Theoretical approaches to the explanation of liberalisation and privatisation[1)]

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1. Introduction

The objective of this work package was 'a systematic stocktaking of different theoretical approaches to the explanation of liberalisation and privatisation as a basis for the critical analysis of their impact in the next phase.'. The intention was to 'examine contributions to the explanation of privatisation from different sciences (economics, business administration, regional science, engineering, political science, sociology) and from different schools of thought (neo-classical, institutionalist, evolutionary economics and sociology, regulationist school, neomarxist approaches). It will establish a comparative synthesis of these and elaborate an assessment of the strengths and weaknesses of the different approaches with regard to the capture of the real process and shape of liberalisation and privatisation in different historical, economic and social contexts.'

This paper begins by a consideration of the Austrian approach to markets, private property and competition. This approach is the one which most unambiguously promotes the role of privatisation and competition in a neo-liberal setting. In the next section, the 'economics of institutions' schema of Williamson (1998) is utilised to enable an overview of the different paradigms which go under the heading of neoclassical, new institutional and original institutional schools of thought. This leads into a more detailed discussion of each of those schools. The notion of efficiency involved in discussion of privatisation is briefly considered and the contribution of the schools discussed to the explanation of privatisation. The next section of the paper discusses the regulationist analysis of privatisation and liberalisation, followed by remarks on the liberalisation of network industries. The final main section of the paper considers the relationship between privatisation and the financial sector.

2. Austrian approach

The Austrian approach views competition as a dynamic process taking place against a background of change and uncertainty. The existence of profits, particularly high profits, is seen as an indicator that the firms concerned are particularly efficient both in terms of productive efficiency and of producing goods which consumers wish to buy. In particular, high profits are not seen as associated with market power, though there may be an association between high market shares and profits. But the link is not from high market share indicating monopoly to high profits, but rather that above-average efficiency generates a high market share and large profits.

It is the threat of new entry into an industry which keeps the incumbent firms on their toes. This leads to an emphasis on the importance of entry conditions into an industry, rather than the number of firms in the industry. One firm in an industry may appear to be a situation of monopoly, but if there are a number of firms ready to enter that industry if the existing firm allows its prices to rise above their level of costs then the incumbent firm is highly constrained in its pricing.

An important element of the Austrian approach is the importance of property rights and of the entrepreneur. If the entrepreneur is to seek after profits, then (s)he must have the claim to the profits generated, and hence, it is argued, the property rights to the profits must be assigned to the entrepreneur. The single entrepreneur is seen to be willing to take risks, to strive for lower costs etc., because (s)he will be the beneficiary of any resulting profits. In an organization with a large number of owners, the link between effort and profits is much diluted. The essential difficulty of nationalised industries, workers' co-operatives and also of large manager-controlled corporations is seen to be that ownership is dispersed.

The Austrian approach places great emphasis on the role of the entrepreneur in a market situation seeking out new opportunities and undertaking innovations. The market process is viewed as one of discovery, as entrepreneurs compete against one another. The outcome of the competitive process cannot be predicted. This raises difficulties for regulation of public utilities. 'Many commentators … have asserted that the purpose of utility regulation, and of price caps in particular, is to mimic the operation of the competitive market. I myself have never claimed that. I agree with Mises about the difficulty of predicting what a competitive market price could be, particularly in markets characterised by heavy capital investments that are location-specific and have long asset lives.' (Littlechild, 2000, p.13)

The Austrian approach would strongly support private ownership over public ownership on the grounds of the allocation of property rights which leads to owners having incentives to pursue profit opportunities. It also plays down the need for any regulation of an apparent monopoly position or industry operating with economies of scale. A leading exponent of the Austrian view (and one closely involved with UK privatisation and subsequently regulation) wrote in the following vein: 'what are we to make of the Austrian view of utility regulation ? There seems to be a general consensus that monopoly is not as widespread or permanent or problematic as generally believed; that such monopoly as does exist is most likely attributable to government restrictions; that regulation of potentially competitive markets is likely to produce shortages or be counter-productive; and that a little intervention is likely to breed more. … Government ownership of utilities is considered to be undesirable because it is likely to be loss-making or too powerful, and likely to prolong the monopoly.' (Littlechild, 2000, p.15)

3. Economics of institutions

In figure 1 the four level model of the ' economics of institutions' (Williamson 1998) is presented with neoclassical economics (NCE) at L4, Transaction Cost Economics (TCE) at L3 , theory of property rights (PR) at L2 and 'social theory', which we will call 'original institutional economics', at L1. The location of the theories is slightly different from Williamson[2)].

In Figure 1 all aspects of a socio-economic-political phenomenon like privatization are covered. The embeddedness of privatization is presented at level 1 (L1): the culture consisting of values and norms is the environment, which is important to understand the nature of privatization. For instance individualistic values of the Anglo-Saxon system represent a culture, which has a different influence on the nature of privatization than the more collectivistic culture in Continental Europe of Asian countries.

The formal legal environment of privatization is presented at level 2 (L2): what are the formal rules, the property rights, the role of politics and bureaucracy? When for instance the property right system is not well defined and enforcement is questionable, then privatization will have other consequences (see the privatization in Eastern Europe) compared to a legal system with well defined property rights and a neutral bureaucracy. Getting the formal rules, like property rights, right is called ' first order economizing'.

When privatization is realized the actors in the market will coordinate their transaction not in a state owned enterprise (SOE) anymore, but in 'private governance structures', such as contracts and different type of organizations. Forced by competition actors are supposed to select the governance structures that minimize the transaction costs (second order economizing). The 'governance 'is presented at level 3 (L3; see below).

Level 4 represents the allocation at markets where actors are forced by competition to minimize production costs (third order economizing).

The arrows between the layers show the relationship: the higher levels constrain and enable behaviour at lower levels. At level 4 for instance actors can only get the marginal conditions right when at level 3 the governance structure is right and at level 2 the institutions are right. The dotted arrows indicate a feed back between the levels from the bottom to the top.

