1 Introduction

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This handbook presents a comprehensive study of privatization and should be of interest to scholars and practitioners of the subject in the public and private sectors. In developing this book, we have attracted leading writers on privatization from across the globe. The result is a thorough summary of the rationale, methods, processes and outcomes of privatization at both the theoretical and empirical levels and for the full range of economies. The book consists of chapters on general privatization issues complemented by detailed country case studies. While it is impracticable to summarize the progress of privatization as policy in each and every nation, the country studies do provide valuable pointers to the reasons for privatization successes and failures. These studies cover the developed economies of the European Union, North America and Australia, the transition economies of Poland, Hungary, the Czech Republic, Ukraine and Russia, and the developing countries of Chile, Mexico and Brazil in Latin America and the sub-Saharan region of Africa and South Africa. China, the outstanding development success of the last 20 years, is also included.

Privatization has caught the imagination of both scholars and policy makers. The study of privatization and related subjects, such as market liberalization and the economics of regulation, are now an integral part of most undergraduate and postgraduate studies in economics and related disciplines. At the policy level governments around the world have introduced privatization programmes since the 1980s, although the results in some countries have been much more successful than in others, as a number of the chapters in this book emphasize. In the 1990s, total global privatization receipts are estimated by the OECD to have exceeded US$936.6 billion (OECD, 2001), making the planning and implementation of privatization a very profitable activity for international banks and consultancy firms. Privatizations have taken a number of forms, from outright sales of state assets, through initial public offering (IPOs) of shares, to sales to domestic and foreign companies and to various forms of operating concessions such as build–operate–transfer schemes (BOTs) and the like. The extent of continuing state involvement in the management of assets varies, with some governments more or less abdicating complete responsibility to the private sector and others retaining considerable residual control rights to protect the public interest.

The largest privatizations have occurred in the utilities sectors, namely in telecommunications, power, water and transport. In these sectors privatization (whether through asset disposals or concessions) has involved the transfer to the private sector of enterprises with considerable market power. Private monopoly is not attractive for all the usual reasons associated with the abuse of market power, namely high prices, lax cost control, a lack of innovation and poor customer service. For this reason, utility privatizations create the need for both the active encouragement of new competition, perhaps involving the development and maintenance of an effective competition policy regime, and continuing state regulation of the monopolist until such time as effective competition is fully developed. Where 'natural monopoly' exists, normally in the operation of distribution networks and the like with high fixed costs, competition would be uneconomic and therefore regulation will need to be permanent. This regulation can be centred in government departments but increasingly the establishment of dedicated regulatory offices or commissions at arm's length from direct political control has been favoured, to prevent continuing political intervention in the management of enterprises by the back door. Chapters 22 to 26 look specifically at the theoretical and practical issues surrounding the regulation of privatized enterprises.

Economists argue that competition in the product market is an important driver of cost reduction and product innovation. Therefore, in the absence of effective competition, or in the case of natural monopoly effective economic regulation as a surrogate for competition, ownership change may have limited benefits for economic performance (Vickers and Yarrow, 1988; de Fraja, 1993). This will be particularly true where the capital market or the market for ownership rights is underdeveloped and does not provide an effective constraint on managerial discretionary behaviour. The *principal–agent* model in economics has drawn attention to the importance for achieving economic efficiency of principals monitoring and controlling agent behaviour effectively (Jensen and Meckling, 1976; Vickers and Yarrow, 1988; Hart, 1995; Martin and Parker, 1997, ch.1). In corporate activities in both the private and state sectors it is to be expected that, in the absence of effective incentives and controls, management will pursue its own interests rather than that of its agents (owners), including the pursuit of high managerial salaries, an expense preference and a quiet life. This will be true of the private sector, where owners can be expected instead to want maximum profits or return on their investments, but equally of the state sector, where the principals (the public) desire some wider and perhaps more nebulous goal of the 'public interest' or 'social welfare'. In the latter case, the issue is complicated by the intervention of a further tier or tiers of agency between the public (voters) and agents (state enterprise managers) in the form of politicians and layers of the state bureaucracy. *Public choice theory* provides a powerful critique of the incentives and information asymmetries within the state sector (Niskanen, 1971 Mitchell, 1988; Boycko *et al.*, 1996). It points to both self-interest as a driver of decision making within government and inadequate information to pursue public interest goals efficiently, even where the pursuit of self-interest does not dominate.

Principal–agent theory, especially when coupled with the arguments from public choice theory, provides a very powerful theoretical rationale for privatization to increase economic efficiency (Parker, 2000), but arguably only where private capital markets operate efficiently to constrain agent behaviour. A discussion and critique of principal–agent theory is provided in the early chapters of this volume. For example, whereas Megginson and Netter (chapter 2) provide a generally favourable review, Willner (chapter 4) is far more critical. The country studies later in the book provide supporting evidence that effective capital markets cannot be taken for granted. This is particularly so in the transition economies where enterprises suffer from 'insider' control. The chapter by Filatotchev (chapter 16) is particularly educational in this respect. In the developing economies of Latin America, Africa and Asia, capital markets are usually thin and cannot be relied upon to police agent behaviour effectively.

