# SYMPOSIUM ON THE PRIVATISATION OF STATE ASSETS AND STATE COMMERCIAL COMPANIES

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## INTRODUCTION

This paper is meant to offer an outline of some theoretical and empirical considerations affecting privatisation The emphasis in on the implications of the economics of property rights for the implementation of economic policy Its main conclusion is that privatisation is for the most part an unnecessary exercise, and is really only justified in limited circumstances Most of the advantages associated with privatisation are in fact due to commercialisation and liberalisation In a competitive environment, the *nett* efficiency gain from privatisation is likely to be small if it exists at all

The paper outlines reasons for suspecting that some of the motives behind the drive towards privatisation are based on misunderstandings about its end results "Popular Capitalism", or "solving the national debt problem" turn out to be doubtful starters

Part I contains some comments on the issues – the objectives of privatisation Part II looks at the basis for the perceived "inefficiency' of public sector production Part III surveys some empirical and theoretical evidence on the consequences of privatisation and liberalisation Part IV attempts to draw some conclusions for Ireland

## PART I PRIVATISATION THE ISSUES

The issue of privatisation is by and large presented in terms of economic costs and benefits, even by those who argue on overtly political grounds The economic debate centres around evidence on the role of privatisation as a means and as an end, the political debate might perhaps be described as a dispute as to whether

(a) privatisation is the effective means to an end which some assert it to be, and

(b) if it is such a means, whether the end justifies the means

### The End – Greater Economic Efficiency?

Traditionally, economists evaluate policy changes in terms of their impact on economic welfare by assuming that costless (or very low cost) mechanisms

for redistribution and compensation exist, and then asking whether the proposed change increases conventionally defined economic efficiency If it does, then, subject to some reservations about compensation mechanisms, they propose that the change be adopted

Social choice economists start from the position that possibilities for Pareto improvements are non-existent (outside prisoners' dilemma situations) and that the key to the acceptance of any proposed change lies in the bargaining strengths of the interest groups affected by the proposal In such a scenario Government acts more as a protagonist than as a redistributing mediator The end result of change is the emergence of nett gainers and nett losers There may well be *no* offsetting compensation Policy changes in general *cannot* improve everyone's welfare if such changes had been feasible, it seems reasonable to assume they would have been adopted uncontentiously at some previous date

The commonly assumed aim of Government to encourage greater economic efficiency, then, implies changes which, while they may well raise the level and growth rate of GDP, will inevitably involve redistributions of real incomes In the context of the privatisation debate, this approach emphasises that what is being sought is a redistribution of property rights in order to achieve an increase in conventionally recorded economic efficiency That is, that losses are to be imposed on one or more sections of the community in order to benefit others, while in so doing, raising the value of aggregate real income The decision on whether to support privatisation will presumably reflect on evaluation of the individual and overall gains and the losses to be incurred

**Or Reducing the National Debt?**

Recent developments in the UK have introduced a new dimension to the discussion on privatisation – the impact of the policy on the public finances (Heald, 1984) The peculiar British practice of treating the receipts from privatisation effectively as current revenue (implied by calculating the PSBR nett of sale of assets) rather than a once-off inflow (a method of financing the PSBR) has given rise to confusion in Ireland It has been suggested that an aggressive policy of privatisation could play a major role in sorting out the country's fiscal problems This is entirely illusory – even if the amounts which could be raised were as high as have been suggested in newspaper comments (Sunday Independent, 1987)

The impact of privatisation on the public finances depends, in the first place, on the type of asset being sold For argument's sake compare a sale of the ESB to a sale of Great Southern Hotels (which we shall assume to be profitable) The ESB, not being a joint stock company, the sale is "off balance sheet" to the Government Since the Government is the taxpayer at one remove, selling the ESB would increase the nett worth of taxpayers by an amount equal to the value of the government bonds, bonds which could be retired using the proceeds of the sale If the shares in the ESB were bought

domestically, the nett worth of the private sector would remain unchanged since, in effect, bonds would have been exchanged for shares in the ESB Since the ESB pays no dividends to the Government, government revenues would not be affected by the sale This looks like a free lunch the taxpayer's gain, while the private asset holders' nett worth is unchanged Not so, unfortunately there has to be losers somewhere, as suggested in the last section In this case the losers would be whoever was enjoying the rents being generated within the ESB, the present value of which determines what the market would pay to purchase the ESB Privatised, the ESB would distribute these rents to the stockholders In the case of GSH, there would be no gain to the taxpayers, since the proceeds of the sale would represent the present value of the future stream of profits being transferred to new owners, and would equal the present value of future taxes avoided through retiring bonds with the proceeds of the sale