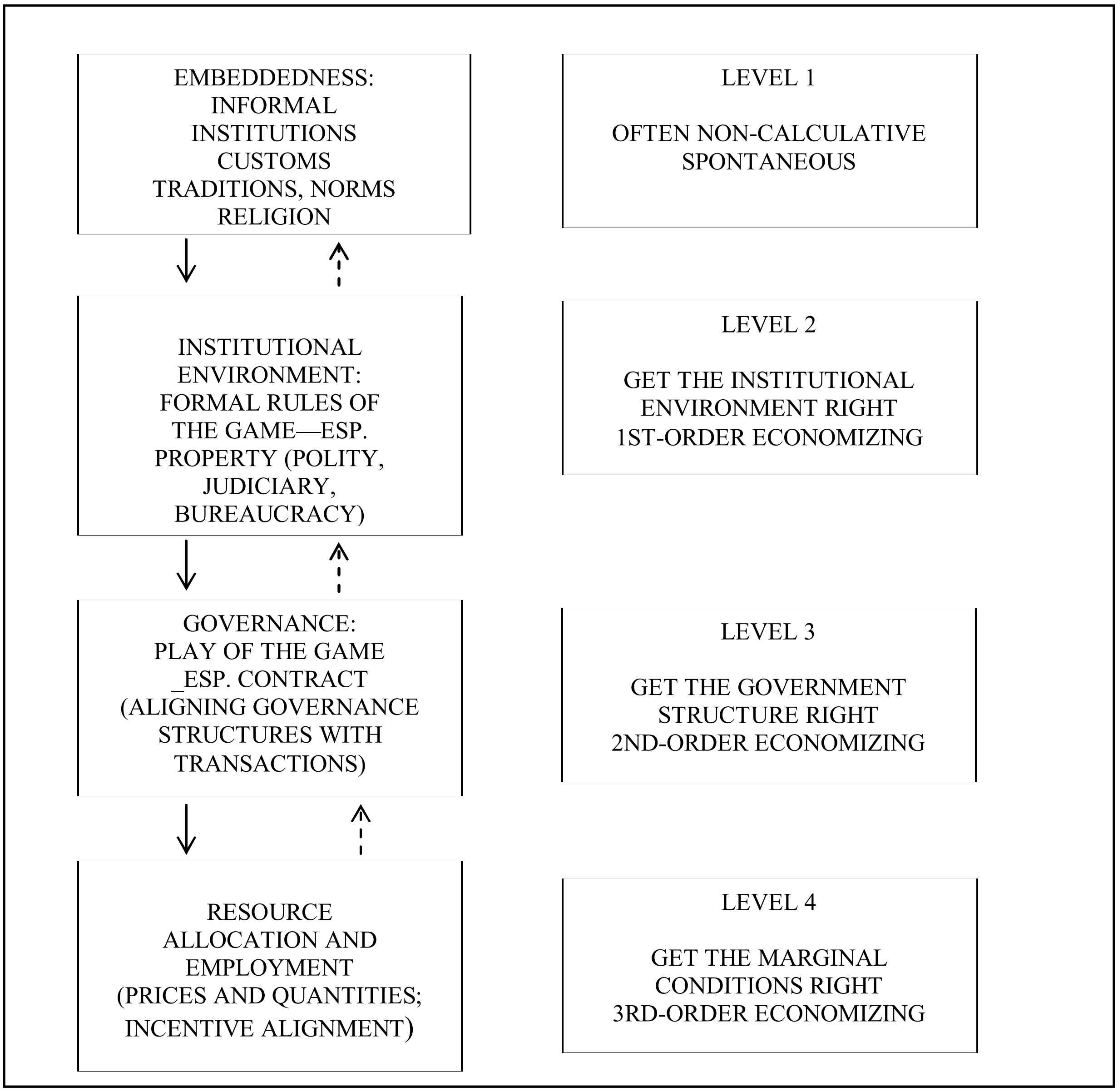
Below we discuss the nature of the theories at the different levels and outline their relevancy for the issue of privatization.

4. Neoclassical economics and privatization

In terms of figure 1 neoclassical economics is located at level 4. Markets are embedded in a context of formal institutions (values, norms, culture), a context of formal institutions (laws, regulations, public organisations of the state) and a context of private institutional arrangements, like private organisations and hybrids like public private partnerships.

At one level neo-classical economics could be viewed as taking a neutral stance on the issue of public verses private ownership. The objectives pursued by a firm would impact on the decisions which it made with regard to price, output, employment, investment etc.. But the objectives set for say managers of a publicly owned firm could, if required, mimic those of managers of privately owned firms, leading to essentially similar outcome. Neo-classical

Figure 1: The four levels of the economics of institutions



Source: adapted from Williamson (1998)

Note:

1. social theory (connects to original institutional economics)
2. theory of property rights (part of new institutional economics)
3. transaction cost economics and positive agency theory (part of new institutional economics)
4. neoclassical economics (including normative agency theory)

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analysis had been used to devise rules for the opera tion of public utilities, for example ideas of marginal cost pricing, investment decision rules.

Neo-classical analysis had long pointed to higher prices and lower output under monopoly as compared with perfect competition. Public utilities appeared as a situation of 'natural monopoly' under which a position of perfect competition (or even oligopoly) would involve much higher costs (as benefits of economies of scale were lost) and indeed perfect competition would be unsustainable as larger firms with lower costs drove out smaller firms.

From a neo-classical perspective, the main argument for public ownership appeared to stem from the 'natural monopoly' case: public ownership to prevent monopoly exploitation of consumers. From that perspective, the argument was undermined in ways. First, doubt was cast on the extent of economies of scale and the degree to which there was a position of 'natural monopoly'. This was linked to the second line, namely that even where part of a production process was subject to economies of scale, other parts were not, and those which were not could be operated separately from the other. Hence competition and private ownership could (should) be injected into those parts of the production process which were not subject to economies of scale. Third, there was perceived to be a strong link between a guaranteed position of monopoly and public ownership. Public owned companies were often granted exclusive rights to operate in a particular industry.

Neo-classical economic analysis had been firmly based on the assumption of technical efficiency, that the technical maximum output was achieved from the factor inputs, and then focused attention on questions of allocative efficiency. The notion that firms did not typically operate with technical efficiency and that the degree of technical inefficiency varied (Leibenstein, 1966) changed that perspective (though as always it could be questioned whether incorporating technical inefficiency and its causes was consistent with neo-classical economics). This chimed with the frequent popular accusation that publicly owned enterprises were inefficient. Leibenstein did not discuss technical inefficiency with regard to different forms of ownership but he did with respect to competition versus monopoly. The possible link between public ownership and monopoly alluded to above would point towards the relative inefficiency of public ownership. Indeed a number of neo-classical economists have argued that public ownership per se does not lead to inefficiency, but the monopoly position does.