While some of the contributions to this book provide differing accounts of the theoretical merits of privatization, a number of the other contributions provide more empirically oriented studies, looking at the actual impacts of privatization on both enterprises and the whole economy. Again the results are mixed: hence at both the theoretical and empirical levels the net benefits of privatization are not clear cut. Nevertheless, privatization as 'policy transfer' (Dolowitz and Marsh, 1996; Parker, 1999) continues internationally, supported by a range of international donor agencies and notably the IMF and World Bank (although in the case of the latter especially recently there have been signs of a greater recognition of the need for appropriate supporting 'institutions' than was the case earlier; see, for example, World Bank, 2001). As many of the studies in this volume indicate, successful private ownership requires supporting institutions including protected property rights, effective contract laws, supportive and efficient banks and financial markets, effective and stable government, effective pro-competition legislation, as well as developed capital markets. In a number of the economies of Central and Eastern Europe and the developing world these institutions cannot be taken for granted. Hence privatization can lead to forms of private enterprise very different to those found in the developed economies of Western Europe and North America. In particular, cronyism and corruption are rampant in some countries and mutually advantageous contracting for resources is therefore replaced by favouritism and fear (Saha and Parker, 2002).

Table 1.1 provides a country breakdown of the global amounts raised from privatization in the OECD in the 1990s alongside estimates of global privatization receipts. It is clear that the 30 largest economies which make up the OECD membership have accounted for the vast bulk of the privatizations since 1990, with 70 per cent of global receipts in value terms. Of these countries, Australia, France, Germany, Italy, Japan, Mexico, Portugal, Spain and the UK have been responsible for 50 per cent of the global total. However, value figures can be misleading as an indicator of privatization activity because they reflect only sales receipts and not necessarily the volume of production transferred. Also they can be biased by a small number of very large sales; for example, Germany's figures are heavily weighted by the sale of shares in Deutsche Telekom in 1996. In addition, the extent of privatization should be considered in relation to the size of an economy: a given figure for the total value of privatization receipts will be more economically significant the smaller the economy. In the transition countries, in particular, privatizations have accounted for a much larger share of GDP than elsewhere, involving large-scale sell-offs of tens of thousands of small and medium-sized enterprises as well as large state firms. Moreover, value figures tell us nothing about the *true* scale of privatization in the sense of removing government control or influence over industries' strategies. In some countries governments have retained influence over enterprises that nominally, at least, have been 'privatized'. This has occurred through formal 'golden shares' or the retention of a strategic minority (and sometimes majority) shareholding, government board-level appointees, sales of assets to political cronies and leading families in the country, and through 'moral suasion' and the threat of renationalization. Even in the EU, with its protected private property rights, the enthusiasm for private sector autonomy and the reliance on private enterprise has varied. As the London *Economist* concluded in a special report on privatization in Europe:

> Arguably only Britain has accepted the true retreat of the state from its biggest industries. Even there, this was done initially with caution. Golden shares were widely used, for example, to block the threat of rapid takeovers in the utilities sectors. In continental Europe, privatization has too often been a phrase that has disguised economic reality. Governments have raised money, either for their own coffers or to boost the balance sheets of state-owned companies. But they have rarely forfeited control and have remained inclined to meddle. (*Economist*, 2002: 73.)

The *Economist* report documents a number of cases where 'privatized' businesses have been subject to continued government interference. For example, it cites a study from Italy's federation of industrialists, Confindustria, which found that only around a third of the assets involved in state sell-offs were fully freed from government control, and Franco Reviglio, then chairman of

Table 1.1 Total privatization receipts for the OECD countries in the 1990s

	Total amount raised US$mn	Percentage of global total
OECD Countries		
Australia	69627	7.43
Austria	10436	1.11
Belgium	9611	1.03
Canada	10583	1.13
Czech Rep.	5438	0.58
Denmark	6048	0.65
Finland	11000	1.17
France	75488	8.06
Germany	22451	2.40
Greece	12329	1.32
Hungary	11530	1.23
Iceland	400	0.04
Ireland	7613	0.81
Italy	108586	11.59
Japan	37670	4.02
South Korea	14275	1.52
Luxemburg	0	0.00
Mexico	28628	3.06
Netherlands	13641	1.46
New Zealand	9413	1.00
Norway	2900	0.31
Poland	17805	1.90
Portugal	25292	2.70
Slovak Republic	1979	0.21
Spain	37645	4.02
Sweden	17295	1.85
Switzerland	10869	1.16
Turkey	7231	0.77
UK	63129	6.74
USA	6750	0.72
Total OECD	655662	70.00
Of which, EU 15	420564	44.90
Non-OECD countries	280962	30.00
Global total	936624	100.00

Source: OECD (2001: 44, Table 1).

ENI and a former finance minister, in the mid-1980s describing privatization as 'a good way to raise cash without losing control' (ibid.). Thus, while economists might concentrate upon the efficiency arguments for privatization, privatization as policy is rooted in *realpolitik* resulting in objectives from financing more public spending without unpopular tax increases, to satisfying special interest groups and paying off campaign supporters. In particular, during the 1980s and 1990s, governments around the world, and not least the Thatcher governments in the UK, found privatization a tempting means of raising cash to fund tax cuts. Nevertheless, maximizing the receipts from asset sales may not always be compatible with privatizing state industries to maximize economic efficiency because firms with market power, and therefore with the ability to earn economic rents, attract a premium price for their shares. Firms facing an effective regulatory regime or a competitive market after privatization may be much less attractive to investors.

