private sector, and rent-seeking if not corrupt. The consequences have not been purely ideological or damaging to public service morale. For the public sector has found it necessary to mimic the practices and criteria of the private sector in order to avoid or deflect such accusations and perceptions.[19] Further, irrespective of the damage

[19]For a comprehensive discussion of these issues, see Haque (1996). He argues, p.191:

> The current ethical challenge to the public service emanates basically from an attempt of various agencies to restore their weakened legitimacy or revive their lost public confidence by adopting the values of private enterprises, although such values are relatively incompatible with mainstream public service norms. However, this incorporation of market values in the public service may lead to a further decline in its legitimacy, because there is no reason to believe that the public will have more confidence in a public service driven by market values than one based on traditional, largely democratic, values.

See also Fine and Leopold (1993, Chapter 21) where it is pointed out that public provision is increasingly been treated as an alternative form of private provision, with a corresponding language of client, customer, etc. For a discussion of the sea-change in attitudes towards the relative America, see Baer (1996), and for Azerbaijan in the former Soviet Union, in the context of the rush to privatize crowding out other, more urgent reform, done to the morale and ethos of the public sector, there is an impact on recruitment to civil service employment. Although subject to nepotism, the state has often been able to enjoy a commitment from its workforce which has allowed lower wages to be paid than in the private sector and for a benefit to accrue from the pursuit of a career as a state employee. With a shift in the ethos of public service, state employment is liable to lose such advantages, leading to inefficiencies through high turnover of staff, and the civil service merely seen as an alternative or stepping stone to more remunerative employment in the private sector.

These considerations are particularly relevant in the South African context, for example. Whilst government in the form of the ANC commands extremely high popular support, the same is not so true of the administration of the state. It remains marked by both the structures and many of the personnel that were part and parcel of the apartheid regime. Unfortunately, rightly of wrongly, as part of the transitional settlement and the incorporation of the former homelands, the majority of white civil servants have retained their privileged employment and benefits, whilst black government employees have frequently faced the threat of redundancy as duplicate and paper functions have been rationalized. Moreover, as the institutional capacity of government is itself being constructed at many different tiers and across a range of departments, against a background of impatience for delivery of basic services for those most in need, it is imperative that the legitimacy, ethics and motivation of state employees be sustained and even advanced. The ideology and practices associated with privatization are damaging in this respect. There is a danger of the private sector "creaming" the most easily sources and commercially viable services, leaving the state with the responsibility of providing a safety net those hardest to serve. Poorly resourced and regarded, the ethos of public service is undermined.[20]

see Wiesner (1997). The erosion of public sector ethos and interest through privatization was usefully emphasized in the conference discussion of this paper.

[20]As Haque (1996., p.200) observes:

> In most of the market economies, the productive, efficient, and profitable sectors are dominated by private firms, whereas the public sector is left with activities which are socially unavoidable but economically non-profit-making and unattractive, such as health care, food provision, housing, and education for the poor··· Due to this monopolization of profit-

History is also important in the performance of the public sector. In Britain, for example, most of the major nationalizations arose immediately after the second world war out of the positive experience of war-time controls in sharp contrast to the failures of the industries under private ownership during the inter-war period.[21] In many ways, the industries' experience before privatizations can be described as a period of successful restoration to commercial viability, something that had to occur in any case before the private sector would be willing to purchase them. More generally, in assessing performance, there tends to be an in-built bias against the public sector for two reasons. On the one hand, there is sample-selection bias – if the private sector were not performing well, it would be eliminated and not remain to be counted. Whilst this is considered to be a virtuous property of the market mechanism, this would discount their relatively negative contribution for the time that they were in existence. It is like assessing health care provision on the basis of live patients alone. On the other hand, the relative performance of the public and private sectors tends to be assessed on the basis of the criteria laid down for the private sector, more of less direct measures of commercial achievement at the expense of the equally important social measures such as employment generation and security, contribution to skills, universal provision, etc.

In general, popular ideology to the contrary, the balance of evidence in favour of either the public or private sector is mixed and fairly balanced.[22] It is, however, difficult to make comparisons in the context of denationalisation, partly because it is relatively recent,[23] limi-

able enterprises by the private sector and the imposition of economically less viable functions on the public sector, the comparison between the two becomes relatively unjust.

[21]See Fine and O' Donnell (1981 and 1985).

[22]See Rowthorn and Chang (1992) and Chang and Singh (1993) for example. See also Haque (1996, p.197):

> There is sufficient reason to suspect the claims of efficiency and competition made by the privatization advocates and there is need for more comprehensive studies and critical research to evaluate such claims.

For and overall assessment of the results of the UK privatizations programme, see Parker and Martin (1995). See also Boussofiane et al. (1997) and Galal et al. (1994).

[23]Remarkably, in terms of its short-termism, Eckel *et al.* (1997) deduce that efficiency had improved under private ownership as airfares were lower one year later on the routes served by British Airways. Further, they

ting the capacity for before and after comparisons, and partly because it is rare that public and private sector companies operate in otherwise comparable conditions. This leads to a rather different point, re-emphasizing the need to address historical and socioeconomic factors; the differences between public and private sector performance within a country are liable to be small relative to the differences in performance of both relative to other countries. Thus, in the case of Britain, the problem is not so much the difference between public and private sector performance as the poor overall industrial performance relative to other countries. Put another way, if the productivity performance between the private and public sectors within countries were equalized, then this would make very little difference to the comparison of productivities between countries. This is not the same thing as saying that ownership as such does not matter, since the running of the state sector can form part of, and a platform for, industrial policies more generally which do affect the performance of both private and public sectors.