Neoclassical economics assumes that competition in the market will result in efficient outcomes. L4 is about 'getting the marginal conditions right'. When producers are put under competitive pressure they are then forced to produce at minimum costs (technical efficiency), to produce what consumers want (allocative efficiency) and to innovate new products and production processes whenever possible (dynamic efficiency). If not, they will not survive in he market place. Much of the literature on liberalization, deregulation and privatization works out of that underlying assumption. Neoclassical economics then predicts what the optimal scale and scope of production will be.

This is the world of fully rational actors who have sufficient information to calculate ex ante the minimum efficient scale of production. The firm is then a production function and the insight provided to management is 'get the scale of production right'. Because normative agency theory works out of the same principles we also (following Williamson) locate that theory at L4.

Markets do not spontaneously result in such efficient performance when market failures and /or market imperfections exists. Failures refer to collective goods (non excludability and non rivalry), to natural monopolies (decreasing marginal costs) and externalities. Imperfection results from abuse of market power. In both cases government should intervene to correct the failures (produce collective goods, nationalize or regulate natural monopolies and correct externalities that are not corrected by the market itself) and imperfections (competition policies).

Privatized firms will be driven automatically to the efficient scale and scope (through internal growth, or external growth (Mergers and acquisitions) or through divestures.

With respect to privatisation NCE considers private firms to be the norm; only in exceptional cases government should regulate private firms and State Owned Enterprises (SOEs) do not really belong to the options NCE would be choosing from. The more the system is moving away from private firms competing in markets, the more inefficiency due to limited market incentives, have to be accepted, according to theories at L4.

5. New Institutional economics and Privatisation

Generally three related schools of thought are suppose to address the question of 'governance' at L3: theory of property rights, positive agency theory and transaction cost economics together called the school of New Institutional Economics (NIE). In NIE the actors differ from NCE in the sense that actors are bounded in their rationally and can behave opportunistically. They do follow the rules of cost minimization.

Below we discuss the three schools of thought that together form the New Institutional Economics.

5.1. Property rights and Privatisation

The insights of property rights play a role at level 2. The economics of property rights demonstrates the importance of well-defined and objectively enforceable property rights to make contracting possible. Due to bounded rationality, contracts are always incomplete. Actors aim at minimising the risks of 'post-contractual opportunism' and the theory of property rights then explains that the owner of the rights has control over the way how the incompleteness is filled in at a later stage. That makes the allocation of property rights crucial.

The allocation of property rights largely determines the incentives structure. The owners can have the right to use, to manage, and to alienate the property. It should be noticed that property rights can be different from decision rights: the owner can give decisions rights to another party (in the case of leasing, or renting), or the decision rights can be limited through laws and regulation.

With respect to the issue of privatization the theory of property rights focuses on the incentives related to the type of property rights. Private property rights are generally efficient because individuals negotiate in contracting processes on the (ex) change of property rights. In case of state owned property the theory predicts large bureaucratic inefficiencies. In case of common property ('Tragedy of the commons') each individual will maximise her profits by letting more sheep graze on the common, or fishing more fish out of the sea. By maximising individual profit the 'common' is destroyed. So in that case the theory of property rights explains the necessity of a set of rules that preserve the common. In case of collective property rights, for instance the ownership of a hall in an apartment building the theory of property rights also explains the necessity to guide individual behaviour on the basis of a set of rules.

So, the theory of property rights provides the basic arguments for privatization. When formerly SOEs are privatized and the domain is of special public interest (energy, public transport and the like), then government is in need of regulation of the privatized firm. Agency theory provides relevant insight then.

5.2. Agency theory and privatization

In the second school of NIE the idea of contracting is taken a step further by the principal - agent theory (AT), in which the firm is characterized as a 'nexus of contracts'. The insights of agency theory play a role at level 3. Principals and agents have different objective functions and information is asymmetric. Otherwise no agency problem would exist. The situation of different objectives between the principal and the agent and the existence of information asymmetry between them raises the question how best how to align the interests of the principal and the agent through contracts and organisational arrangements like monitoring and bonding.

Different kinds of principal-agent relations can be distinguished:

* Government (ministry) vs. state-owned enterprise

* Government vs. private firm

* Shareholder vs. manager

* Manager vs. employee

According to AT privatisation means replacing the bureaucratic internal control mechanisms by competitive pressures and contracts between the government (principal) and the agent (privatised firm). How managers of privatised firms that need to be regulated behave depends on different internal (workers council, internal auditing) and external disciplining mechanisms on management of private firms: product market, labour market for managerial labour and the market for corporate control. Regulation by government should be studied in the context of those other disciplining mechanisms.

When formerly SOEs are privatised, transactions between and within these firms are no longer coordinated through a vertical command system, but through institutional arrangements like contracts and organisations. How this can best be done is the question addressed by TCE.

5.3. Transaction Cost Economics and Privatisation

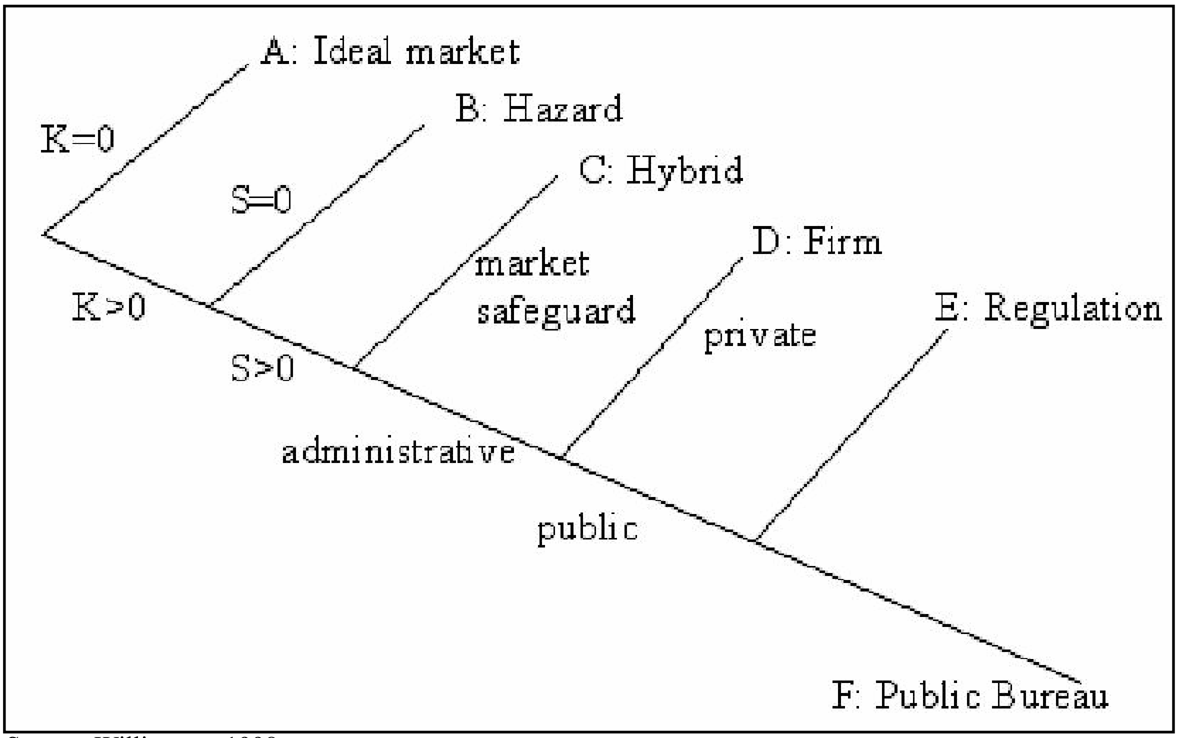
Transaction Cost Economics is located at L3 in figure 1 and builds upon the theory of property rights and agency theory. The issue now is what governance structure most efficiently coordinates transactions including privately and state owned firms.

