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Privatization in Nepalese Context

Ishwor Dhungel*

INTRODUCTION

Sometimes ago privatization was surprising matter to many observers familiar with the Eastern European environment. For, if the communists had any success in their attempts at ideological indoctrination, it was in persuading many Eastern Europeans that private property in the area of large industry was a thing of the past.

Few oppositions arranged for and much of them in the last years of communism, came from worker movements for instance, the Polish Solidarity Trade Union was for decentralization, with at most a marginal role for private property outside retail trade and the service sector. In this regard it becomes worthy to mentioned it here that following the collapse of communism, privatization became the word of the day, and many influential East Europeans became, at least on the surface, the keen proponents of the purest version of capitalism.

Now, these days privatization is still talked about and seemingly pursued, but the results are mixed. It is too early, of course, to judge the effects of privatization where it actually occurred, but it is not too early perhaps to observe that not much of its occurring in most places, and that what does occur, is much more vague than originally expected.

Very broadly, privatization should be understood as a transfer of assets, entrepreneurship from the state to the private sector. One can say that it is accompanied by radical reallocation of available productive resources, restructuring of the existing institutional setting in which production takes place, and the introduction of new methods of corporate governance, freed from the most noxious kinds of political interference. Regarding this matter one could expect privatization to lead to far reaching economic and social transformations, but a mere transfer of title is unlikely to have such an effect.

So far it is learned that privatization, where it has occurred, has been the most effective in retail trade and the service sector. But the nature of this phenomenon only highlights the complex meaning of the term privatization. Most stores and service outlets in Eastern Europe hardly resembled their western counterparts: the constant shortages meant that their inventory was not worth very much, and their substandard service did not create a great amount of valuable *goodwill.*

Regarding the above mentioned matter, it is interesting to note that, in most cases, the privatization of the retail sector did not entail a transfer of the ownership right to the premises; instead, the state retained

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* Mr. Dhungel is associated with EAST Consult, Kathmandu, Nepal.

the title and most of the premises have been merely leased for relatively short periods of time, often with no secure right to new one and a number of burdensome restorations. It is, thus, difficult to decide whether to count, the new units operating in the premises as new or *privatized* establishments. What is quite clear, however, is that the partially released real estate assets have often been used effectively by the private business now controlling them. The vibrant present in this area is quickly transforming the production of goods and services in a number of countries in the region. What is also interesting is that, once a significant private sector appears, the success of further transformation in the trade and service area may depend as much as on the change in the general economic environment including monetary stabilization, currency convertibility, and price and trade liberalization on the completeness of the privatization itself.

Part of the reason why small privatization has been a relative success in some countries is that it raises few of the hugely complex corporate governance problems endemic in all efforts to reform large industries. The privatized shops and services outlets are usually owner managed, and the low capitalization requirements make for a potentially lively secondary market that is able to correct for many mistakes in the initial allocation. For this reason, it may not be particularly important whether the state turns over the running of small business to workers or whether it sells them to the highest bidder in an open competitive process, for instance the case in the former Czechoslovakia, so long as there are no crippling transferability restrictions on the privatized assets.

So far, receiving information and observing situation is more complicated in the case of larger industries, where privatization encounters serious technical and political obstacles. The initial difficulty faced by the state, if it wants to withdraw from ownership, is the need to find and empower new owners. The first instinct of Eastern European policy makers and their western adviser was to avoid any experiments and follow well known precedents, like the British style privatization which involved selling shares to the public or to a selected number of private investors.

PRIVATIZATION: FAILURE OF WESTERN MODEL

It is well recognized that the attempts to enhance western privatization were, by and large, a failure. Some Eastern Europe enterprises have in fact been sold to outside private investors because of the unattractiveness of investment in Eastern Europe state enterprises, the slowness of the process, the problems of valuation, the shortage of domestic capital, and the unwillingness of foreign investors to enter at a large enough scale.