This leads to a seventh point about the new synthesis which incorporates many of the earlier points. Because it is essentially microeconomic and partial in its analytical scope, it takes no account of the macroeconomic environment. The theory is perceived to be generally applicable across a range of circumstance give or take a detail or two. It does not seem to matter whether unemployment is high or low, with the same applying to other targets of short- and long-run macroeconomic management as for inflation, budget deficit, balance of payments, and growth in the economy and productivity.

A final point about the new synthesis is its understanding of regulation. Here, for natural monopolies, the idea is that the regulator should impose conditions on prices and quality, etc of service. Whilst this is all very well in principle, there is much detail to be determined in practice and, echoing an earlier point, how the public and private sectors relate to, and attempt to manipulate, regulation is liable to be very different as each is governed by different goals and processes. Here, however, it is worth emphasizing a different aspect of regulation which follows from the other features of the new synthesis. This is that the regulator is essentially a

suggest the same conclusions can be drawn because the share values of US competitors to British Airways fell upon its privatizations, the more so for closer rivals.

surrogate for surrogate for industrial policy but with two special features. The first is the extremely limited powers that the regulator commands – given a focus primarily on pricing and profit at the level of the enterprise, there is usually no way of directly influencing wage differentials, employment levels, R&D, skills and training of the workforce, the promotion of economies of scope, etc. The second feature is the limited accountability of the regulator over extended periods in terms of democratic representation. Whilst this might be seen as a positive aspect in terms of independence from particular interests, including those of an established government, it is more fundamentally a negation of popular participation in decisions that often crucially affect the day-to-day lives of citizens dependent upon the provision of basic utilities.

V. From Theory to Practice

The theoretical literature on privatization is, then, sorely limited in its ability to address the issues with which it is concerned. This is not simply a matter of omissions which can be corrected. The whole approach is deficient for its undue generality, for being exclusively concerned with static conditions of resource allocation and efficiency as opposed to the dynamics of industrial change, and for its lack of socioeconomic, political and historical content. The reasons for this lie in part in the attempt to impose previously developed theory to a host of very different circumstances. It is like the drunk who is found looking for his door key under a lamp-post and, when asked if that is where it was lost, replies not but that it is the only place where it can be seen. Not surprisingly, however, as the search proves futile, tentative attempts are made further afield. This explains the previously observed process of incorporation of supposed insights from the new political economy, the new institutional economics, and neo-Austrianism. Developing countries and the economies in transition have been pressed into privatization before analytical and practical lessons have been learnt even from experience in the developed countries.

Literature for developing countries or those in transition is informative for analytical purposes despite, or even because of, the wide divergence in conditions compared to those in the developed countries. It is almost impossible to ignore the wider economic, political and ideological conditions as well as the sectorally specific details attached to particular privatizations. Conditions that are not only taken for granted in developed countries but which are also presumed to be neutral in their effects, cannot be overlooked elsewhere except in that market-led Panglossian view in which appropriate socioeconomic mechanisms are miraculously conjured forth merely by virtue of the need for them.

More specifically, and in some brevity,[24] drawing upon the experience of the developing countries suggests the importance of the following factors. First, one of the principal requirements for the implementation of a privatization programme is an adequate administrative capacity. Divestiture is a technically demanding exercise, even in advanced economies. The nature and quality of administration can have a significant impact on policy and on outcomes. In addition to the mechanics of the sales themselves, which can take a variety of forms and vary in their conditions, how enterprises are prepared for privatization is of importance. Although, not surprisingly, the World Bank has argued that restructuring should be left to new private owners to avoid wasting resources, preparations that may need to be made prior to sale include redundancies, plant closures, legal restructuring and debt write-downs.

Second, although privatization is often motivated by the wish to increase market competition, the opposite can occur. Privatization, especially of public utilities, may exchange a private for a public monopoly in which the former already has considerable conglomerate resources at its disposal. In any case, however privatization is administered and whatever the competitive environment that results, subsequent developments depend upon the regulatory environment and capacity within which industry functions more generally, This is far from uniform within and across countries.

Third, access to technology is an important determinant of both productivity increase and market structure. High levels of minimum efficient scale of production and large-scale, capital-intensive production can present a barrier to market entry. This has some bearing on the impact of privatization. Anticipated productivity increases would be restricted given the cost of new technology. The picture may be further clouded by the fact that state enterprises prior to privatization may have faced severe restrictions on their ability to invest.

[24]For discussion at greater length, see Fine (1997a).

Technical innovation hinges to some extent on the access of enterprises to imported technology, possibly through joint ventures. Technical advance also depends upon levels of R&D expenditure and the skill composition of the workforce, Such considerations clearly cut across the public/private sector divide, with privatization potentially shifting considerably the factors underlying skill and technology provision.