Given the institutional environment of (in)formal institutions what then are the efficient modes of governance (second order economizing) ? TCE characterizes the transaction according three dimensions (asset specificity, uncertainty and frequency) and matches different governance structures with different transactions. The level of asset specificity is generally considered to be the most decisive one: when asset specificity is high, the risk of opportunistic behaviour is high, so the need for safeguards is high. This will be more costly to realize in a market contract then in a hierarchy. Between the market and hierarchy an intermediate category of hybrids is located: long term contracts, strategic alliances, networks, and the like.

Privatisation often implies regulation (access to the network, quality, prices, security of supply, investments) to safeguard competition and the public interest; what is the net benefit?

We can draw a continuum of governance structures from the contracts on spot markets to the vertically integrated hierarchies and further to the area of public ordering (regulation and public bureau). See figure 2.

Figure 2: a contracting and organizational schema



Source: Williamson 1998

It would be a mistake to think of governance structures as only private arrangements: government plays a role as well and sometimes even a dominating role. This can be the case in sectors of the economy where competition needs careful regulation in order to prevent firms to make abuse of a dominant position, or to prevent unwarranted collusion between firms. In sectors such as railways, energy, telecommunication, public transport, health services, and the like, government creates governance structures to assure a specific performance of the market. For instance the provision of energy at reasonable prices to all citizens is an objective of public interest that needs specific governance. The continuum in figure 2 shows the type of governance structure related to the degree of asset specificity (k). The asset specificity concerns the type of investments actors make in order to have a good or service transacted. When the investments are very specific then the investment is worthless when the transaction is ended. The degree of asset specificity has implications for the possibility of opportunistic behaviour and therefore for the need of safeguards. In figure 2 the asset specificity increases from left to right. When no asset specificity exists the transaction can be efficiently coordinated with a 'contract on the ideal market' (potential opportunism is absent because of the high level of competition and low level of asset specificity). When asset specificity increases safeguards are built into the contract, e.g. through long term contracting, and so-called 'hybrids': governance structures in which contracts are combined with organisational structures for monitoring, arbitrage and sanctioning. When asset specificity increases further the hierarchy (vertical integrated firm) will be most efficient from a transaction cost point of view. Private ordering is complemented by public ordering (regulation and 'public bureau', or State

Owned Enterprise) when government is responsible for a specific performance of the sector and the market does not automatically produces the desired outcome. Competition authorities and sector specific regulators are typical examples.

6. Original Institutional Economics and Privatisation

The original institutional economists were first of all interested in issues of institutional change, in the analysis of processes. The analytical framework based upon their ideas is presented in figure 3.

Compared to NIE the differences are to be found in the extension of the model with the technology and the political layer, the different attributes of the actors, and the feedbacks between the layers. This approach allows for the analysis of path dependent processes and power of interest groups that can influence government policies and strategies of private firms. The OIE approach is dynamic, multi-disciplinary and more holistic.

Efficiency

Private ownership vs. public ownership is often discussed in terms of the relative efficiency of the ownership forms. The Austrian approach most clearly postulates that private ownership will be more efficient than public ownership and in effect judges efficiency in terms of profitability. Survival in the

Figure 3: Layered dynamic institutional model

Layer 1 — Informal institutions:
- Culture
- Values
- Norms

Technology:
- Trajectories
- Artefacts
- Operationalisation

Layer 2 — Formal institutions:
- Political system
- Role of the state
- Relationships between bureaucracy, politics and business

Layer 3 — Formal institutions:
- Laws (property rights) and regulations (price regulation)
- Policies (competition, technology, economic, financial)

Layer 4 — Institutional arrangements:
- Contracts
- Organisations (vertical integration)
- Hybrids like networks

Layer 5 — Individual actors:
- Mental maps
- Habits, routines
- Human creativity and learning
- Powerbase for opportunism (encapsulation)

market becomes the test of efficiency. The neo-classical approach has clear notions of efficiency in terms of allocative and technical efficiency. It is relevant to note the shortcomings of such an approach to efficiency. First, it is well-known that the efficiency criteria of neo-classical welfare economics pay no attention to issues of distribution. Privatisation may well lead to a different structure of prices (as compared with public ownership) which has a differential impact on income groups. It is often seen that the pricing structure post-privatisation favours the rich rather than the poor. Second, little attention is paid to wages and conditions of labour. If cost efficiency is increased through the payment of lower wages and/or the intensification of labour, it would be doubted as to whether that can be considered as improving social welfare. Third, the neo-classical approach adopts a rather static approach and does not pay sufficient attention to issues of investment and technical progress. The impact which privatisation has on the extent of investment particularly in the public utilities has been little considered but of considerable importance for the secure supply of essentials such as water and electricity. Fourth, the nature and 'quality' of the product is liable to change under privatisation and liberalisation. Regulation of privatised utilities has focused on price and has found difficulty in ensuring quality. Liberalisation in the form of 'contracting out' of public services has faced problems of writing and monitoring the contracts in a way to ensure good quality services are provided.