Hungary exemplifies this type of development, where a decentralized enterprises resulted in a different system of institutional cross-ownership, with companies and banks holding assets in each other. Hungarian economy is likely viewed as the most advanced in the region, yet a very small proportion of large Hungarian enterprises is actually privately owned. Now somewhat paradoxically, the sales-driven transformation of the Hungarian economy not only negated a large-scale privatization but also has hampered the emergence of a clear system of property relations.

Till this date it is reported that the most successful mass privatization programmes has been in the former Czechoslovakia. The plan involved a distribution of special vouchers to every interested citizen. The recipients could then use privatized enterprises of their choice and deposit them in an intermediary financial institution ,may be an investment fund, offering greater investment expertise and diversification. On the supply side, each enterprises and other interested party could propose a privatization project specifying the method of disposition of the shares of the privatized enterprises, including some combinations of vouchers sales, trade sales and sales to enterprise insiders. In a coincidence that may have been crucial too to the plan's success, enterprise insiders often proposed that a very large portion of the shares to be sold for vouchers, apparently in the belief that dispersed public ownership would facilitate the retention of insider control.

What is also interesting is that the Czechoslovakia's plan, with its large measure of external control over the namely privatized companies, is so far unique than somewhere else where privatization plans have been proposed, but the very threat of outside control immediately made it an object of intense political controversy. Similarly in Hungary, where enterprise managers have dominated the privatization process, mass give away plans have been described as anti-capitalist and have never been given serious consideration. In Poland, proposal of this kind have been discussed since early 1990 but due to some political controversy it is under process. Likewise in Russia, a mass privatization programme is underway.

These days in Russia every citizen receives, free of charge, vouchers with the nominal value of 10,000 Rubles. The plan contains a number of features, including immediate and unlimited transferability of all shares and vouchers, which seemingly facilitate the acquisition of control by enterprise outsiders. But the program also offers insiders unprecedented me preferential terms, allowing them to acquire up to 51 percent of their companies at 1.7 times book value unadjusted for inflation. In addition, Russian law prohibits investment funds from owning more than 10 percent of the shares of any one company, thus effectively confining them to a subsidiary role in the governance of the privatized enterprises. Russian economist believed that the introduction of a more open system, modeled on the Czechoslovakia's programme, was not a politically viable option in Russia.

In this connection one can say that the programme should be strengthen the role of the workers, who are more interested in achieving employment than maximizing profits, since wages are likely to be significantly more important to them than dividends. It is a universal truth that the managers, especially in less viable enterprises, are likely to view the continuation of state subsidies, rather than the costly and controversial restructuring, as their dominant goal, though there is some hope that the managers of the more viable enterprises will show some interest in breaking away from the old mold. Most of the Russians hoping that secondary markets will develop quickly enough to permit subsequent corrections in the initial distribution of ownership rights, with the workers in particular cashing in early on their substantial capital gains. Unfortunately, there are some reasons to doubt that secondary markets will be able to play such a role in the near future. Economists are arguing that the most serious obstacle to the creation of viable secondary capital markets in Russia is the potential lack of demand for the share of the privatized companies. In the conditions prevailing in Russia, however, it is not clear that an outside investor can expect to achieve either of these goals.

Under current Russian conditions, however, the financing of large enterprises is done largely through generous credits backed by the nearly unlimited printing capacity of the central bank. It is also known that the incentives for outside investors to acquire control positions in the privatized Russian enterprises are also problematic. To begin with large concentrations of capital necessary for takeover of large firms are not likely to exist for sometime in any East European country. There is a risk that the Russian state may not be able, at this time, to provide sufficient protection of property entitlements and realistically enforce the right of significant external enterprises.. This risk is especially likely if an assertion of external control rights over a significant proportion of Russian enterprises were to lead to a threat of large scale unemployment and labour unrest .

NEPALESE CONTEXT

As far as Nepal is concerned, it is commonly known that the majority of the existing 62 public enterprises are operating unsatisfactorily. The government has been bearing the financial losses and also fulfilling their managerial responsibilities. Such a situation cannot be described as conducive to the economic growth of the nation.