Now allow the possibility that government debt can be held by foreigners as can equity in de-nationalised industries Privatisation followed by a reduction in foreign-held government debt merely alters the *composition* of foreign asset holders' portfolio Future *tax* liabilities are replaced by future *dividend* liabilities The overall national position is unchanged we owe foreigners as much as before All that has changed is the method of payment Instead of being obliged as *taxpayers* to raise funds to remit abroad, we are now obliged as *electricity-users* and/or producers to produce and sell energy at a price and cost sufficient to generate a flow of dividends to the foreign owners of the ESB The GNP/GDP gap will in principle be unaffected by the transaction As a community we shall be no better off To promote privatisation, then, as a remedy for our fiscal problems, or to reduce the national debt, or to pay off foreign borrowings is misleading

This "rationale" for privatisation has been credited as a major factor in determining the attitude of the UK Government, especially in the second round of sell-offs (Kay and Thompson, 1986) In the cases of the airports (BAA), British Airways, Telecom and British Gas, and in the proposed denationalisation of electricity, HMG did nothing to ensure that any substantially increased competitive pressures would face the firms they were proposing to sell In part at least this seems to have been done in order to maximise the price at which the Government could sell its interest while still providing an attractive stagging profit to successful share applicants Although the sales would do nothing to change the *nett* worth of the taxpayer (profits foregone would equal tax saved) the Government was anxious to reduce *gross* public sector liabilities as much as possible - in the main because this maximised the potential for tax-rate reductions (Brittan, 1986)

The gains in terms of the benefit supposed to flow from the efficiency consequences of lower taxes will, then, have been achieved at the expense of minimising the efficiency gains potentially achievable from replacing a public sector monopoly by competitive private sector supply.

### Or Is It Basically Political?

The most comprehensive recent survey of the privatisation experiment in the UK came to the conclusion that the programme's execution suggested " that economic efficiency has systematically been subordinated to other goals" (Kay and Thompson, 1986) One of these other goals, already discussed, was the achieving of fiscal room to cut taxes Another, express, goal of Mrs Thatcher is to achieve wider share ownership This aim goes hand-in-hand with her desire to increase home-ownership in the UK, to be achieved by the very popular means of selling off council housing to occupants at knock-down prices Mrs Thatcher's long-term aim in doing this is to achieve a non-reversible shift in the climate of political opinion against the collectivist philosophy of the Labour Party Privatisation, then, must be seen as a single part of a broader programme which includes lower taxes, increasing private provision and finance for health, old age and education These deep changes require the creation of a stable coalition of interests committed to a non-collectivist political stance "Popular Capitalism" is seen as a necessary condition for such a sea-change in opinion The privatisation programme, then, has been introduced and orchestrated with this object in mind

By privatising, then, Mrs Thatcher would increase the size of the private sector, by ensuring that the allocation of shares was weighted in favour of small applicants she would widen and deepen the household sector's commitment to a market capitalist system To encourage the small investor, the terms on which the firms to be privatised were floated off were such as to guarantee a profit - even if only on paper - to those who were allocated shares This in turn required that the firms to be sold would be profitable hence the reluctance to break up the monopoly positions of those firms before or during the process of privatisation

## PART II ARE PUBLIC SECTOR FIRMS INEFFICIENT?

During the 1970's a considerable volume of research on the issue of the relative efficiency of public sector and private sector firms was published In the main, the empirical evidence was drawn from the United States, Canada and Australia Much of the US literature attempted to isolate the effect on prices, profits and costs of the ownership of firms in electric utilities Other studies examined costs in garbage collection, air and rail transport and franchising as opposed to direct supply of public sector services The overall picture obtained by examining these results is rather inconclusive

> " there is no systematic evidence that public sector enterprises are less cost effective than private sector firms "
> "Clear differences between public and private firms do appear [in] pricing and profitability [W]here firms have monopoly coverage of a geographic area the prices of private firms are

more closely geared to marginal costs and, cet par , public firms have lower prices and bigger output levels " (Millward and Parker, 1983)

