

PRIVATIZATION POLICY: ITS ECONOMIC AND SOCIAL IMPACTS

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Abstract

Privatization is one of the major policies to the world for improving the ill-health of national economy. Its primary goal is to reduce the financial burden of government through privatization of all loss makers' public enterprises. Besides this, it also helps to increase the competition among all privatized enterprises to promote productivity and profitability. It makes able to all privatized enterprises to operate freely in context to quality, quantity, taste, design, colour, packaging, pricing, promoting for generating the profit. Consequently, privatized enterprises use full resources, increase productivity, run in profitability, develop rapidly, provide more jobs to unemployed workers with high salary and benefits, pay more taxes to government, raise per capita income, facilitate consumers to select desired products, bear well responses to society. Lastly, nation improves itself economically and socially. This paper embodies the discussion of concept, objectives, methods, impacts and conditions for success of privatization.

Key words

Privatization; public enterprises; privatized enterprises; productivity; profitability

Introduction

After the great depression of 1930 and 2nd world-war, many public enterprises were established all over the world to meet the national, international demand and for improving the national economy by mobilizing labor, capital, capacity, and the national resources available in the country. Really, surplus generation was also necessary to them for the long life existence, growth, expansion and for declaring the dividend to shareholders

and paying the governmental revenues etc. But, most of the public enterprises failed in these tasks due to low performances, huge accumulated losses, rigid bureaucracy, cost insufficiency, poor management, overstaffing, economic corruptions and negligence. Mostly, were not in a position to survive them without taking the huge amount of subsidy from the government. They have been creating the financial burden to the government year by year for even survival. Then, in 1969 as

a resolution of problems created by public enterprises, the term 'Privatization' was first originated and used by Drucker (1969) in his book 'The age of discontinuity'.

Therefore, 'Privatization' as an English word is totally a late comer. The word 'Privatize' first appeared in a dictionary in 1983 and was defined narrowly as 'to make private' especially to change (as a business or industry) from public to private control or ownership (Webster, 1983).

According to the World Bank (1988) Privatization is broadly defined as increased private sector participation in the management and ownership of activities and assets controlled and owned by government.

In the words of Shirley (1988) Privatization is not only the sale of state assets to the private sector but also privatizing the management of state activities through contracts and leases and contracting out activities that were previously done by the state.

Pant (2002) argued that the term 'Privatization' is as the participation of private sector in the management of enterprises or selling it or giving on lease or transferring of government ownership to private sector, employees, or desirous groups either partially or fully in such an enterprise.

Thus, privatization is generally regarded as the recent origin. It is the transfer of ownership or control of an enterprise from the public to private sector through financing, leasing, contracting and divestiture or liquidation.

Now, there is a rapid wave of privatization all over the world. The State Owned Enterprises (SOEs) are decreasing rapidly all over the world. Since 1990, more than 15000 SOEs in over 100 countries have been privatized. However, privatization has not been recognized at each and everywhere with the same name. Privatization has different nomenclature in different countries like as: 'Privatization' (in Nepal), 'Disinvestment'

(in India), 'Prioritization' (in Australia), 'Industrial transition' (in Bolivia), 'De-statization' (in Brazil), 'Popular capitalism' (in Chile), 'Economic democratization' (in Costa-Rica), 'Partners-in-development' (in Egypt), 'Disincorporation' (in Mexico), 'Assets-sales programme' (in New Zealand), 'Peopleization' (in Sri Lanka), 'Transformation' (in Thailand), 'Restructuring' (in Tunisia), 'Denationalization' (in U.K.), (Narain, 2003).

Objectives of privatization

Many economists have presented their views about objectives of privatization in the world. According to Joshi (2003) the major objectives of privatization are to reduce the financial burden of government, access the private finance, increase competition, increase efficiency, mobilize resources, increase production, improve the financial return, fulfill the social objectives, dilute the strength of trade unions, and develop the domestic capital market.