Privatization, both in theory and in practice, is therefore complicated by a set of conditions relating to: (a) the motivation for sale – *why* is privatization favoured? (b) which industries to sell and in what order – *what* is to be privatized and *when*? (c) to whom should assets be sold – *how* should privatization be conducted? Alongside these 'why', 'what', 'when' and 'how' questions lie a series of complementary ones relating to the following:

- The institutional environment: do the institutions exist to support a thriving and efficient private sector? If not, can they be quickly created?
- The degree of competition: will the privatized firms face real competition and in what forms (for example, do tariff barriers need to be reduced or restrictive licensing conditions removed)?
- The role and nature of current state intervention in the economy: to what extent will state involvement continue and what forms will it take? This will be particularly an issue for the utilities sectors where monopoly activities need continued state regulation. But the argument could extend to defence and other 'strategic' sectors such as agriculture, as well as liberalized utility markets where regulation to preserve competition may remain a permanent necessity.

Peter Evans has written that 'exogenous inspirations . . . build on indigenous institutional foundations' (Evans, 1995: 243). Privatization programmes reflect a transfer of policy around the world reflecting mimetic influences tempered by normative interpretations based on local conditions. It should not be anticipated, therefore, that privatization transfers policy simply and neatly from country to country, leading to the same predicable improvements in economic efficiency.

Although this is not a comforting conclusion for policy makers looking for clear guidance, the chapters in this book do provide assistance in addressing the above issues. An understanding of privatization theory and practice is critical to establishing a sound appreciation of both the potential and the limitations of privatization and the need to achieve a complementary institutional context. In sum, a thorough understanding of both theory and practice is necessary if privatizations are to be appropriately designed and implemented and are not to disappoint.

A summary of the contents

It is not possible to do justice to the detailed contents of each of the chapters in this book. Each provides a rich source on the theory and/or the practice of privatization. Nevertheless, to assist the reader we provide here a brief summary of each chapter.

The first contribution, in chapter 2, is by William L. Megginson and Jeffry M. Netter, who look at both the history of privatization and its rationale and the different methods of privatization that have been adopted. They demonstrate that the trend to privatization worldwide is a reflection of the failures of the nationalization introduced after the Great Depression and the Second World War. State ownership led to inefficiencies that a range of both developed and developing economies felt the need to tackle by the 1980s. In the view of Megginson and Netter, privatization as government policy developed because of a new and more favourable attitude to markets at around this time, but also because government ownership 'did not work'. The Thatcher governments in the UK are seen as a model. On methods of privatization, Megginson and Netter summarize a number of studies that identify the circumstances under which either direct assets sales or share issues are most likely to occur. This chapter provides a solid foundation for the more specialized studies of privatization at both the theoretical and empirical levels found later in the book.

Chapter 3, by Colin Robinson, argues that privatization is not a matter of the political 'right' versus the political 'left', as often portrayed. Instead he points out that governments of all political persuasions have introduced privatization programmes and discusses why. His study complements that of Megginson and Netter by arguing that the benefits of private over state ownership lie in an acute failure at the heart of state ownership, which can be summed up in terms of the statement, 'what is owned by everyone is perceived to be owned by no one'. He also looks at the relationship between privatization and market liberalization, concluding that 'a move from state to private ownership is usually a necessary condition for significant market liberalization'. At the same time, he recognizes that not all privatizations have gone smoothly. He attributes some of the failures of privatization to the political process and conflicting policy objectives. Using the UK as the exemplar, he describes a number of problems that were left to be sorted out by the competition authorities and industry regulators. He concludes that achieving the full potential benefits from privatization requires market liberalization.

Johan Willner in chapter 4 is far more sceptical about the benefits of privatization than the authors of the two previous chapters. He criticizes the international trend to privatization for undervaluing the benefits of state ownership and argues that, both on theoretical and empirical grounds, the policy is open to challenge. He also holds some dissenting views on the benefits of market liberalization. Concentrating upon the claimed gains from privatization in terms of cost efficiency, he concludes that neither excessive costs nor biased objectives in state firms are sufficient grounds for advocating privatization. This is because state ownership may achieve superior allocative efficiency, especially when the pay-offs to different stakeholders are taken into account. Using a simple model with linear demand, he outlines the circumstances under which privatization would lead to a deterioration in allocative efficiency that could more than outweigh any cost efficiency gains. He also explains that the social welfare consequences of privatization are sensitive to the weights placed on the rents to consumers, employees and owners. Willner also cites both theoretical and empirical studies that question the possible benefits from privatization.

The various methods of privatization used internationally are discussed by Cosmo Graham in chapter 5. The chapter's aim is to provide an overview of the different methods of privatization, with some observations on the success or failure of the techniques. Countries have used varying methods reflecting in part the differing aims and speeds of privatization. These techniques, including sales to the public, voucher distribution and private sales and buy-outs, are reviewed. Graham demonstrates that there is no one ideal method of privatization and that each method has trade-offs. These trade-offs significantly affect the likely outcome, or success or failure, of a privatization programme. This chapter, read alongside the chapters by Megginson and Netter, Robinson and Willner, provides an excellent analytical foundation for the country studies that follow.