The origins of this literature are to be found in theoretical developments in the 1960's and 1970's in the fields of property rights and transactions costs These highlighted the importance of institutional arrangements in determining the behaviour of economic agents They also drew attention to the impact of optimising behaviour on the evolution of market organisations (Furubotn and Pejovich, 1972) They shed new light on the rationale behind government regulation (Stigler, 1971, Posner, 1974) and the decision to produce certain outputs in the public sector (Borcherding 1980) They focused attention on the consequences of incentive systems in the context of the principal-agent relationship The more striking conclusions of this upsurge in institutional economics, relevant to the debate over privatisation, were the following

I Property Rights and Incentives

(i) x-inefficiency (see below) is the consequence of defective incentives structures,

(ii) managers of *all* economic organisations behave as objective function maximisers,

(iii) institutional arrangements are critical in determining the degree to which the organisation's incentive system succeeds in aligning the behaviour of maximising managers (agents) with the interests of the firm's owners (government or stockholders principals)

II Monopoly and Competition

(i) secure monopolies *always* enjoy rents, the presence or absence of accounting profits is irrelevant, as is formal ownership,

(ii) competition *always* erodes rents, but competition is not sufficient to induce a "competitive" price-output result

(iii) contestability of markets is at least as important as competitive structures in securing economic efficiency

III Government in the Economy

(i) public sector firms *which are not profit maximisers* will, cet par , seek different price/output/input combinations from profit maximising private firms,

(ii) the existence of market failure is not a *sufficient* condition to justify public production or regulation,

(iii) the case for *direct* public provision of a good or service depends on the prohibitively high costs of writing, monitoring and enforcing a contract for private supply,

(iv) Government regulation of private markets is at least as likely to be a device to diminish competition and enhance rents as it is to be a method of safeguarding the public interest

**Possible Sources of Public Sector Inefficiency**

In 1966, Harvey Leibenstein (Leibenstein, 1966) attempted to quantify conventional economic inefficiency in US industry by source He estimated that the loss to the US economy from "x-inefficiency" substantially exceeded losses due to monopolistic structures By x-inefficiency he meant roughly, 'slack' in the system inappropriate input proportions, under-utilised resources, unrequited demands Whether or not one accepts Leibenstein's quantitative estimates, what is important is the source of the phenomenon to which he was drawing attention - non-maximising behaviour by economic agents

Non-maximising behaviour is inconsistent with the basic concept of economic rationality - and Leibenstein's results must be accepted as a theoretical and empirical challenge to the fundamental paradigm on which the edifice of micro-economic analysis is based To rescue this paradigm it would be necessary to show how maximising behaviour by agents could and would produce the output/price results characterised by Leibenstein as x-inefficient Broadly speaking, the upsurge in research in property rights incentive systems and the principal-agent problem during the early 1970's produced a maximising explanation of Leibenstein's findings This was achieved by developing a property rights theory of the firm, and a transactions cost analysis of market-based resource allocation The core of both approaches is the economics of contractual relations

Firms are run by decision-makers who act as agents for the ultimate owners The decision-makers - managers - are assumed to behave in an economically rational fashion, maximising their *own* objective functions subject to the constraints they face These, in addition to the market condition for their outputs and the technology of production, include the incentives structures operating in the organisation Ideally, the principals will have designed the incentives structures in the contract of service in such a way that managers, to maximise their own objectives, must maximise the objectives of their principals

In the case of conventional firms, policing and enforcing of (even ideal) contracts is costly These costs constitute a constraint facing principals Hence, if principals' objectives (presumed to be consistent with the necessary conditions for optimal resource allocation) do not coincide *identically* with

those of management, some economic "inefficiency" is predicted as a combined cost-minimising contractual outcome In the context of Leibenstein's study, this means that "x-inefficiency" should be treated as a visible expression of a part of the transactions costs of using a market system where scale economies and other factors result in the use of a corporate structure

This theoretical apparatus may be applied to the analysis of decision-making by public sector management, whether in the central civil service, state agencies or in state-owned industries It implies that civil servants are not inefficient recipients of economic rents Instead, what conventional economic analysis treats as inefficiency is a combination of (a) the express execution of non-market resource allocation decisions (e g planning permissions) which require administrative safeguards against corruption (Rose-Ackerman, 1975), and, (b) the predictable maximising response of decision-makers in terms of price, quality and level of output where profit maximisation is not permitted, or when price, or quality, or output levels or allocation of outputs is politically determined The advantage of this approach to public sector economic performance is that one does not have to have recourse to the Weberian notion of the self-less and public-spirited public servant to explain the activities of state enterprise or civil service management This concept, an implausible *deus ex machina,* requires us to believe that people in the public sector as a rule have a *totally* different approach to life from those in the private sector, with disinterested pursuit of an ill-defined "public good" supplanting personal welfare in their objective functions