A few objectives of privatization such as to raise cash through SOEs sales, reduce the role of state in the economy, increase exports, attract Foreign Direct Investment (FDI) and new technology, contribute positively in economic and social aspects of national economy are pointed by Lieberman (1993). Besides, Veljanouski (1987) had also argued about objectives of privatization those are to raise revenue and create an enterprise culture.

Methods of privatization

Some methods of privatization are discussed as follows:

- Corporatization:- This method of privatization is also known by the name of Organizational restructuring. Generally, public enterprises operating as departmental undertakings or as statutory corporations are transformed into joint stock companies with a view to helping them to operate better as Commercial entities. The Industrial

Finance Corporation of India, the first public sector financial institution established in 1948 under act of parliament was converted into a joint stock company called IFCI Ltd., in July 1993. It now enjoys greater operational freedom (Narain, 2003).

- Sale of enterprise assets:- Under this method of privatization, sale- transaction consists basically of the sale of assets, rather than shares in going concern (Vuylsteke, 1988).
- Leasing:- leasing is another modality of privatization. It is a contractual agreement between the owner of an assets (Lesser) granting another party (Lessee) the right to use the assets and to profit from it for an agreed period of time in return for payment of rent. The key feature of a lease agreement is that the ownership remains with the government while the Lessee assumes full responsibility for operations and maintenance (Mandal, 1994).
- Management contract:- In this method of privatization, the management contractor assumes the responsibilities of managing the enterprise to get the best possible results. Here, the contractor receives the agreed fees from the state sector unit for the services extended for a time. The length of contract and method of payment vary from the case to case (Mandal, 1994).
- Contracting out:- In contracting out, a public authority contracts a private firm to perform some specific service in place of a public entity. This would involve decision of an enterprise to acquire an input from outside sources instead producing it itself. This method has been a success where the contractor has the requisite know-how and equipment for carrying out the services. It has been mainly used in the U.S.A. where advantages of reduced cost have been noticed (Shukla, 2003).
- Liquidation:- Liquidation means to close-down when the state enterprises have been suffering from losses since last many years. Neither their possibilities of privatization by any method are there, nor can they be survived in any way. At last moment, a government does not want to protect them in long run except to close them. At that time, a government liquidates them legally for improving the national economy by eliminating the burden of ex-chequer. Therefore, liquidation is also seemed as method of privatization (Yadav, 2009).
- Divestiture:- Under this method, a government sells the shares of state enterprises to the private sector. In the words of Narain (2003) divestiture can be classified into three groups as (i) full divestiture (ii) Partial divestiture with majority equity being held by the government. (iii) Partial divestiture with minority equity being retained by the government. In recent years, divestiture method of privatization looks like so popular in the world.
- Co-operatives:- The responsibility to run public enterprise can also be given to a group of people under co-operatives. For example, agricultural co-operatives or farmer associations can be formed within the agricultural sector to take over functions previously run by public enterprises (UNDP, 1991).
- Management/Employee buy-out:- This buy-out generally refers to the acquisition of a controlling shareholding company by a small group of managers/employees or both. This is a noble method of privatization (Mandal, 1994). For smaller companies particular those that are highly dependent on their personnel, this method can be successful to them (Narain, 2003). This method is widely

used in Britain, India, Russia, etc.

- **Deregulation/ Liberalization:-** Deregulation means the removal or loosening of government restrictions on pricing, output and investment decisions of both public and private industries (Weyman, 1993). Privatization thus is one of the most important aspects of liberalization or deregulation. Lesser (1991) has observed as "it is shown that privatization without deregulation will not necessarily improve efficiency".
- **Franchising:-** Under franchising, public authority is given to the private sector for delivering of certain services in designated geographical areas in return of royalty from the private company (Paul, 1985).
- **Concession:-** Concession involves transfer of operating & development rights to a private operator by the state. Concessions can be granted at the municipal level, national level or international level. The state can grant concessions directly or through public enterprises. Unlike leases, holder of a concession has responsibility for capital expenditures and investment. Concessions have been used in Argentina for privatization of railways and telecommunications (Shukla, 2003).