Fourth, for employment, privatization is frequently associated with staff reduction. The state sector is often characterised by strong trade unions and, as a result, the cost of shedding staff in political as well as economic terms can be so great that the continued employment of excess labour is preferred. The workforce may also take action to impede the privatization process in the expectation that private ownership will reduce staff levels. This further politicizes the privatization programme. It may be that state employees are not favoured by the private sector as they have been cocooned in state employment for many years. Private investors may be deterred from purchasing state enterprises as they will either inherit a public sector oriented workforce or be faced with the substantial expense of dismissing staff. The costs of this can be extensive with many staff entitled to severance pay. Alternatively, attempts can be made to increase employee productivity and cooperation, for example, by making provisions for employee share ownership schemes. The role of employees in the privatization process is just one example of how politicized it is. In the case of developing countries, the role of the World Bank and the IMF has been important in exerting political pressure on those countries undertaking adjustment programmes. The absence of the influence of these institutions in other countries does not, however, imply the absence of considerable economic and political interests at work.

Finally, how the financial system functions is crucial to the privatization process. This determines the options of grow privatization can be arranged, the potential involvement of different parties as sources of funds both to purchase and for future investment, and the likely impact on saving rates and sources of foreign funds. There is also the issue of how well the financial system functions as a monitoring device for the subsequent performance of privatized enterprises.

VI. Lessons from the UK

From the previous discussion, two central conclusions can be drawn. First, given the multiplicity of factors in any privatization, it is erroneous to seek a general theory or explanation.[25] Interestingly, exactly the same conclusion was drawn many years ago in the context of nationalized industries before privatization had been seriously contemplated.[26] Each sector of the economy in terms of its finance, markets, international position, technological prospects, political context, etc is very different from another. Second, by the same token, at a systemic level, the role played by privatization will be very different from one country to another depending upon the particular structure and dynamic of the economy irrespective of any tendencies towards "globalization".

These propositions are well-illustrated by consideration of the British example. As argued elsewhere, Fine and Harris (1985), the UK economy has been characterised by the three "lows" – low productivity, low investment and low wages. This is the consequence of the particular role of finance, industry and labour. The British financial system is what is known as market-based, as opposed to the Japanese bank-based system,[27] with armslength relations between finance and industry and relatively limited provision of long-term industrial investment funds. British industry has been heavily based upon multinational corporations whose strategic restructuring has been based more upon global considerations than upon the regeneration of British industry. Despite reputations for militancy, the British labour movement has primarily been engaged upon defensive struggles to protect employment levels and advance wages and conditions of work rather than being influential in the formulation and implementation of industrial policy or economic policy more generally.

The result has been that industrial policy has long lacked for coherence and commitment over the long-term, since no major economic interest group has been able or willing to direct the corresponding strategies and policies. In this light, far from the priva-

[25]See Parker (1994) who examines a matrix for examining changes induced by privatization with the corporations as a row vector and goals, management, labour, operational structure and nature and location of business as the column vector.

[26]See Fine and O'Donnell (1981 and 1985).

[27]For a review of the financial systems literature, see Fine (1997d).

tization programme being a break with the past, it is better seen as a continuity, even a perfection, of the lack of systematic industrial policy that has gone before.

This has proved disastrous in the case of British privatization which has been accompanied by the simultaneous decline of lack of integration of industries that are mutually dependent upon one another through the linkages associated with the input-output table – as for coal, steel, electricity, cars, and water, for example. In the case of coal, the Thatcher governments' commitment to defeat the union took overwhelming precedence over energy and industrial policy. The use of domestically produced coal within the UK electricity industry has been sacrificed for reliance upon other energy sources irrespective of the direct impact on domestic employment within the coal industry itself, and quite apart from the indirect effects through the economic multiplier. In addition, coal-fired power stations have been set aside for gas-fired power stations, as the latter require less capital expenditure and incur lower risks for individual power suppliers if not for the system as a whole. These effects together have had a large negative impact upon the British engineering industry; major parts of its market were suddenly spirited away without the opportunity to retool and retrain for provision of the new equipment irrespective of the rationale for its being preferred.[28]

As argued in Fine and Poletti (1992), the privatization and reorganization of the British steel industry was based upon considerable destruction of public sector basic capacity prior to privatization in order to guarantee profitability of the continuing private finished steels sub-sectors. McLaughlin and Maloney (1996) provide an outstanding account of the reorganization and privatization of the British car industry. They demonstrate the lack of coherence and continuity in policy towards the reorganization of the major British and state-owned producer, British Leyland, with policy shifting according to the political imperatives and ideologies of the Tory government as opposed to rational industrial policymaking. Similarly, Hunt and Lynk (1995) examine the privatization of UK water industry and conclude that it has set aside the economies of scope that exist between the provision of water supply and more general environmental services.[29]

[28]See Fine (1990) for details.

Under privatization, both electricity and water have become subject to distribution under twelve and ten separate regional companies, respectively. As privatized companies, they have been able to relate to the rest of the economy quite differently than the corresponding enterprises under public ownership. Then, the companies were generally prohibited from diversifying into other sectors for fear of their competing with the private sector. In addition, the public sector was used more positively to promote the private sector by, for example, the orders that it made for equipment which often reflected broader strategic goals. Under privatization, such restrictions on diversification no longer hold and strategic goals are different, primarily if not exclusively tuned to private profitability. Thus, for example, the first takeover bid for a UK electricity distribution company was made by a general holding company, Hanson PLC, seeking to set the electricity company's profits against its own losses in order to reduce an overall tax liability. By early 1997, ten of the original twelve UK electricity distribution companies had been acquired, some by US utilities, others by privatized water companies.