Instead, one can assume maximising behaviour, examine the theoretical implications of market structures and incentive systems and compare them with such observations as are available As it turns out, this methodology yields fairly impressive results and some important policy conclusions Public sector agents are treated as non-profit firms producing a commodity or service which they "sell' - either to Government, or to the consumers or to both (respectively, Health, Education, Electricity and Public Transport will serve as examples) In this analysis, two key questions are addressed what are the implications of not-for-profit organisation of the firm, and what are the implications of the market place for the firm s output? One approach to the public sector agency is to treat it as a not-for-profit firm which may be modelled as a form of labour-managed enterprise Under competitive conditions with free entry, theory suggests that there is relatively little difference between the *static* equilibrium value for price, output or choice of input, which emerges from assuming a conventional profit maximising firm as opposed to a labour managed firm This is hardly surprising, since such a market will drive all rents to zero, maximise nett output and allocate resources between firms so as to maximise total factor productivity Unhappily, it does not exist outside text-books (Meade, 1972)

The implications of more realistic market conditions may be examined first by relaxing the assumption of perfect entry or full contestability In that case, labour managed firms (now fixed in number) are predicted to produce a lower level of total output at a higher overall price and using more capital than their capitalist counterparts Further, LME's are predicted to display a much lower, even negative, price elasticity of supply, so that demand changes are to a greater extent matched by output responses under a regime of profit-maximising capitalist firms Under LME's, price adjustments bear the brunt of the response These conclusions apply to an increased degree under conditions of oligopoly or monopoly

Treating the public sector agency as a labour-managed enterprise yields, then, the following general predictions for their behaviour

(i) the level of output and employment - will be such as to maximise income per worker rather than equate the marginal product of labour to the going wage rate,

(ii) the public sector firm will seek to use more capital - and other factors - per worker than non-subsidised capitalist firms,

(iii) the public sector firm will show a *relatively* poor response in terms of supply of output to changes in demand

These predictions, which are reasonably consistent with the way in which public sector firms are viewed, flow from the incentive structures of LME's - in other words, the particular set of property rights

An alternative approach to the public sector agency assumes a management which maximises its *own* objectives (not worker incomes) subject to a no-profit constraint Instead of the profit maximising capitalist, the "firm" is run by a utility maximising management ("bureaucrats") Reasonably plausible assumptions about the bureaucrat's utility function coupled to the non-profit incentive structure produce the results made famous by Niskanen in his description of the "budget maximising bureaucrat" (Niskanen, 1971, 1976)

(i) under *monopolistic conditions* the level of output and the inputs chosen will be such as to equate expected revenues (from a budget allocation or from sales) to total costs incurred,

(ii) in general this will mean *either* over production (marginal cost exceeding price or marginal social benefit), or the incurring of unnecessary costs, or some of both,

(iii) The decision-makers in the agency will use political pressure and propaganda to increase government spending in the area they are concerned with,

(iv) the agencies have an incentive to conceal real information from Government on minimum cost methods of production

Summarising, this line of argument suggests that there are two sources of inefficiencies in public sector production

(a) property rights and incentive structures

(b) market structures Since defective market structures equally imply inefficiency for private sector firms, the issue of privatisation, strictly speaking, stands or falls on the cost and benefits of changing the ownership of the firms concerned In practice, however, the questions of privatisation and liberalisation usually arise together, since most public sector firms enjoy monopoly or quasi-monopoly status, either through statutory restrictions on entry or through subsidy based government protection

## PART III PRIVATISATION AND LIBERALISATION THE RESULTS

The evidence to hand may be used to evaluate the theoretical considerations outlined in the previous sections

**(a) Economic Efficiency** privatisation tout court has had little impact on economic efficiency Such benefits as might be expected to flow will do so only after a period of time, and after considerable internal re-organisation (a costly process) except in those cases where privatisation has been undertaken in the context of a competitive market On the other hand liberalisation has had substantial effects - although in some cases the results have been quite different from what was expected