The first 'country' study is a regional survey. David Parker, in chapter 6, studies the privatization experiences of the countries that make up the EU. After a brief history of public and private ownership in each of the countries, he goes on to explain how, while there is some similarity across the various privatization programmes, the similarity is potentially misleading. EU countries have their own motives for privatization and have conducted it with differing degrees of enthusiasm. In particular, it is not the case that the motive of promoting greater economic efficiency has dominated.

Indeed, budgetary pressures, especially ahead of the introduction of the Euro, have been important in a number of instances, while the various EU market liberalization initiatives have also made it less desirable to retain industries in state hands. Parker also considers some of the potential consequences of privatization in Europe in terms not only of economic efficiency but of social welfare. He stresses that the UK's 'outsider' model of corporate governance contrasts with the 'insider' model still prevalent in much of the rest of the EU and that, in terms of social welfare, privatization is leading to possible changes in the distribution of economic power that have yet to be properly explored.

Chapter 7 deals with privatization in North America. Anthony E. Boardman, Claude Laurin and Aidan R. Vining concentrate particularly on Canada, where most of the interesting privatization activity has taken place. The United States has a much less extensive state-owned sector and this has necessarily limited the scope for privatization activity. Nevertheless, the chapter does review some of the limited privatization activity that has taken place. In Canada, important privatizations have occurred at both the federal and provincial levels. Turning to the effects, Boardman, Laurin and Vining provide evidence that the privatizations have led to performance improvements, using a range of financial and economic measures and stock market data. For example, they show that profitability, efficiency and dividends increased in the three years after privatization. They also comment that there is still considerable room for further privatizations. However, the more straightforward privatizations have already taken place and they conclude that the remaining state assets in Canada will prove more difficult and controversial to sell because of plausible market failure concerns.

In chapter 8, Graeme A. Hodge provides a review of privatization activity in Australia, where the state of Victoria has been especially active. He explains the rationale for privatization in a country with a long history of state-owned industry. He details the privatizations of electricity and telecommunications and comments that the resulting economic effects of privatization still await full consideration. Nevertheless, on the basis of the available evidence, he concludes that 'the divestitures have been generally well implemented, resulting in reasonable value for money for taxpayers and modest public welfare gains in some cases. . . . although Australia's divestitures have not been perfect, the performance has probably been better than for many earlier privatizations around the globe'. This chapter provides useful case study material relevant to an understanding of the basis for successful privatization, including the need for appropriate reforms in competition and regulatory policies.

Chapter 9 by Michael A. Crew and Paul R. Kleindorfer, returns to privatization in North America, concentrating upon the scope for privatization of the United States postal service (USPS). This study provides a useful complement to the previous chapters by focusing on the arguments surrounding privatization of an activity almost universally provided by the state sector. Comparisons are made with the management of postal services elsewhere and notably in Germany and the Netherlands where, unusually, privatization has occurred or is occurring. While they argue that privatization of USPS appears at first glance to be attractive, given the organization's obvious inefficiencies, they emphasize the practical difficulties of bringing about a successful privatization. They provide a possible scenario for the future of a privatized postal service but recognize significant problems in establishing an effective regulatory regime. The USPS, like incumbent postal services in other countries, faces serious challenges in terms of the impact of technological change, financing, institutional constraints and, especially, the power of organized labour. Adding to these problems is the recent enhanced awareness of the vulnerability of the mail service to terrorism following well-publicized anthrax incidents in the USA. Hence, although they believe that privatization of the postal service could lead to significant static and dynamic efficiency gains, they are pessimistic that it will come about, especially in the short term. This chapter provides a useful illustration of the public policy tensions that lie at the heart of privatization policy.

Paul Cook and Colin Kirkpatrick turn our attention from privatization in the industrialized economies to privatization in the developing world. In chapter 10, they first assess the impact of privatization in terms of its objectives in the context of development needs and constraints. They then review the various empirical studies of the impact of privatization in developing countries on economic performance, at both the macroeconomic and microeconomic levels. They conclude that the results 'reveal a complex and sometimes contradictory picture . . . The experience with policy and performance has been diverse, making it difficult to identify common patterns of experience or to draw general lessons for policy'. Like a number of the other authors in this book, they warn that simply changing the ownership from public to private is unlikely to be sufficient to bring about economic gains. Privatization is effective in terms of promoting economic development only where appropriate 'corporate governance, institutional capacity, market competition, and political economy' conditions exist. These are commonly absent or at least immature in the developing world and need to be created and nurtured if a privatization programme is to be successful.