More generally, and hardly surprisingly, the newly privatized companies have used their considerable financial muscle to speculate in the acquisition of other companies on the basis of acquiring capital gains rather than on the basis of economies of scale and scope. Inevitably, these operations involve internationalization of investment, whether inward foreign investment in public utilities or outward investment by the newly privatized companies. This makes industrial policymaking even more difficult. Interestingly, even as this paper was being written, British Telecom has merged with the US company, MCI, to form the second largest telecommunications company in the world. This may or may not be an advantageous strategic move but, more significant, it has been made without any apparent reference to UK industrial policy or broader objectives as defined by government strategy or policy.

To some extent, the differing terms and conditions under which privatized companies are now reorganizing themselves can be interpreted as a shift in the nature as well as the distribution of property rights. Nonetheless, the redistributive effects of privatization have been prominent, with a presumption amongst proponents of privatization that measures to support the disadvantaged should be

[29]See also Davidson (1993).

pursued through other areas of policy. Macroeconomics should correct unemployment, for example, and income subsidies should be used to ensure that the poor can afford public utilities rather than distorting prices by making them cheaper. As Alan Walters, a prominent economic advisor to Mrs. Thatcher, reputedly argued in response to the idea that rail fares should be subsidized, "Why do you want to favour poor people simply because they go by railway. If you regard them as poor give them as poor give them money".[30] The idea is that this will allow the poor to buy what they want and also not impair allocative efficiency by distorting price signals with a subsidy.

Of course, the unemployed and the poor might feel rather differently about whether such policies will actually be implemented. Those who favour such marker-led solutions are also notorious for opposing income redistribution as providing negative incentives against the rich who would pay higher taxes, as well as discouraging the supposedly work-shy unemployed from taking up work. This is of particular significance in Britain, where the programme of privatization has been associated with a dramatic increase in income inequality. The same applies to the increasing inequality elsewhere in the world of privatization. Whatever benefits privatization brings, they do not appear to filter down to the poor.[31]

For reasons that should be clear from the earlier discussion of how the theory of privatization has evolved, issues concerning industrial policy, economies of scale and scope, and the redistribution and redefinition of property rights have all arisen in the indirect form of

[30]As quoted in Bos (1996, p.53).

[31]See Haque (1996, p.198):

> During the period of privatization between 1980 and 1992, the number of people in poverty in Latin America increased from 136 million to 266 million, and in Africa, the number of people in poverty has already reached 200 million··· In terms of living standards, the incidence of undernutrition increased from 22% in 1979-81 to 26% in 1983-85 in sub-Saharan Africa, and health services have become less affordable to the poor in countries such as Zaire, Swaziland, Lesotho, and Uganda··· More recently, in many of the emerging market economies in Eastern Europe and the former Soviet republics, the standards of living have deteriorated significantly. Although these examples do not prove that privatization has caused this decline in living standards in these Third World and post-socialist countries, which might be caused by other unknown factors, they at least represent the fact that privatization does not necessarily enhance the welfare of common people.

how best to regulate the industry. Initially, regulation was seen as a more or less simple matter of devising the appropriate criteria, and hence formula, for pricing. Now, in retrospect, the process of competition is perceived to be much more complex, involving not only the market for a single output but also product composition and quality, diversification and transfer pricing across activities, access to finance, acquisitions and mergers, franchising, access to inputs, quite apart from the role of shifts in government policy and orientation and of long-term contracting. There is also the issue of what is termed "stranded assets", those that are acquired but not necessarily falling under the purview of the regulator or the core business of the privatized company. Their presence should not simply or primarily be seen as indicative of problems in regulating privatized companies but as a lack of strategic thinking in the privatization policy itself and in industrial policy more generally.[32]

This is hardly surprising given that the imperatives to privatize often dominated consideration of the practicalities involved. By its own parliamentary committee, the Thatcher government's plans for privatizing electricity were strongly criticised, Energy Select Committee (1987/88, p.xix):

> We cannot make recommendations about policy when policy is unknown··· (and) runs the risk of producing ill-considered, spatchcock legislation. Electricity is too important an industry for the country to gamble that everything will come out right.

One factor pushing the process of privatization is that it is itself a particularly profitable business for those concerned. The cost of arranging the sale of assets, including the commission, is usually three or four percent of their value. But this can be a huge amount of money. It is hardly surprising that financial institutions should be keen on privatizations taking place. Often there has been a close relationship between political and financial advisors. As one of these commented.[33]

[32]These points are well-illustrated by the collection edited by Helm and Jenkinsn (1997), where the problems of economies of scale and scope clearly emerge in the context of price regulation. For a clear discussion of the inadequacy of the regulation of water through simplistic pricing formula, see Davidson (1993).

[33]Letwin (1988, p.61). See also Redwood (1988, p.31). the erstwhile challenger for the Tory Party leadership and an active consultant on, as

> So, my first advice is to take the plunge. My second advice is, don't listen too much to too many experienced professionals. Choose advisers who will take the plunge with you and get it. You will find as I say, that it's not perfect, but it does work.