This brief discussion points to the conclusion that privatisation cannot be adequately assessed using the narrow concept of efficiency associated with neo-classical economics. Social welfare cannot be narrowly aligned with costs of production or profitability. A broader range of considerations, some of which have been indicated above, have to be brought into the picture.

7. Explaining privatisation

7.1 Austrian approach

The Austrian approach has always championed private ownership over public ownership (and more generally any forms of social ownership), and viewed barriers to competition as arising from government intervention rather than from economies of scale and activities of incumbent firms. In the Austrian view, private ownership is inherently more efficient than public ownership : the key argument in their approach is the identification of a 'residual claimant' who has the interest of maximising the residual (i.e. profits). In seeking to maximise the residual, costs are minimised, and in that sense efficiency is pursued. In the Austrian view any firm which does not have a well identified residual claimant will not operate in an efficient manner. In the Austrian approach, the natural monopoly argument is not given a great deal of weight as a rationale for government intervention. Even if economies of scale are strong enough leading to a dominant firm in the industry concerned, the Austrian approach stresses the competitive pressures which arise from the possibility of other firms entering the industry if the incumbent becomes inefficient.,

Government policy should then to be focused on ensuring that no impediments are placed in the way of new entrants. The public ownership of natural monopolies often includes the exclusive rights to operate in the industry concerned. The Austrian approach would stress the change of ownership from public to private and also the removal of any barriers to entry. The Austrian approach would also stress the difficulties involved in regulation of utilities arising from problems of 'agency capture' (regulator operating in the interests of the producers), issues of information and 'government failure', the subjective nature of costs and the inherent difficulties of replicating a competitive market. One summary of this position is given by 'when technical conditions make monopoly the natural outcome of competitive market forces, there are only three alternatives: private monopoly, public monopoly, or public regulation [of private monopoly]. … 'All three are bad so we must choose among evils … I reluctantly conclude that, if tolerable, private monopoly be the least of the evils'. (Friedman, 1962, p. 28)

The Austrian approach would seek to explain the shift to privatisation in the past quarter of a century in terms of the 'triumph of ideas'. The advocacy of privatisation by that approach has been unchanging and not related to the economic, political or material circumstances. For the form of privatisation, the shift to private ownership would be seen as the key element with little need for regulation of the private industry (other than ensuring that there are not limits on entry of firms into the industry concerned). Any regulation (notably over prices) should be limited in time until the barriers to entry can be removed.

7.2 Neo-classical approach

The neo-classical approach has generally seen public ownership as a response to the 'natural monopoly' problem. It was always recognised that regulation (of prices, profits) private 'natural monopoly' was an alternative to public ownership. As indicated above the neo-classical approach only favour private ownership over public ownership in so far as the objectives pursued as more conducive to the achievement of allocative efficiency. The neo-classical approach may be able to explain privatisation through the idea that technological changes have changed the extent of 'natural monopoly' (telecommunications may be an example) and hence the need for public ownership as a form of regulation. Another route, which may be debatable whether it would be a neo-classical explanation, would be changing perceptions of the objectives of public versus private corporations and the effects of those objectives on technical efficiency. The notion of X-inefficiency permitted the discussion within neo-classical economics of the factors which may influence the degree of technical inefficiency, and a favoured line was the role of competition in this regard. The absence of competition in the natural monopoly setting could then be viewed as a cause of technical inefficiency (and hence higher costs).

The neo-classical approach can be seen to have influenced the form of privatisation in two particular respects. First, the structure-conduct-performance paradigm (from industrial economics which can be associated with a neo-classical approach) postulates the relevance of industrial structure including barriers to entry and exit for industrial performance. Second, the nature and form of regulation has been strongly influenced by the neo-classical perspective. The 'natural monopoly' perspective suggested the need for regulation of prices and profits of privatised utilities, at least with regard to those parts of the production process where economies of scale prevailed. The neo-classical approach has generally informed the approach to the precise regulation of prices and costs and the allocation of costs between activities (in contrast the Austrian approach stresses the subjective nature of costs which raises some obvious difficulties for regulation). The focus of regulation on price rather than say investment, research and development, may also reflect the essentially static nature of neo-classical economics.

7.3 New institutionalist approach

The discussion of the new institutionalist approach above highlighted three aspects, namely property rights, agency theory and transactions costs. This approach could then explain the occurrence of privatisation through some combination of changes in perceptions of the role of property rights and of principal-agent issues and changes in the structure of transactions costs. This would though leave unexplained how and why the perceptions of the role of property rights and of principal-agent issues changed. A thorough investigation would be required to see whether there had indeed been changes in the transactions cost technology which would have generated the observed changed.

It is rather debatable as to whether the principal-agent issue and transactions costs have had much effect on the nature and forms of privatisation. Some utilities have been privatised in a vertically dis-integrated form (the British railway system is a well-known example) and the ways in which principal-agent matters arise and the transactions costs (in a broad sense) arise in a disintegrated industry do not appear to have had much impact on the way in which privatisation has been structured.

8. Privatisation and regulation theory

8.1 Growth regime and institutions in the regulation approach

The regulation theory is an institutionalist approach developed in France by authors like Aglietta (1976) or Boyer (1986) which focuses on links between institutions and growth regimes. Periods of well established growth can be associated with some stable institutions which serve as pillars of the growth regime. In this context regulation mechanisms underpin the reproduction of the whole system and can be regarded as sufficiently stable. But these mechanisms are not immutable as they are submitted to progressive changes in institutions induced by the growth process itself. After a more or less long delay, misalignments appear between regulation mechanisms and institutions. Sustained growth can be no more warranted and the economy enters in period of 'great crisis'. During this period structural changes happen, institutions are reshaped and regulation mechanisms adapted in order to recreate conditions for a new growth regime. This process of adaptation and transformation can be more or less long and painful, according to characteristics of each country and period.

In the traditional regulation approach (Boyer, 1986) five main institutions are distinguished: wage relations or wage nexus, competition forms, the monetary and financial regime, State and institutional compromise, internationalisation forms. In the varieties of capitalism approach (Amable, 2003), which is close to the regulation one, five main institutions are also considered: competition forms, wage relations, financial intermediation and corporate governance, welfare state, education system. The importance of institutional complementarities is underlined and helps to characterise varieties of capitalism. In this perspective five models of capitalism are distinguished during the 1980s and 1990s and have been analysed in details: the Anglo-Saxon model; the social-democrat model; the continental European capitalism; the Mediterranean capitalism; the Asian capitalism.