This set of conclusions is borne out in the subsequent chapters by Werner Baer, Joseph C.H. Chai, Erwin Schwella and Paul Bennell on the privatization experiences of Brazil, China, South Africa and sub-Saharan Africa, respectively. Werner Baer's study of Brazil in chapter 11 draws attention to the importance of state enterprise in the country's economic development and the fact that for a long time the active role of government was considered both necessary and beneficial. Benefits extended to 'crowding in' private investment by providing crucial physical inputs and cheap official financing. However, by the 1970s and 1980s, weaknesses in the management of state enterprises were becoming increasingly evident, exacerbated by governments using state firms as instruments of macroeconomic policy. Brazil's privatization programme began in the late 1970s in the face of declining economic growth but developed only slowly during the 1980s owing to political and other constraints. From 1990, the privatization programme of the Collor administration led to a larger scale of privatization, which was continued from September 1992 by the two subsequent presidents, Itamar Franco and Fernanco Henrique Cardoso. Amongst other things, this led to the spread of privatization into the utilities sectors. In the decade from 1991 to 2001, 121 state-owned enterprises were sold, raising US$103bn. Baer stresses, however, that the privatization programme of the 1990s was largely driven by the need of government for revenue and that this led to the sale of state assets to the highest bidder, normally large domestic private firms and foreign enterprises. The result was a worsening of a traditional problem in Brazil, that of income and wealth inequality.

Joseph Chai's account of privatization in China describes a number of the most important changes that have occurred in the Chinese economy since the late 1970s and are associated with an opening up to international trade and investment. In chapter 12 he catalogues how state enterprises have been subject to a series of reforms aimed at incentivizing management to pursue efficiency improvements, and highlights the results of these reforms. While paying tribute to the contribution of state-owned enterprises to the maintenance of political, social and economic stability in China, through employment preservation and the continuing provision of social welfare services, he concludes that China's continued fast economic growth requires their privatization. He dismisses the argument that in China privatization is unnecessary, pointing to the scale of productivity improvements possible in the state-owned sector. However, he stresses that privatization of the state-owned sector will need the provision of an efficient capital market, legal protection of private property rights and effective forms of corporate governance to prevent principal–agent abuses. Chai's account confirms that, while China has gone far down the road of economic development in recent years, the state-owned enterprises remain a real economic burden owing to their inefficiencies.

Chapter 13 is concerned with privatization in Mexico and Chile. Here Miguel D. Ramirez provides a critical account of policy in the two countries. In particular, he points to the resulting concentration of economic power in a small number of firms and business groupings (*grupos*). As he comments: 'There is a general presumption that the transfer of state-owned enterprises to the private sector takes place in a competitive environment that is devoid of major market failures. However . . . product market competition under optimal conditions rarely exists, if at all, in most Latin American countries, including Chile and Mexico.' He also stresses that in Latin America a major reason for state asset sales has been financial. Cash-strapped governments have seen privatization as a convenient way of balancing the state's books, irrespective of the longer-term economic consequences. Using case studies of the banking, telecommunications and power sectors, Ramirez's chapter confirms that, in the absence of adequate antitrust laws and regulatory structures, the results of privatization can be contrary to expectation.

By contrast, chapter 14 is concerned with South Africa, where privatization policy is less well developed. Here Erwin Schwella discusses the continuing tensions within the post-apartheid government about the future of state ownership. Historically the ANC and its alliance partners favoured state enterprise to help transfer income and wealth to the newly franchised black community. Also, under the apartheid regime, state enterprises had been created across the South African economy as part of the effort to stave off the effects of international sanctions. This resulted in extremely inefficient firms, such as the arms maker, ARMSCOR, and SASOL, which produces oil from coal. Tracing policy developments in the 1990s, Schwella identifies a gradual shift in favour of liberalized markets and private ownership, but at the same time he identifies institutional constraints revolving around the black empowerment agenda and the role of the powerful Congress of South African Trade Unions (COSATU). He emphasizes that, although the country is not immune to the international tide in favour of privatization, historical baggage and the current political balance continue to limit the degree of progress that can be expected. Even the term 'privatization', he notes, is still avoided within government circles, in favour of the less politically contentious description of 'restructuring' state enterprises.

Chapter 15, by Paul Bennell, turns to privatization in sub-Saharan Africa generally. In spite of political and economic failures, privatization has occurred, although sometimes hesitatingly. Bennell emphasizes the role of changing attitudes to state ownership in the major donor agencies during the 1980s, notably the IMF and the World Bank, as a catalyst of privatization in this part of the world. The most far-reaching privatization programmes have been in Côte d'Ivoire, Mozambique and Zambia, with the latter two countries very heavily aid-dependent. While he concludes that 'most governments are genuinely committed to completing their privatization programmes as quickly as possible', the lack of developed domestic capital markets, a lack of transparency in government and outright corruption continue to dog the privatization process in sub-Saharan Africa.

Chapters 16 to 21 turn our attention from the problems in developing countries to those in the transition economies of Central and Eastern Europe. These economies are generally more developed than those found in much of Latin America, Africa and Asia, but are heavily distorted because of the years of misallocation of resources during the communist era. Following the turbulent events of 1989, these countries have chosen to destroy socialist planning and to introduce capitalist principles. This is particularly true of the countries studied here, although the progress, form and success of privatization have varied, for the reasons discussed.