But for whom does it work, apart from those who advise to take the plunge? For, in order to obtain cooperation from workforces and, workforces and, especially management in valuing businesses and in keeping them in running order, their cooperation often has to be recompensed. In Britain, there has been a public scandal over the extent to which the managers of previously public corporations have been rewarded with share potions and increases in salaries. More than fifty directors of previously publicly-owned utilities have each made more than £1 million more in salaries, share options and pension rights than they would have before privatization.[34]

An interesting aspect of this scandal is that the UK public were outraged both by the extent of the forwards received by the management in the newly privatized enterprises and by the absolute levels of these rewards. Not surprisingly, the rather lame but, in some sense, legitimate defence on the managers' behalf has been that their remuneration was simply being raised to a level comparable to the private sector. In effect, this suggests two different conclusions: how outrageously high but unnoticed are the levels of rewards common within the private sector and only brought to attention in the context of change from public to private sector management; and how substantially and quickly can the ethos of public sector management be transformed to that of the private sector. And, of course, there is nothing that a regulator nor the government can do about it.

In discussing, however suitably, the process of privatization, and the corresponding redefinition and redistribution of property rights, the literature has inevitably moved forward to the results of privatization itself for this is nothing other than the exercise of those newly formed property rights. Whilst there has, in Britain for exa-

proponent for, privatization:

> When you are setting about your task of privatization, don't go for the two-year slog or the two million pound consultancy to work out absolutely every detail··· if you are seriously interested in privatizing, there is no substitute for doing it.

[34]See Conyon (1995) for a full account of directors' pay in the UK privatized industries. He finds no correlation between the extent of increases in rewards and enterprise performance.

mple, quite correctly been considerable emphasis on the excessive profits that were made out of the privatization process (with selling prices often offered too low) and the excessive profits made by privatized utilities, even leading to the imposition of an extra tax (thereby undermining or revealing the weakness of regulation), this is to some extent misleading. For it involves treating the privatized utilities as of they were simply the public utilities under private ownership. But this is not the case, as will become increasingly apparent over time as they diversify their activities in sectoral and global scope (or become the victims of others doing likewise).

Once again, it can be considered that the associated financial restructuring of the privatized corporations has been recognised only indirectly and in line with continuing analytical concerns that do not necessarily derive from privatization as such. Much has been made, for example, of the extent to which privatization has given rise to a share-ownership democracy. Although shareholding has been widened by privatization, the most important impact has been to consolidate formal ownership in the hands of institutional investors such as insurance and investment funds. However, Hayri and Yilmaz (1997) have investigated whether the prices of shares of privatized companies perform in a similar fashion to the prices of other companies. They find that they do not do so and suggest this may reflect stock market inefficiency due to the large number of small shareholders who act in concert on less than perfect information or motives. Whilst an important result, from the perspective offered here, it misses the point of how the UK financial system functions as a whole. Even if th privatized stocks performed comparable to others, the overall functioning of the British financial system in generating and monitoring finance for investment would remain sorely inadequate.

VII. Implications for South Africa

From a systemic point of view, with its historical background and legacy of apartheid, the peculiarity of South Africa is well-known for its systemic oppression of the majority black population. Less well understood is the economic system to which this has given rise.[35]

[35]For an account of the South African economy from the perspective adopted here, see Fine and Rustomjee (1997).

South African industrial development has been and remains seriously deficient. A major weakness of South African industry is the relative absence of productive capacity in intermediate and capital goods. This has a negative impact on the economy in a number of different ways:

(a) Economic expansion leads to growing imports of these goods and so creates balance of payments pressures.
(b) Up- and down-stream integration of economic activity is poorly coordinated, in terms of the provision of mutually reinforcing access to finance, markets and technology.
(c) Employment generation, broadening of the skill base, and the opportunities to diversify into new sectors of industry are severely constrained.

Further, South African industry has suffered from stagnation in investment since the early 1980s, whilst South African corporations have engaged in:

(a) capital flight, much of it illegal (estimated to be as much as 7% of GDP),
(b) speculative purchase of existing industrial assets as disinvestment was prompted by international sanctions, and
(c) heavy lobbying for policies to promote their interests, whether materializing in the past under the previous apartheid regime or currently under the newly elected democratic government. This is most notable, for example, in the pursuit of state- subsidized mega-projects and the pressure for privatization, in part to undermine the state's influence over the economy as well as to obtain productive assets cheaply.

Some key aspects, then, of the South African economy are:

(1) A lack of capacity in intermediate and capital goods.
(2) An aged capital stock, reflecting limited investment in the past.
(3) Declining shares in critical world markets for manufactured exports, especially those in which other successful developing countries have been prominent.
(4) A lack of integration across sectors.
(5) Limited skills and employment opportunities for the workforce, complemented by pooly trained and inadequate management.
(6) A highly concentrated pattern of corporate ownership which straddles the economy as a whole and not just industry.
(7) An institutional structure and governance that continues to reflect the economic and industrial imperatives of the past.

(8) There is a highly skewed distribution of economic and industrial activity both within South Africa and across the southern African region as a whole.