Impacts of privatization

Some views of philosophers about the impact of privatization are discussed here under economic and social impacts:

A. *Economical Impact:*

- **Budget deficit reduction:-** Privatization programme has been able to help the curtail budget deficits to the government by way of "not having to support loss-making public enterprises" (Manandhar & Bajracharya, 2000).
- **Output diversification:-** Privatization

often emphasizes to produce outputs as required of consumers. Thus, privatization usually encourages the diversification in outputs as choice of consumers (Yadav, 2009).

- **Production increment:-** In majority of enterprises, production has been increased in average after privatization (Shrestha, 2004).
- **Investment increment:-** Privatization programme has helped to increase private investment. IT has also brought some foreign direct investment (Yadav, 2009).
- **Capacity increment:-** Privatization is the market oriented economy. Consumers are always the king in this economy. They often want to buy their required products at lower price with good quality. For supplying the outputs in time as required quantity of consumers at lower price, privatized enterprises often utilize the full capacity of their plants. Thus, installed capacity has been increased by majority of enterprises after privatization (Shrestha, 2004).
- **Improvement in profitability:-** Privatization does not mean the government pulls out from industrialization. Japan is a very good example of privatization that did well in setting up industries and leaving it to private sector as soon as it became profitable (Upadhya, 2002). After privatization, mostly privatized enterprises have improved their profit and loss situation in more or less (Yadav, 2009). So it is believed that privatization is done for improving the profit.
- **Productivity increment:-** Productivity is simply defined here as the units of outputs divided by the total number of workers. Since private enterprises are not financially supported by the government, they are often engaged to earn maximum

financial return for surviving by using their labour-forces effectively in production. The productivity performance of the privatized enterprises is seen as good in comparison of before privatization (Yadav, 2009). So, privatization often encourages the productivity of a firm.

- Technological development:- In the words of K.C. (1999) "Many privatized enterprises are found involved in technological development." Because, it makes possible to produce outputs and provide services effectively as required of their consumers for timely earning purposes. Hence, privatization also encourages involving new technologies in the firm.
- Sales increment:- There is no political interference and governmental financial support in privatized enterprises. This makes independent of all. This increases efficiency to them. The increase in efficiency means increase in production and reduction in cost. Cost reduction and quality increment mean increases in demand of consumers. The increase in demand means increase in sales volume. So, in the privatization, sales often increase in comparison of previous sales (Manandhar and Bajracharya, 2000).
- Improvement in export:- In the words of Manandhar and Bajracharya (2000) "privatized units have also been able to generate export potential In terms of export performance, there has been a notable positive improvement in privatized units." So, it is cleared that privatization improves the export performance of a firm.
- Development of the capital market:- According to Manandhar & Bajracharya (2000) "public participation in privatized units through share ownership has contributed to the development of the capital market in the country." Thus,

privatization often emphasizes to develop the capital market in a country.

- Contribution to GDP:- Competition is an essence of privatization. Privatized units have to compete everywhere in regard to products/services/profits for surviving themselves. Nellis & Kikeri (2002) have also argued that in competitive industries with well-informed consumers, privatization consistently improves efficiency. Such efficiency gains mean a one-off increase GDP, but through improved incentives to innovate and reduce costs also tend to raise the rate of economic growth. So, privatization often contributes positively to the GDP of a country.

B. Social Impact:

- Employment generation:- According to Shukla (2003) "privatization will help in expanding an enterprise and an industry, in the long-run creating more jobs and generating wealth for the country".
- Nature of job:- Privatization usually prefers the contractual, temporary, daily wage & piece rate wage of jobs instead of permanent nature of jobs (Yadav, 2009).
- Job security:- Under the privatization, feeling of job insecurity is high amongst workers. In the words of K.C. (1999) "privatization has failed to provide job securities to the employees to a large extent".
- Job losses:- According to Manandhar and Bajracharya (2000) "job losses have occurred in almost all privatized units".
- Salaries & other benefits:- Privatized units often maximize profits by seeking out the least costly clients or by employing lower wage workers, often on a part-time basis (Starr, 1988). Hence, it is cleared that privatization does not provide good salaries & other benefits to the workers in

compare to SOEs.