Igor Filatotchev initiates the discussion with a study of the theory and concepts relating to privatization and corporate governance in the transition economies. The starting point for these countries, and the stresses they have faced in reorienting their economies to survive in the international market place, has inevitably meant numerous failures as well as successes. The transition economies have had to learn not only about how to operate competitive private sector businesses but also about what instititutional structures are necessary if these business are to thrive, and have subsequently needed to implement them. Some have gone about this more successfully than others. Using a mixture of privatization methods including voucher schemes, the economies have transferred very large numbers of both small-scale and large-scale enterprises from the state to the private sector and over a remarkably short period of time: the scale of privatization in Central and Eastern Europe as a share of national production far outweighs that in the rest of Europe and North America combined. The result, however, as Filatotchev stresses, has too often been 'insider' privatization and managerial entrenchment, with 'the extent of managerial equity ownership . . . identified as a crucial aspect of managerial willingness and capacity to implement change'. Weighing the relative merits of 'insider' and 'outsider' control in the context of economic transition, he argues that effective restructuring requires outsider ownership, but also that 'Diffused share ownership among individual, inexperienced shareholders is unlikely to provide an effective constraint on self-serving behaviour by former "Red Directors"'. Externally imposed change may be the only way to bring about the changes needed and this is probably best facilitated by large block shareholdings held by dominant, strategic investors. However, such a shareholding pattern can bring with it other problems, not least the protection of the interests of the minority shareholders. Using a simple theoretical model, Filatotchev is able to show that the impact of privatization on a firm's performance 'depends on an interaction between the entrenchment and incentive effects of concentrated ownership'. In other words, on the basis of the specific experiences of the transition economies, he confirms that good corporate governance, supported by institutions such as sound regulation and an efficient capital market, are crucial to the success of any privatization.

This conclusion also applies to Russia. In chapter 17, Paul Hare and Alexander Muravyev study the difficulties Russia has faced in introducing efficient and effective forms of private ownership. Barriers to reform have included traditional networks for commerce that were inherited from the Soviet period and are based on barter and similar forms of trading, the banking system and the financial markets more generally, and the labour market. The task facing reformers has been enormous. In the late 1980s, state enterprises with more than 200 employees accounted for 95 per cent of industrial employment and production in Russia. Large firms with more than 1000 employees accounted for 75 per cent of employment and output. Compared to a market economy, the Russian economy was dominated by relatively few large firms. Private enterprise was effectively discouraged and enterprise management followed plans determined by government. The 1990s saw a mass privatization programme, including a voucher scheme, alongside programmes of small-scale privatizations. This resulted in substantial ownership in the hands of managers and employees or 'insiders'. Following the loans-for-shares scheme in 1995, under which banks lent funds to government in return for blocks of shares in state enterprises as collateral, the privatization programme became even more deeply mired in controversy. Hare and Muravyev argue that 'the outcome of the process has been disappointing, characterized by weak and often poorly directed restructuring efforts, and the survival of many enterprises that should have disappeared long ago'. Using the examples of the power sector, the railways and telecommunications, they underline the degree of reform that still needs to be implemented if the reputation of the Russian privatization programme is to be rescued.

Chapter 18, by Michal Mejstrík, again picks up the theme of the importance of institutional structures and corporate governance in the transition economies. Mejstrík argues that the success of Czech privatization, which in the early reform period had relied on both enterprise sales and voucher or coupon privatizations, was at first severely hampered by an inadequate legal framework that could not support the functioning of a market economy. As a result, incomplete contracts led to the unenforceability of contract obligations, and an unassailable position of debtors vis-à-vis creditors and of majority shareholders vis-à-vis minority shareholders. This had detrimental effects, with the most significant being that those in control of the large investment funds in which many citizens had invested their coupons were allowed to employ the incomplete contracts for their own individual benefit at the expense of their minority shareholders. This seriously biased corporate governance structure resulted in the departure of many portfolio investors and the poor performance of the Czech capital market. It also substantially limited the possibility of restructuring state-owned enterprises through coupon privatization, and meant that the most stable ownership structures were dominated by foreign, strategic shareholders. Subsequently, bank privatization, the creation of an independent regulatory Securities Exchange Commission, and the current plethora of necessary reforms and legislation to facilitate accession to the EU, have all contributed significantly to improvements in the Czech Republic's corporate governance structure. However, Mejstrík also believes that substantial improvements in the Czech institutional structure will still need to be made before the transition to a market economy will be complete.

The privatization process seems to have been much more successful in Poland. In chapter 19, Tomasz Mickiewicz and Maciej Baltowski review this country's privatization programme since 1989. Again various forms of sell-off were adopted, including a voucher scheme, but with employee buy-outs common. Although the process was pursued more slowly than privatization in Russia, the results appear more immediately encouraging. The results of research, reported in the chapter, suggest that privatization has had a positive impact on economic performance and that the ownership structure in privatized companies has undergone changes with both the emergence of dominant ownership groups inside companies and major outsider investments. These changes have come about following privatization as a result of market competition and the resulting financial pressures on undercapitalized businesses.

In chapter, 20 Iván Major provides an appraisal of Hungary's privatization experience since the political changes of 1989–90. While finding much to celebrate in terms of Hungary's economic transformation, his study cautions against any simple interpretation of the link between private ownership and economic performance. While he concludes that privatization and the associated company restructuring led to a considerable improvement in productive efficiency and profitability, 'the improvement was not without setbacks … [and] … profitability and economic efficiency did not always improve with the expansion of private ownership'. Using his own detailed analysis of data on ownership and performance in Hungary since 1988, he is able to identify the significant role of foreign ownership in raising performance after privatization, especially through a 'core group of foreign companies'. At the same time, the method by which performance is assessed – using profitability indices and value added to total cost ratios – raises a challenge to Central and Eastern European economists to develop more robust measures of enterprise performance in the transition economies.