It is crucial to recognize that these general characteristics of the South African economy differ in weight from one sector to another and within sectors, and that these factors are integrated with one another in different ways depending upon the sector concerned. Clothing and telecommunications, for example, have obviously evolved along quite separate paths and pose different policy challenges despite their common origins within the South African economy. In addition, it is important to recognize that the South African economy enjoys certain advantages—such as large-scale public and private sector corporations, an extensive if unevenly delivered infrastructure, and, especially important, the capacity and prospect of delivering such social land economic infrastructure to a varying degree.

Against this economic background, it is possible to assess South African prospects for privatization. First, there are historical aspects. Huge state corporations, such as ESKOM (electricity), SASOL (coal to oil conversion and associated petrochemicals), TRANSNET (transport) and ISCOR (coal and steel) have been built up in the past, partly as a strategic element in securing the apartheid regime against the threat of international sanctions, but also as a concerted attempt to provide infrastructural and other economic support to large-scale private capital and secure jobs for working class Africans. In the mid-eighties, policy gradually switched towards privatization of these and other corporations. The rationale at that time was relatively clear. The apartheid regime sought to obtain short-term funding in order to handle the economic and political crisis that is faced, especially in the wake of the international debt freeze of 1985. In addition, privatization held out the prospect of removing the ownership and control of significant assets from the hands of a prospective democratic government.[36]

In the event, the government's strategy was primarily defeated, partly as a consequence of political opposition, especially that emanating from the trade union movement which could easily have been swayed by the offer of sweet deals. Current proposals for privatization continue to recognize the influence of the trade union

[36]For a discussion of past and present proposals for privatization, see Fine (1995). See also Makgetla (1995).

movement, as in the National Framework Agreement for negotiating "the restructuring of state enterprises". This last phrase is in itself an encouraging sign for the labour movement in so far as it distances itself from the terminology of privatization as the only or main from of dealing with public enterprise. In this respect, it will be crucial to keep under close scrutiny the substance that is given in practice to the restructuring of state assets within the context of the National Framework Agreement. Privatization does tend to have a logic of its own, generating a momentum that veers towards the incorporation of commercial at the expense of social or other criteria, particularly during the process of negotiating the details of implementation and putting them into place. Good and honest intentions in advance tend to be sacrificed to the dictates of commercial viability–not least in response to the pressures generated by donor agencies and private domestic and foreign business interests.

It must also be borne in mind that the failure of the apartheid regime's attempts at privatization did not derive exclusively from political opposition. On any realistic assessment, particularly at a time of international sanctions, the only major source of finance for purchasing privatized assets must have been the South African conglomerates. The limited extent of privatization that did occur reflected the unwillingness of these corporations to invest in privatized utilities for a variety of reasons, including a reluctance to commit large-scale finance in political uncertain conditions together with the comfortable relationship that was enjoyed with the state corporations in any case. To have forced South African corporations into financing privatization would have been equivalent to a policy of proscribed assets. However, with the demise of apartheid, much of the political uncertainty surrounding the future of privatized assets will have been removed, opening the way for investment by both domestic and international interests.

However, other circumstances have also changed. The spread of privatization around the world means that the portfolio of choice available to investors in privatized utilities is considerable. The pricing of privatized assets would have to be extremely keen. More important, the wish for South African corporations to avoid tying up their capital in privatized utilities remains. South African corporation are continuing to seek to globalize their operations. Also, as in the past, the extent to which they will fund privatization will depend upon the alternative uses to which they can put their finances and their strategic stance towards the South African economy.

It is crucial to recognize, however, that both of these factors should not be taken as given – they are open to be influenced by government policy and strategy. In these respects, the current situation is far from positive in some respects. On the financial side, government has argued that privatization will be a source of funding for the government's Reconstruction and Development Programme, RDP, although such earmarking has always proved elusive, and there are already signs that privatization funds will be set against the government deficit. In addition, the notion that privatization will provide funds for the RDP is misleading in the sense that it suggests that the major constraint on RDP delivery is availability of finance. This is arguable given that much of the funding for RDP programmes remains unspent, and that the continuing major constraint on delivery is the institutional capacity to deliver for which the creation of public sectors skills and ethos is of paramount importance. There is no evidence nor guarantee that the finance raised through privatizations will in fact be earmarked and used for progressive policies, such as the RDP in the South African case. In fact, the funds simply become a general part of government revenue, and it can always be said that whatever is spent on the RDP came out of the privatization fund. Further, funding the RDP out of privatization revenues is to concede the principle that its policies are contingent upon a successful raising of revenue so that they are always a hostage to the more general fortunes of the state's finances. Moreover, those supporting privatization as an economic policy more generally are usually conservative in economic outlook and will be prepared to sacrifice the RDP, and even to abandon it, whether privatization is successful or not. In short, the RDP should take priority as an economic policy and not be made contingent upon a privatization programme.

Moreover, the argument concerning privatization as a source of potential funding in incorrect or, at least, fundamentally misguided. As is generally recognised, as far as state financing is concerned, privatization merely substitutes one form of asset for another. In the ideal world of perfect capital markets, this should make no difference to the state's finances, although it could bear losses through the costs of privatization itself and from selling shares in a large tranche, thereby depressing the sale price. In addition, the privatization programme would inevitably be wasteful in transforming the state's physical assets into finance. The process of privatization is itself expensive in terms of consultancy fees, advertising, share issues, etc and can cost up to 10% of the value of the revenue raised.[37] Experience suggests that in order to guarantee a successful privatization, in terms of a complete and assured sale, the share price has to be set at a level below real worth, partly because most companies' shares are only sold piecemeal and not all at once. This is widely reflected in the immediate rise in a privatized company's shares following flotation, and has the effect of rewarding those who are already in the advantageous position of being able to afford to purchase shares, further consolidating inequality in wealth. Further, privatizations place unusually large demands upon financial markets and tend to crowd out the availability of finance for other investments.