In spite of differences between the main industrialised countries, the crisis of the Fordist regime during the 1970s can be characterised by some common features: a decline of the labour productivity rate of growth and a fall of the capital productivity due to the erosion of the mass production system, a rise of the wage share and a fall of the rate of profit, a rise of the inflation rate in most of the countries, except in Germany and Japan, an increasing public deficit due to the slowdown and the use of some Keynesian tools to try to sustain economic activity. Facing a persistent crisis, a turning point appeared at the end of the 1970s with clear announcement of the need of structural changes to engage towards new growth regimes (Mazier, Baslé and Vidal, 1984). This search for a new growth regime followed different paths according to specificities of each country (or varieties of capitalism).

8.2 The search of new growth regimes during the 1980s and 1990s

From 1979 the USA and the United Kingdom were pioneers in the implementation of a new regime based on a liberalisation process and changes in macroeconomic policy and reliance on monetary policy. Japan followed a different strategy, but the success of the 1980s did not resist financial liberalisation. Lastly the continental Europe was confronted by a gradual sliding towards liberalisation.

With a highly restrictive monetary policy, strong deregulation, pressures on wages and trade unions, but also demand sustained through public deficit, the USA managed to find a way out of crisis and were able to reduce significantly unemployment. During the 1980s the US growth regime was still based on services, low wages and low productivity growth. New economy and finance led growth regime emerged only during the 1990s. However, beyond the financial crisis of 2001, increasing international unbalances lead to question the sustainability of the US growth.

The break was even more important in the United Kingdom since 1979 with the starting of a liberalisation process and search for labour flexibility. Monetary policy became progressively less restrictive. Based on services and a strong financial sector, a finance led growth regime also emerged during the 1980s with increasing inequalities.

Japan explored a very distinctive strategy. It found a way out of accumulation crisis very early in 1978 through a yen depreciation and an export led growth, based on a highly competitive manufacturing sector. During the 1980s Toyotism was considered as the new productive model, able to give answers to limits of the old Fordist model. Unfortunately, financial liberalisation, largely imposed by the USA and implemented too quickly, led to a financial bubble and a deep crisis in 1990. Since then, banking crisis, credit rationing and deflation locked the Japanese economy in stagnation.

Continental European economies represent another type of case. Here also deep institutional changes occurred since the beginning of the 1980s with more labour flexibility, a decline of the State intervention and financial liberalisation. The profit rate was restored, but without recovering a sustained growth and full employment. The failures of the European economic policy in many respects explain a large part of the growth in many European countries in mass unemployment. A relative convergence towards a more Anglo-Saxon model has been observed but the continental European capitalism with its different specificities has resisted. Some small European countries, especially those belonging to the Social Democrat model, have been more successful. Their former institutions were better fit to new forms of competition and their high degree of openness can explain the larger efficiency of the costs-cut strategy.

8.3 Privatisation: a general trend inside the liberalisation process

The liberalisation process has been a main component of institutional changes which occurred since the 1980s with the objective of restoring profitability and accumulation rates. More competition was supposed to improve productivity and competitiveness , and consequently to increase growth. More labour flexibility was also a factor of increasing productivity and of costs reduction. Lastly financial liberalisation was a tool to improve capital financing, both by reducing the capital cost and by increasing the volume of financing.

Inside this broad liberalisation process, privatisation was a key factor as it was supposed to have a positive impact on, at least, five fields which were at the heart of the crisis. Privatisation meant more market oriented systems which were seen as more efficient. Privatisation offered new markets for private capital accumulation at a time where demand was often regarded as too weak. Privatisation could be seen as a partial answer to the crisis of Public finance. Privatisation could be used to improve labour flexibility. Lastly, privatisation could be favoured by recent technical change.

Privatisation took different forms according to varieties of capitalism. The process of privatisation began very early in United Kingdom but came very late in France where, contrary to all countries, large nationalisations were realised at the beginning of the 1980s before the beginning of the privatisation in 1987. Three distinctive fields were concerned with quite different implications: the productive sector in countries where a large public sector was inherited from the previous period with strong State intervention; public utilities which could be delivered at a larger scale by the private sector in the new growth regime; social services where new opportunities appeared within the crisis of the welfare system, especially in the health system and pensions.

8.4 Five main determinants of privatisation

The evolution towards more market oriented systems was one of the answers to the crisis of productivity appeared during the 1970s. Competition was considered as more efficient than public monopole to improve productivity, decrease prices and stimulate innovation. This was notably the case in countries, like United Kingdom, where the efficiency and the quality of services of the public sector were weak. Telecommunications, energy, transport and health sectors have been the first concerned with the settlement of new forms of regulation. In this matter the European Commission has plaid a leading role since the Single Act of 1986 which launched the liberalisation process at the European level.

Beyond the technical reasons put up front, the decline of the notion of public services and the crisis of the State intervention linked to the failure of Keynesian policies during the 1970s have been strong determinants.

Privatisation offered new markets for private capital accumulation when demand was seen as insufficient. This was especially the case in European countries since the 1970s with restrictive economic policies which became predominant. Profitability was restored since the end of the second half of the 1980s, but without durable recovery of the rate of accumulation at the macroeconomic level due to the insufficiency of demand, but also, presumably, to the impact of the financial liberalisation which favoured more financial accumulation. In this environment large and secure markets, mainly in public utilities and pensions systems, and to a less extent in the health system, were made accessible for private capital accumulation thanks to the privatisation process. Profitable activities were easily privatised while activities with deficit remained public.

The public productive sector also gave good opportunities for private accumulation after costly restructuring financed with public funds, as it has been notably the case in France.

Privatisations were used as a partial answer to the crisis of public finance which affected most of countries recurrently since the 1970s. The context of public austerity induced a decline of the public sphere. The State could hardly finance large public investments. At short term they gave new resources to the Budget through the sale of public assets.

In the medium or long term privatisation was falsely presented as an answer to the crisis of the pensions system. The development of private pension funds was supposed to give additional incomes in the future in complement to public pensions whose amount would be reduced with ageing population. The same evolution, although less advanced for the moment, can be observed in the case of health systems.

Lastly financial liberalisation was favoured by governments to finance more easily the public deficit by issuing bonds on larger markets, especially at the international level.