The privatization process in Ukraine is the subject of chapter 21. Here Saul Estrin and Adam Rosevear explain how the opportunities that opened up when independence from the former Soviet Union was achieved in 1991 were squandered. Although the private sector had grown from 10 per cent of GDP in 1991 to 60 per cent by 2000, privatization had faced significant political and social obstacles. The result has been enterprises transferred into private hands in forms unlikely to lead to productivity improvements. Corruption and 'capture' by powerful groups have occurred and the supporting institutions necessary for a sound private enterprise economy are still underdeveloped. State ownership has commonly been replaced by 'insider' ownership by managers and employees because of entrenched interests who would otherwise have opposed the ownership change. Even where 'outsider' ownership exists it tends to be widely dispersed and not conducive to effective corporate governance. The shift from insider to outsider ownership which has occurred, for example, in Poland, and the important role of foreign investment in Hungary discussed in the previous chapter, appear to have been largely absent in most Ukrainian firms. In their survey work, Estrin and Rosevear find that there has been disappointingly little restructuring of Ukraine firms following privatization. They also find no obvious relationship between ownership and performance: privatized firms were not found to be significantly more profitable or productive than state-owned ones. A key factor in the economic growth of neighbouring Poland has been the development of new privately owned firms. Again, there has been the absence of a similar development in Ukraine, suggesting that the institutional context still remains insufficiently supportive of private enterprise.

The last five chapters of the book turn in detail to the subject of economic regulation. As part of an effective institutional structure for private enterprise to flourish and to protect the public interest from market failure, governments need to develop and maintain efficient and effective regulatory systems. This is particularly so where public utilities are transferred to the private sector retaining considerable market power, as has been the case in a number of the countries covered in the earlier chapters. When these enterprises are sold, and even if broken up or 'unbundled' at sale, they have tended to retain important monopoly power, leading to the real threat of market failure. To counter this effect and protect consumers from resulting high prices and poor services, normally state regulatory regimes have either had to be created from scratch or improved.

In chapter 22, Dieter Bös models the regulatory process, taking as the starting point a two-person game with information asymmetries. The regulator is a welfare maximizer (or a politician wanting to maximize votes or a bureaucrat wanting to maximize power) and the enterprise manager is an agent interested in his/her personal income and the disutility of effort. A regulatory constraint exists in the form of regulation failing if the enterprise is forced into bankruptcy or, alternatively, the manager quits. Bös then explores simple regulatory rules, developed first using an iterative process of regulatory adjustment of prices based on costs and then using 'yardstick competition'. He finds both approaches wanting; in particular, regulating prices according to costs provides disincentives for the manager to minimize supply costs, while yardstick competition is open to collusion and difficulty of operation where firms' cost and demand functions differ. Dieter Bös then explores the economic implications of information asymmetry with regulation under different forms of contracting or incentives. The implications for price cap regulation and quality regulation are then discussed. This theoretical chapter highlights the behaviour of the manager of a privatized enterprise if the regulator lacks information and the role of an appropriate incentive mechanism. It also highlights how difficult it is to design an effective regulatory mechanism.

The theme of regulatory information asymmetries and incentive mechanisms is also pursued in Thomas Weyman-Jones's chapter, chapter 23. Thomas Weyman-Jones provides a detailed study of the price cap regime for setting prices, now widely adopted internationally. After summarizing the principles of price cap setting (using an RPI-X formulation), he identifies two major issues of principle and one of practice. The first issue of principle concerns the difficulty of achieving incentive-compatible and individually rational forecasts for demand and costs. The second concerns the explicit financial modelling used and whether this 'adequately represents the decision making behaviour of a firm maximizing the present value of future cash flows and operating through agency relationships with the firm's managers'. The practical issue relates to the incentives for cost savings in terms of the timing of regulatory price reviews. As the length of the control period declines so the incentive power of the RPI-X mechanism also falls because of the resulting decline in the net present value of the cost savings passed through to profits. Weyman-Jones then develops his critique by considering how to establish the benchmarking of operating and capital expenditures and thereby derive the extent of reasonable efficiency gains that can be built into the X factor. He explores some of the various methods used by regulators to benchmark costs and the difficulties faced. Other subjects covered are the valuation of depreciation allowances and the regulatory asset base and deriving the cost of capital. Whereas Dieter Bös considers information asymmetries and incentives very much at the theoretical level, Thomas Weyman-Jones's chapter illustrates the practical difficulties of implementing optimal state regulation for privatized companies. Both chapters underline why privatizing enterprises is particularly problematic where competition cannot be assured.