In terms of switching a long-term physical asset into short-term finance, for example, it must be asked why the state is unable to raise such finance more readily and cheaply through more conventional methods of financing government expenditure such as by issuing a bond of the preferred time structure for repayment. The obvious answer is that the capital market is far from perfect. This does not imply, however, that privatization is preferable as a means of raising finance. Doing so may worsen the market imperfections and their consequences. As has been witnessed in the case of developing countries, privatization does not appear to improve the ability of government to raise finance, nor does it necessarily call forth or strengthen financial markets that are otherwise absent and, even if it does, the sequencing in doing so may not be ideal. Nor does privatization necessarily improve macroeconomic performance, as documented for Latin America by Pinheiro and Schneider (1995).

Such considerations do not apply to the South African financial system in the same way as in other countries, but they are of relevance. South Africa has an extremely well-developed financial system, along the lines of developed countries, especially the UK model, in terms of the range of markets and institutions available. But it is market by a number of features which are particularly relevant to the impact that might result from privatization. Without going into details,[38] the South African financial system is deficient in

[37] When Simpson McKie James Capel, a subsidiary of the Hong Kong and Shanghai Bank, was appointed as advisor on the restructuring of state assets to the South African Government in August 1996, the fee bandied about for a year's service was quoted by the *Financial Mail* as around R10 million.

the level and composition of investment that it generates for industry, and this is in part a consequence of its speculative and short-term orientation despite the conglomerate ownership of both industrial and financial corporations. The consequences of funding government expenditure or relieving government debt through privatizing is liable to worsen this situation, since it will add nothing to real productive investment in the economy and it will add to the portfolio of assets around which there can be speculative activity.

The implications of this analysis are more far-reaching. It is to observe that government has presumed, irrespective of the merits on other grounds, that privatization will have a positive impact upon the levels of domestic and foreign investment and on the functioning of the financial system, especially in so far as the funding of government expenditure and debt are concerned. From a theoretical point of view, this can only be so if the financial markets are working imperfectly. For, if not, reorganization of public and private finance would be best achieved through more direct methods, rather than through the indirect method of exchanging one form of asset for another. Consequently, the government's case must rest on the presence of market imperfections. No attempt, however, has been made to identify what these are and whether the financial consequences of privatization will remedy or worsen them. The latter seems most likely given the deficiencies currently observable in the financial system as a source of investment for industry. Elsewhere, it has been argued that the financial system needs to be subject to critical public scrutiny for the role that it plays in raising finance for, and monitoring and coordinating, investment, in funding government expenditure, and in influencing macroeconomic policy more generall y.[39] To these should be added the relationship between the public enterprises and the financial system. Further, all proposals for the restructuring of state assets, taken singly or as a programme, need to be fully assessed in terms of their impact upon the functioning of the financial system as a whole, without presuming that advantages necessarily accrue directly or in net terms from the short-term flows of funds that result. Thus, a drawback of a privatization programme is that it will strengthen what are already bloated institutions in South Africa dealing in the speculative buying and selling of financial

[38]See Fine (1997d).

[39]See Fine (1997c and d).

assets. What is needed are financial institutions primarily geared to the raising and directing of funds into productive investment.

The role played by the financial system and the financial institutions within it, as argued, is not pre-determined but depends in part upon government policy towards it. But finance does not operate in a vacuum, merely responding to options for industrial investment according to their profitability. For the portfolio of possible options will depend upon the industrial policies adopted and the determination with which they are pursued. Here again, there are some positive features of the South African situation. Policy has not been contingent nor driven primarily by World Bank, market-led dogma. Plans for restructuring of state assets have, in principle, been sector and corporation specific and reviewed at some level of detail. In addition, such considerations have taken precedence over whether privatization should be a preferred policy option and, if so, what form privatization should take. The pursue of joint ventures, to enhance technological capability, for example, and the retention of majority state ownership is a sensible way of proceeding subject to informed and hard bargaining, rather than handing over state assets in return for cash and then letting the private sector get on with it.

However, this still leaves open the substance of what is to be bargained and how it is to be bargained. This has a number of separate components.[40] First, there is the issue of the overall strategic vision of industrial policy of which the restructuring of state assets is a part. The priority must be the goals of the RDP, but these are increasingly being displaced by secondary or intermediate objectives, which have become primary targets of their own – most notably in the predominance of conservative macroeconomic policy. In addition, the goals of the RDP are themselves being weakened in so far as the highest priority to basic needs and redistribution is concerned. Accordingly, plans for restructuring state assets must specifically and explicitly account for the goals of the RDP, justify other intermediate criteria – such as commercial viability, export earnings, employment creations, etc – and ensure that outcomes are accountable in these respects.