As we know, His Majesty's Government of Nepal has called upon the private sector to play a more dynamic role. The Government has accordingly adopted various policy measures to encourage the private sector to increase their participation. These policies are based on minimizing the interference of the government in production, distribution and pricing activities in order to give the private sector maximum possible freedom in operation. At the same time, the government has adopted a policy of privatization, so as to reduce its financial burden and administrative responsibilities, release funds for better alternative uses, enhancing operational efficiency resulting in higher productivity, encouraging the growth of the private sector and increasing public participation in the efforts to industrialize the nation.

Accordingly, His Majesty's Government has already privatized the Bansbari Leather and Shoe Factory, the Bhrikuti Paper Factory, the Harisiddhi Bricks and Tiles Factory. All these factories are reported to be improving their performance, both in terms of quantity and quality. The process of privatizing the Balaju Textile Industry, the Nepal Film Development Company Ltd. and the Raw Hides Collection and Development Corporation have also been completed recently, and the Seti Cigarettes Factory, the Nepal Foundry Industry, the Agricultural Tools Factory, the Dairy Development Corporation, the Raghupati Jute Mills, the Nepal Lube Oil Company, and the Nepal Bitumen and Barrel Ltd. are said to be the next in the list of privatization. After completing the privatization of some of these enterprises, the experiences gained will be utilized to refine the privatization policy, and another privatization programme will be designed accordingly and the process of the privatization will be continued in a more systematic manner.

Thus, various experiments are being carried out in different countries. The experience gained so far does not give the clear picture of the road ahead in the process of privatization. If it is used properly in the right way, privatization might be a useful instrument to exploit the available resources and make a nation economically sound, otherwise dismal picture and controversial result might be appeared. One can hardly deny that there is no way of success without exposing to risk. This is the age of market economy, it will, therefore, be no exaggeration to say that the policy of privatization is very useful. Accordingly, this policy is gaining ground rapidly all over the world and becoming a powerful instrument day by day. This is true and applicable both in developed and developing countries, including Nepal.

CONCLUSION

It is clearly too early to pass any definite judgement on the success of the privatization programme especially with respect to the establishment of a clear and secure system of property rights. Till now privatization programme has resulted in large degree of decentralization of economy's decision making, which is certainly not equivalent to the introduction of a governance structural characteristic of modern capitalist economy. Whether this decentralization will also turn out to be a genuine and lasting, privatization is a matter that will become clear only with passage of time.

The World Bank's economists conclude that three tentative conclusions can be formulated on the basis of the first three years of the privatization experience in Eastern Europe. First, the meaning of privatization in the context of Eastern Europe has turned out to be complex and often ambiguous. Instead of the expected clarification of property rights and the establishment of a system of economic incentives, the characteristic of a capitalist society, the intended privatization process has so far resulted in a maze of complicated economic and legal relations that may sometimes even empede a speedy transition to a system in which the rights of capital are clearly delineated and protected.

Second, the conflict between the interests of insiders, intent on retaining authority over their enterprises, and the right of outside investors to acquire control, has consequences that are often overlooked. While much attention has been devoted to this conflict, it has usually been analyzed in terms of the special historical and political conditions of Eastern Europe and in terms of the standard incentive problem associated with insider control. What is worth drawing attention to, however, is that insider control and barriers to the entry of outsiders have also retarded the development of a system of clear property rights including the rights of those considered as the owners of capital.

Third, there appears to be a hitherto unrecognized connection between the absence of monetary stabilization, with the associated soft budget constraints at the enterprise level, and the absence of a clear system of property rights to capital. By weakening the commitment of firms to fulfill their promises to the providers of capital, soft budget constraints contribute to a situation in which the rights of owners of capital can not be firmly established.

Seventy years of communism have not resulted in the predicted withering away of the state. Perhaps not very surprising, the elimination of the inherited hypertrophy of the state in the post communist economies of Eastern Europe is also proved to be much more difficult than originally expected.

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