Four British examples provide an insight into the impact of the Thatcher policies British Petroleum, Jaguar Cars, Telecom and National Express The key characteristics before and after recent changes are outlined in the accompanying table

In three cases ownership changed, in three cases the modus operandi changed, in only one case was there a substantial change in the firm's market position In two cases there was an "improvement" in conventional terms in economic performance But only one of these involved a change in ownership BP's performance has been unaffected by the denationalisation, Jaguar has recorded a dramatic improvement in market share and profitability, associated with an equivalent improvement in product quality, National Express has succeeded commercially in maintaining its market share while in the industry as a whole, fares have fallen and cross-subsidisation has been reduced (Davis, 1984), Telecom remains a matter for music-hall jokes

| | BP | Telecom | Jaguar | National Express |
|---|---|---|---|---|
| Industry | Oil | Communication | Auto | Road Passenger Transport |
| STATUS, M O | | | | |
| Before | Majority state shareholding | State-owned | State-owned | State-owned |
| | Commercial | Public service | Commercial /subsidised | Public service |
| | Contestable market | Monopoly | Contestable market | Monopoly |
| After | Private | Private | Private | State-owned |
| | Commercial | Commercial (regulated) | Commercial | Commercial |
| | Contestable market | Effective monopoly | Contestable market | Contestable market |

The key to a change in economic efficiency (in the short run) is clearly a move from an ill-defined "public service" approach to performance to commercial considerations, without subsidies - but only in the context of an existing or a newly contestable market environment The evidence on relative performance of public and private sector firms strongly supports this approach In terms of a static analysis of relative efficiency, private ownership per se is only weakly correlated with superior performance Even then, it is clear that the superiority of the private sector firm is related to *efficient resource use,* rather than to *consumer welfare* Monopolistic private sector firms will, cet par , be induced to use cost-minimising methods of production - admittedly, *private* cost minimising methods, they will be more likely to align prices to marginal cost in the different areas in which they operate, they will only use cross-subsidisation as a technique of deterring entry In a world of scarce resources this is, presumably, preferable to resource wastage Public sector monopolies - again by conventional standards - have a strong incentive to "waste" resources - although it must be accepted that some of the "wastage" is a supply response to politically determined quality or delivery characteristics of the goods or services they supply Public sector monopolies have good reasons at the margin to improve the welfare of vocal pressure groups either

by cross-subsidisation (i e at the expense of intra-marginal non-vocal groups) or by incurring production related expenses (i e by deviating from the requirements of productive efficiency) They are also vulnerable to external political pressure in these areas (Manning and McDowell 1985 chs 6, 7 8) At the same time, the performance guidelines imposed on them frequently bear little relationship to any economist's concept of efficiency

The only case for change of ownership above producing results is related to moves from civil service production to commercial production whether by public sector or private sector monopolies In this case "public service" (usually defined - cui bono? - by the civil servants in charge) considerations are replaced by "commercial" criteria as operational guidelines The moving of postal service in Ireland to An Post is a case in point the proposed transfer of forestry to some form of commercially orientated agency is another The fundamental weaknesses, however, remain in the absence of competition, consumer welfare is likely to take the back seat, and allocative efficiency, desirable as it may be, will do little to offset this Even this latter will be minimised if the commercial monopoly is a public sector one operating under "break-even" guidelines

Liberalisation, on the other hand, at both a theoretical and empirical level offers much greater potential benefits It much be emphasised that liberalisation implies not only permitting competition - but accepting *all* the possible consequences of competition as well, up to and including, especially, the possibility of bankruptcy and asset redistribution In the absence of this last commitment which, in Britain as well as in Ireland, has been the main cause of both the fiscal and resource waste cost of the public sector since the end of World War II It is a welcome development of late in Ireland that bankruptcy is now a possibility for public sector firms in this respect we have the endorsement of non other than Mikhail Gorbachev, who has made the same innovation in Leningrad!