The search for more flexibility of the wage relation was regarded as a key issue since the 1980s as it was supposed to help to reduce costs and improve profitability. In most cases trade unions benefited of strong positions in the public sector. Consequently privatisation weakened trade unions' positions and helped indirectly to promote more flexible wage relations. More generally it changed the rules in the privatised sectors and introduced more competition, notably in the wage relation.

Lastly, criteria justifying public intervention have changed under the effect of technical evolutions.

Some activities, like telecommunications, formerly with increasing returns, have turned into activities with decreasing returns thanks to technical innovations, thus rendering the monopolistic situation obsolete. The segmentation of activities, like in railways or electricity, has been developed and allowed the division of companies into several segments which could partly be submitted to competition. Consequently, traditional criteria (increasing returns, externalities) tended to disappear in favour of the nature of the information which could be easily manipulated or not. Contract theory has been developed a lot. When a contract could be established, privatisation and competition allowed recourse to private sector under the control of regulation authorities. Conversely, the difficulties involved in the contracting out of an activity arising from asymmetric information, costs of writing and monitoring contracts justified maintaining a public operator.

8.5 Privatisation: unequal success to support finance led growth regime

On the whole, since the 1980s privatisation has played an important role in shaping a new growth regime. According to varieties of capitalism, the forms of privatisation have differed between countries. Without increasing the efficiency of the whole system, privatisation has been coherent with the settlement of a finance led growth regime.

It has first given a strong support to financial markets, especially in European countries where these markets were underdeveloped. Through foreign investment funds, mainly Anglo-Saxon, it has led to an important penetration of foreign capital in many strategic activities. Reforms of pensions systems have also given large opportunities to financial markets.

Regarding investment, results appear unequal. Private accumulation in network services (notably telecom) has been booming, but with a financial bubble at the end of the 1990s. Investment growth in the electricity sector has been problematic. Privatised enterprises were poorly incited to invest by fear of loosing their market power. Interconnection investments have been insufficient and excess capacities limited facing a rather fluctuating demand. The strong volatility of market prices and the high capital intensity of the sector were combined to increase the risk of alternative phases of overcapacity and under-capacity.

Beyond these sectoral evolutions, the new growth regime has not been characterised by a sustained recovery of investment at the macroeconomic level in spite of the restored rate of profit.

Market regulation has varied in its efficiency and effectiveness. The split of network firms in distinctive centre of profit has raised problems. The separation between various activities (infrastructures, production, distribution, trade) had impact on firms' technical capacity, quality of services, and supply security. Management costs have been high with important advertising costs, overlapping supply in many cases as consequences of increasing competition. Productivity gains have been insufficient to compensate these high costs. By sectors specific problems can be underlined: excess of competition in telecommunications in European Union and distortion due to national authorities of regulation, risks of supply rupture and prices instability in the electricity sector. On the whole efficiency gains cannot be regarded as evident in spite of the initial discourses.

Growing inequalities cannot be ignored. They resulted first from the drawback of the notion of public services with more difficulties for accessing to networks for peripheral and poorer customers. Compensating mechanisms did not appear sufficient to restrain increases in inequality. The possibility of preserving the mission of general interest has been introduced through contracts approved by public authorities but this has not avoided higher charges for poorer customers.

The transformations of pensions systems and health systems have been regressive. More generally the financial liberalisation and the new corporate governance, linked to privatisations, have led to major inequalities.

9. Liberalisation of network industries

The network industries have many characteristics of natural monopoly and have in Europe typically been operated under public ownership and in a protected monopoly situation. The policy thrust in the past decade or more has been towards the liberalisation of these industries, and specifically the removal of the monopoly situation. A summary of the advocacy of this approach is given by:

'Liberalisation of network industries usually starts by inducing a restructuring process in these industries, characterised by entries and mergers and

acquisitions. This leads to employment and productivity changes. The productivity gains can be translated into price reductions, which benefit industrial users and households. Increased competitive pressures can also induce companies to be more innovative and this contributes to additional productivity gains. Finally, price reductions and technological developments can stimulate demand, offsetting the initial employment losses due to the restructuring process. However, the net impact on employment can not be predicted.' (EC HEPNI 2004)

This same report provided its own assessment of the effects of liberalisation in the network industries within the EU:

'the overall performance of services of general interest in the EU is good in terms of prices, employment, productivity, service quality, fulfilment of public service obligations and consumer satisfaction.' (EC HEPNI 2004)

Data from EUROSTAT sources however suggests a more mixed picture on prices, though a rather weak one (Hall 2006). From January 1996 to January 2005, prices have gone up by 41% for gas, by 21% for railway services, by 18% for airline services, by 10% for electricity, while the general price increase was 17.5%. Even in telecommunications where prices have fallen by about 25%, they may be doing little more than continuing previous trends. The results showing no dynamic productivity gains: *'the introduction of consumer choice of suppliers was associated on average with a reduction in employment levels of about 12%... one-off changes in the level of productive efficiency, without creating any increase in longer-term dynamic efficiency.'* (Griffith and Harrison, 2004). Further, *'any gains from deregulation in terms of technological catching-up or from privatisations of state monopolies should be interpreted more in terms of static efficiency gains and not with the dynamic efficiency gains needed to achieve an outward shift of the 'technology frontier'* (Denis et al 2004)

With oligopolies, effective competition seen as crucial to policy, But note the horizontal mergers of electric companies and cross-sectoral mergers between electricity and gas companies, and the vertical integration of electric generation/supply. Consumers have been sceptical on liberalisation. The industry believes electricity market manipulated to maintain prices : Dutch energy council 2004: *'The type of competition that can be expected to arise is not the type envisaged at the start of the liberalisation operation. The clients - and in fact, society as a whole - will not benefit from a static oligopoly. This will place too much pressure on the public interests: price, reliability and sustainability.'.* Most consumers in EU10 expect state protection and provision, believe electricity prices unjustified, concerned re extensions: *'The possibility of urban transport services being opened up to competition arouses mixed reactions, ranging in most of the Member States from outright rejections of this prospect to the limited or sceptical expectation of benefits for consumers… a very substantial majority of the people simply opposes the prospect of opening the [rail] market….the United Kingdom being cited in many other countries as a negative example of the consequences that can be expected '* (Euro Barometre 2004)

There is mixed evidence with regard to efficiency of the private sector relative to the public sector. 'While there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed.'(IMF, March 2004). General empirical evidence shows no consistent advantage (Willner 2001). UK privatisations created no significant productivity gain, but did create negative distributional effects (Florio 2004)

There is no evidence for EU liberalisation increasing efficiency. For the water industry : 'the econometric evidence on the relevance of ownership suggests that in general, there is no statistically significant difference between the efficiency performance of public and private operators in this sector….For utilities, it seems that in general ownership often does not matter as much as sometimes argued. Most cross-country papers on utilities find no statistically significant difference in efficiency scores between public and private providers.' (Estache et al 2005)

There has been acknowledgement of the empirical evidence by World Bank and IMF where in energy and water the World Bank strategy paper of 2003 says privatisation and liberalisation are not working and concerns surrounding Public Private Partnerships have been expressed by the IMF, EC economic directorate (impact on fiscal limits, avoidance as perverse motive for PPPs).