Second, the strategic vision must itself go far beyond a set of goals and come to terms with key aspects of the economic and political

[40]See Fine (1997c) for a discussion of each of these elements in some detail

realities of the South African economy. It needs to take account of the low levels of industrial investment, that its composition is skewed towards capital-intensive mega-projects, the poor level of export performance, low levels of formal skills amongst the workforce, the skewed distribution of infrastructure, and the limited capacity in intermediate and capital goods which has substantially constrained the ability to develop dynamic economies of scale and scope. On the other hand, South African conglomerates have long displayed a strategy of organizing their productive and financial assets globally with an emphasis towards capital export for almost two decades. The restructuring of state assets needs to build upon the inherited strengths of the South African economy but also to address the continuing weaknesses and the causes that have created them.

To a large extent, third, this must be done through well-developed and more broadly informed but specific, case-by-case consideration for individual state enterprises in the context of a sectoral strategy. As mentioned, there are encouraging signs in so far as the DTI has proposed a supply-side policy which goes beyond privatization alone and getting the prices right, and seeks to provide support for clusters of enterprises through a variety of mechanisms. But it is not clear that such welcome supply-side measures have gone far enough in a number of respects, nor that they are always taking precedence over more conventional market-led policies such as excessive trade liberalization. For example, it is questionable whether sector strategy has been worked out, let alone implemented in sufficient detail—what are the plans and prospects for levels of investment, output, exports, employment, training, technological upgrading, coordination with other sectors, etc. Nor does government appear to have the capacity to undertake full social cost-benefit analysis of the impact of its plans for the restructuring of state assets with adequate weight given to RDP goals. Further, responsibility for state assets is fragmented across a number of ministries and departments so that the prospects for individual and collective strategic planning and implementation is limited. In most of the proposals for privatization, it is notable that two crucial issues have been neglected. On the one hand, there is the issue of promoting economies of scope, i. e. vertical integrations, as well as of economies of scale. How are the public utilities to be integrated with other sectors? On the other hand, there has been a total neglect of the extent to which privatized utilities will engage in financial speculation and internationalized acquisitions and mergers, rather than develop productive investments for the direct or indirect provision of basic needs within the domestic economy. This is especially true of Eskom, for example, given its already large-scale involvement in international financial markets.[41]

Fourth, then, whether in institutional or personnel terms, there must be doubts about the capacity of government to undertake privatization and subsequent regulation in a way that maintains consistency with RDP goals and corresponding strategic and sectoral goals. This is, in part, simply a matter of existing administrative capacity.[42] But it has to be set against the power and resources of the corporate capital with which administration will be dealing and which will be pressing for commercial criteria alone within existing regulatory and administrative frameworks and for the transformation of those frameworks in the direction of commercial rather than social goals. Further, careful consideration must be given to whether the devotion of scarce resources to privatization and regulation might not be better deployed in more extensive and efficient commitment to public enterprise and delivery, especially as this is generally deficient even where the public sector is not being considered for privatization. The latter also has the effect of undermining the morale, ethos and motivation of the continuing public sector. This is of general importance but also of relevance to the pace and content of the privatization process itself. International Financial Institutions and business interests exert a constant pressure for privatization and can judge government economy policy accordingly. In order to meet demands for delivery of a privatization programme, this may lead to privatization being embarked upon before all options have been taken into account and properly considered and before measures to ensure orderly and efficient restructuring have been put in place.

In short, privatization is not itself a simple policy to implement, like buying or selling food in a supermarket. It requires that assets

[41]By way examples, government proposals from the Ministry of Public Enterprises for the restructuring of state assets, Goldman and Sachs in its detailed promotional literature as a privatization advisor, and Eskom's own submission on restructuring, all essentially overlook the issue of inter-sectoral and financial restructuring.

[42]For some discussion of these points in the context of South African transport, see Roberts (1996). See also Makgetla (1995) for reservations about the institutional environment within which privatization is being contemplated.

are fully identified and valued, that finance is raised, that the conditions under which the company will operate under private ownership should be determined, etc. These requirements mean that scarce resources and skills in management and government, etc. will be commandeered to implement the privatization programme when they could more usefully be used to implement the RDP directly. Interestingly, on of the first arguments, used against renationalisation is the demands it would place upon the legislative programme of the government concerned. Exactly, the same applies to privatization.

Finally, what is the likely impact of privatization upon the redistribution of wealth? Evidence from around the world is that it leads to a further concentration of corporate control and even of ownership. This is despite the sweetener deals that might be used to solicit trade union and management support for the privatization process itself. Besides, these schemes have certain drawback. Management tends to be disproportionately advantaged. Individual worker shareholdings and even those owned collectively by trade unions tend to come under the control of financial corporations. Such redistribution of shares is, in any case, highly skewed in so far as only those already in employment can benefit directly. This constitutes a minority and unrepresentative section of the population and workforce – those who have already benefited to a greater or lesser extent from state employment, thereby disproportionately excluding women, those in rural areas, the long-term unemployed, those employed non-commercially in the state sector, etc. Last, but by no means least, comparative evidence suggests that increases in productive efficiency do not depend as such upon employee or other participation in share-ownership but upon the greater participation of the workforce in day-to-day and strategic decisionmaking.[43] This participation may more easily and directly be achieved, and prosper, within public enterprise but, in any case, can and should be pursued independently of the form taken by the restructuring of state assets.

(Received August, 1997; Revised December, 1997)

[43]See Cable and Wilson (1989 and 1990) for example.

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