Anthony Ogus continues on the same theme in a comparison of regulatory systems. Whereas Bös and Weyman-Jones take a strictly economic approach to the subject of state regulation, in chapter 24 Anthony Ogus takes a wider perspective, beginning with an attempt to identify how regulation fits into the constitutional and cultural environment of a country. He shows that economic regulation will take on varying forms reflecting each country's constitutional and cultural environment and hence its laws and norms. This in turn leads to different regulatory styles and differing degrees of autonomy for regulatory agencies. However, 'One reason for the observed world-wide trend towards consensual, decentralised regulatory rule-making, is the growing recognition that governments cannot always be relied on to possess or properly process the information necessary to meet the regulatory goals at low cost'. The degree to which discretionary power should be devolved to quasi-independent governmental bodies continues to remain a source of disagreement. Ogus's study helps in ascertaining under what environments such devolution is most likely to be favoured. Similarly, differences between countries in regulatory accountability, procedures and management are to be expected. He concludes that, while ideas about regulation have been evolving across jurisdictional boundaries and there may have been some convergence of view (no doubt influenced by developments in the economics of regulation discussed by Bös and Weyman-Jones in their chapters), 'the character of national regulatory institutions is still best to be understood within each jurisdiction's culture'.

This conclusion is pertinent to the discussion of privatization and regulation of public utilities in developing economies, as discussed by David Parker in chapter 25. This chapter considers the problems faced in developing countries when monopoly public utilities are transferred to the private sector through direct sell-offs or operating concessions. Around one-third of all the privatizations that have taken place in the developing world have involved the public utilities and they dominate in terms of revenues raised from privatization. Parker argues that privatization in these economies cannot be separated from the need to develop appropriate institutions by improving both the regulatory and the competitive environments for enterprise and investment. Like Anthony Ogus, Parker embeds his discussion of regulation (and privatization) within the institutional and cultural environment of the countries. After setting out the usual arguments for regulation, and a price cap regime in particular, he points especially to costs that can arise in terms of reduced efficiency incentives, the costs of administration and compliance, information asymmetries, regulatory risk and regulatory capture. It is to be expected that all of these costs will be prevalent and perhaps appreciable in developing economies, given their institutional weaknesses. Parker particularly singles out the concept of 'trust' and its relationship to regulatory risk. He also stresses that in developing economies poverty reduction is a high priority, which further complicates the task of regulating privatized companies. Parker's chapter is exploratory and conceptual and is based on study and practical experience of working on privatization and economic regulation in a range of developing countries. His main conclusion is that, while much privatization and regulation research has been concerned with the developed economies, 'it is not self-evident that the lessons from these economies are readily transferable to developing nations'. The conclusions of this chapter seem also relevant to the transition economies.

Lastly, in chapter 26, David Saal reviews the liberalization and restructuring of the UK's telecommunications, gas and electricity industries, which had originally been nationalized on natural monopoly grounds. The chapter reveals that, despite high hopes that privatization would rapidly result in effectively competitive markets, with only the rump natural monopoly essential facility of these industries being subject to regulation, the necessary restructuring to promote competition has subsequently proved to be much more difficult to accomplish than was initially anticipated. Saal argues that creating and sustaining competitive markets has required much more regulation than the early UK proponents of utility privatization had believed, because of both the failure properly to separate essential network facilities from potentially competitive activities at privatization, and inherent difficulties in creating and sustaining competition that had not been anticipated. Thus, even though some of the UK's utilities have achieved substantial levels of competition, the creation of functioning markets required constant regulatory pressure over many years, including forced vertical and horizontal divestiture, just to break down the dominant market position that incumbent firms held in the potentially competitive parts of the industry. Likewise, as competition in formerly vertically integrated natural monopolies is dependent on access to the pipe or wire network, there can be no competition without regulation to define the terms and cost of network access and to ensure a level playing field for all potential competitors. Similarly, detailed regulation for competition will be permanently required because such network access rules will require continuous policing and are industry-specific, thereby making general competition law insufficient to maintain competition. It has therefore been necessary for UK policy makers to refocus their objectives, leading to a system with both regulation of the non-competitive network as a natural monopoly and the establishment and regulation of appropriate structures to maintain competition in potentially competitive sectors. Industry-specific regulation of the former state-owned natural monopoly industries has therefore remained a fundamental necessity to both promote and sustain competition and also to prevent monopoly abuse. Thus Saal's review of UK experience suggests that utility privatization has not resulted in the withering away of the regulatory state, as early advocates of utility privatization had once believed would occur.

Conclusions

Both the theory of privatization and practical experience of implementing privatization schemes continue to develop. This book provides a comprehensive coverage of the issues in theory and policy that surround the current privatization debate. It is intended to foster critical analysis with a view to improving understanding of the appropriate form of economic restructuring of industries internationally. The contents suggest that many challenges remain, related to an understanding of when privatizations are most likely to succeed in improving economic performance and what forms the institutional context must take to increase the chances of success. Controversy continues about the appropriate speed of privatization and the form it should best take. Controversy also continues about the extent to which the transfer of privatization policy around the globe involves some form of Anglo-American hegemony that is not appropriate in many economies. Moreover, the degree to which ownership and market liberalization can be usefully separated, and whether privatization without either competition or effective regulation is worthwhile, continue to be discussed.

Privatization has been a dominant feature of industrial restructuring since the 1980s and continues to be so. The studies in this volume provide evidence of its scope and effects and therefore provide the basis for improving both policy formulation and implementation. However, they also emphasize that privatization is not an end in itself. Moreover, they demonstrate that, for privatization to be worthwhile and for lasting economic efficiency gains to be achieved, supporting reforms in the arenas of corporate governance and capital markets, product market competition and state regulatory processes must accompany most privatization programmes.

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