10. Privatisation and finance

10.1 Budget deficits and public finances

There have been different practices over the treatment of the sale of public assets. The British approach has been to treat such sales as negative public expenditure thereby reducing the recorded budget deficit. The early phases of privatisation, at least so far as the UK was concerned, were linked with a perceived need to reduce the budget deficit. This budget deficit requirement cannot be claimed to be the prime driving force behind privatisation but played a contributory role. An argument which was prevalent in the first half of the 1980s in the UK, and closely associated with the rise of monetarism, related to the alleged relationship between budget deficit and the growth of the money supply. The linkage was alleged to be : budget deficit impacts (perhaps determines) change in money supply, which in turn sets the pace of inflation. This took a concrete form in Medium Term Financial Strategy (MTFS) which set out targets in terms of both budget deficit and growth of money supply. This argument has now been thoroughly discredited.

The treatment in the EU under the Maastricht Treaty conventions is in effect to treat sales of public assets as one form of funding of the budget deficit, and consquently privatisation does not immediately effect the recorded budget deficit. In effect the sale of public assets goes alongside sale of bonds as a means of deficit funding. As bonds have a cost in terms of future interest payments so the sale of public assets has a cost in terms of the financial and other benefits from the public operation of those assets. If it were the case that the private sector was unwilling or unable to fund a budget deficit, then the use of the sale of public assets rather than the issue of bonds is unlikely to make much difference. The funding requirements placed on the private sector are the same, though the financial instruments used are different.

The Stability and Growth Pact places emphasis on public debt being less than 60 per cent of GDP. Hence it pays attention to public liabilities but without any regard being paid to public assets. As privatisation reduces public debt and at the same time reduces public assets this attention to only the public debt provides accounting encouragement for privatisation. Public assets can for this purpose be convenient divided into two. There are firstly those assets which help to provide public goods and services but which do not directly generate a financial flow (e.g. profits). Secondly, there are assets (typically operated by public corporations) which help to produce goods and services which are sold to the public and on which profits could be said to be earned (State owned enterprises SOEs).

Privatisation with regard to the first type of asset has essentially involved a leasing back arrangement whereby the asset is owned and operated by the private sector in exchange for a leasing and service fees. The private finance initiative, public private partnerships fall in this category. The immediate impact of the use of an PFI (as compared with a conventional finance capital project by government) is to reduce government borrowing requirement. However, the longer term effect on budget deficit is likely to be negative : the future stream of leasing payments under PFI will in general exceed the stream of interest payments (which would arise under conventional finance).

A similar argument applies in the case of state owned enterprises. In public ownership, those enterprises would yield a future stream of profits which are now lost to the public sector following privatisation. It could be argued that SOEs are often loss-making, but if so that makes them an unattractive proposition for private investors.

The loss to the public sector is amplified by the general underpricing of privatised companies. There does not seem any doubt that there has been underpricing in general, though the question can be asked as to how the degree of underpricing compares with that which occurs with share floatation of private companies.

10.2 Property owning democracy

The creation of a 'property-owning democracy' was a declared aim of the British Conservative Party election manifesto in 1979, which lead to the election of the Thatcher government and the initiation of privatisation. It was though largely linked with wanting 'more people to have the security and satisfaction of owning property' (1979 Conservative Party election manifesto). Privatisation has strong political underpinnings in terms of the spreading of share ownership.

The sale of shares in the privatised utilities were also undertaken at a significant discount with small individual shareholders as the target group. These policies not only indicate the intentions of these privatisation in terms of changing ownership patterns, but also that the financial benefits of privatisation are concentrated on a relatively small number. In contrast, the financial and others costs are spread and diffuse. An individual tenant purchasing their public authority house at a discount can readily appreciate the financial gains. The loss of social housing has a much more diffuse cost, e.g. those who would have otherwise had access to social housing. In a similar vein, the financial benefits of privatisation of utilities arose for those who were able to purchase shares, whereas the losses were spread over the whole community.

10.3 Privatisation and financial markets

The interests of the financial sector in privatisation are perhaps self-evident. There are substantial fees, commission and income generated by privatisation. The underwriting fees of the share issues, the income from dealing in the shares in the privatised companies etc. come immediately to mind. Public private partnerships are also lucrative for the financial sector (including accountancy and consulting firms). Deals have to be arranged, finance provided, consultancy advice provided at a price etc..

In varying ways, one of the objectives of privatisation reflected in the way in which the privatisation was undertaken has often been the development of equity markets and the spread of share ownership. Privatisation has also been promoted on the grounds of developing the stock exchange (e.g. in terms of breadth and liquidity) especially in the context of emerging markets. This argument in turn has rested on the view that financial development (particularly with regard to the stock market) is a stimulus to economic growth.

The financialization, 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (Epstein, 2005, p.3), of the economy is a widely observed phenomenon. Privatisation is clearly making a significant contribution to that process of financialization. As has been discussed it is seen to contribute to the growth of financial markets and provides significant income for the financial sector. But a much more significant element comes from the increased role of financial motives and financial institutions in the operation of large public utilities. Further, privatisation serves to inject financial motives into the provision of a range of public services. This is probably the most significant aspect of privatisation with regard to finance. As the quote from Epstein indicates it serves to inject financial motives and institutions into the operation of public utilities and services.

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1) This is a report for Work Package 2 of the PRESOM project. Malcolm Sawyer has taken editorial responsibility for this report. The report incorporates material written by John Groenewegen, David Hall, Jacques Mazier and Malcolm Sawyer.

2) Normative agency theory (AT) is located at layer 4 and positive agency theory is added to level 3.