- Worker's exploitation:- In the privatized units, most of personnel are hired on contractual or temporary basis. Personnel are so weekend by heart & moral. Due to the fear of losing the job, they are more exploited by the firm in regards of salaries & other benefits (Yadav, 2009).
- Working hours:- Since the philosophy of privatization belonging to the profit motives, privatized enterprises are often exercising to maximize their profits by increasing working hours of workers with providing them minimum economic facilities. The increase in any benefits is being compensated by increase in work hours (Manandhar & Bajracharya (2000).
- Leaves & training facilities:- According to Shrestha (2004) "majority of respondents are found not very much satisfied with the monetary benefit and training facilities provided by the privatized firms.
- Worker's moral & job satisfaction:- In the words of Manandhar & Bajracharya (2000) "the worker's moral & job satisfaction have declined in the privatization in compare to SOEs.
- Job sincerely:- Generally, privatization acts as a fuel to fire to the workers. Workers are always working with very sincerely by the fear of losing the jobs. Through field visits, it is found that almost all workers are too sincere on their duties in the privatized enterprises (Yadav, 2009).
- Social responsibility:- According to Agarwal (2007) the private sectors do not care the responsibilities as well as SOEs.
- Managerial efficiency:- In the words of Boukbari & Cosset (1998) efficiency in divested firms in the middle-income economies has been quite favourable while the same did not apply to the firms

in the low-income economies.

- Industrial relations:- In privatized units, the fear of losing the jobs have contributed to seal off collective labour disputes and establish the good industrial relations in between employees & Management (Manandhar & Bajracharya, 2000).

Conditions for success of privatization

In the context of its implementation, Paul (1985) has advocated that if privatization is to be succeed in the sense of raising efficacy or effectiveness in the production or delivery of goods and services, certain conditions must be met which are as follows:

- Political commitment:- For privatization, there should be the hall-mark among all political parties at high level.
- Freedom of entry:- For privatization, there should be freedom of entry of private enterprises in production & distribution sectors.
- Avoid fraud:- For privatization, all harmful actions against of consumers should be avoided by the private enterprises.
- Transparency:- The privatization process should be transparent and effectively communicated. There should be no room for corruption.
- Liberalization:- It must be in financial sectors. As a result, chances of private monopoly would not be there and exploitation of consumers is also impossible there.
- Educating consumers:- Consumers should be able to study the benefits they receive from a service to the costs they pay for it. Education & information are also necessary for the success of privatization.

- Policy environment:- Government policy and legal environment should be suitable for the privatization.
- Developed capital market:- For privatization, capital market should be developed for selling shares/assets of the enterprises.
- Administrative capacity:- For privatization, effective administrative capacity is required to evaluate the assets of SOEs, to assess the bids made by potential buyers, to select the best one method of privatization, to arrange finance, to cover insurance, to deal with the complex legal entanglements, etc.
- Social cost:- For privatization, labor issues should be cleared before it.
- Adequate preparation:- A government is necessary to do adequate preparation about privatization program and its implementing strategies before stepping in privatization. Objectives of government, methods of privatization and priorities of public enterprises for the privatization should be cleared.

Conclusion

Conclusively speaking 'privatization' is derived by Drucker in 1969 A.D. as a resolution of problems created by public enterprises in the country. Certainly, its main objectives are to improve the nation economically and socially through free-market competition. Its economical impacts are seen totally positive on a firm but social impacts are moderate. However, its moderate impacts can be converted into positive by a government through launching privatization program carefully with its successive conditions. Then only, a nation would definitely improve economically and socially through privatization. Thus, privatization has become a global phenomenon in recent years.

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