Liberalisation basically reflects the view that regulation is an inappropriate method of aligning firm behaviour (public *or* private sector) with the requirements of overall economic efficiency when markets are contestable The criterion by which we may judge whether liberalisation works is whether liberalised markets, following deregularisation, move in the direction of the configuration which is implied by (perfect) contestability The overwhelming evidence is that they do Study of the US experience shows that in the airlines, telecommunications, stock-brokerage and surface transport sectors deregulation, while producing some surprising changes (the growth of the "mega-carriers" was not predicted, for example), has consistently pushed the sectors concerned towards a price/output/product mix/profitability configuration implied by the theory of contestable markets (Bailey, 1986) This means a move towards conventional economic efficiency In the two sectors where de facto, if illegal, liberalisation has occurred in Ireland (long-distance road passenger carriage and radio-broadcasting) there are clear signs that the

theoretically predicted results are being realised, too What are the limiting case characteristics of contestability? They are (Baumol, 1982)

(a) in any market producing differentiated goods, a wide range of goods will be produced, by single and multi-product firms, with zero rents in the production of each type of good,

(b) cross-subsidies will be eliminated, so that *all* goods are produced and sold at a price equal to or in excess of avoidable cost,

(c) overall costs or production for the industry will tend to a minimum

The impact of PAMBO buses on the structure and cost of the road passenger transport sector in Ireland is well known - as is the recent response of Bus Eireann to the market inroads of PAMBO This outcome is clearly in line with the prediction of the theory of contestable markets If the state bus company is financially constrained at least to break even, the outcome will be very close to that of perfect contestability It seems equally clear that it is only the (paternalistic(?)) public service function of RTE coupled to its licence for monopoly that prevents broadcasting from approximating to perfect contestability too

**(b) Political Considerations** The public choice approach to the debate on privatisation has two political angles to it In the first place, it states that the policy may be politically based, and aims a la Thatcher at altering irreversibly the manner in which a society's real assets are held This in turn underpins a political commitment to an individualistic, market dominated allocation of resources In the second place, it suggests a 'cui-bono?' approach to the marshalling of arguments and political pressure for and against proposed changes

If privatisation has had as its aim an irreversible shift to the right via increased direct private wealth-holding, it is certainly unlikely to achieve this aim through selling off the state commercial sector Even after Telecom had been denationalised in Great Britain, over 90 per cent of the population owned no shares An increase in the shareholding public from about six per cent of households to about nine per cent - even if it persists - seems unlikely to achieve this aim Despite considerable administrative effort to spread share ownership through discrimination in favour of smaller applications and prohibitions on multiple applications, the results have been disappointing Within a year of selling off British Aerospace to 160,000 shareholders, less than 30,000 shareholders remained, in the case of Jaguar, 60 per cent had sold out a year later Within 6 months of flotation, and despite incentives to hold onto shares the number of Telecom shareholders fell by 25 per cent (Buckland, 1986) In Canada in 1979 one third of the 2 million plus shareholders in BCRIC disposed of their holdings with 3 months of flotation (Ohashi, 1980) The reality, unfortunately from the point of view of those favouring a "people's capitalism", is that under existing tax provisions

affecting saving, direct holdings of equity are penalised relative to holding via claims on institutions In addition, consideration of optimal portfolio composition coupled to scale economies militate strongly in favour of indirect holdings of shares via claims on financial institutions

On the other hand - and perhaps reflecting the tax advantages - the UK government *has succeeded* in increasing the spread of the direct ownership of wealth by privatising the publicly owned part of the housing stock This has, however, also been due to a policy of selling council houses at a price considerably below their market value - an approach which has been initiated in Ireland The sensitivity of this programme to tax/subsidy arrangements, however, may be judged by the fact that recent cut-backs in grants were associated with a fall in the number of tenant purchases by over 50 per cent per annum in Ireland (information from the Department of the Environment) The second political angle is related to the implied re-distribution of real wealth in proposals to privatise or liberalise This helps explain both the orchestration of criticism hostile to privatisation and some of the tactics used in the process of privatisation in the UK

Broadly speaking, trades unions are opposed outright to privatisation On liberalisation, the hostility is less uniform - indeed one would argue that the trade union movement is split over proposals to liberalise This tells us something about well-founded perceptions concerning the likely results of such initiatives as far as unions are concerned Management, however, is ambivalent over privatisation - certainly in the UK, and that is probably generally the case in Ireland (S Independent, 1987) On liberalisation, it seems to this observer that management attitudes to it are the same as those of US industrialists to free trade it should be imposed on everybody else but the speaker When a monopoly is privatised, the new property rights will result in efficient input/output combinations Rents at present dissipated in low productivity factor utilisation, inefficient input combinations and other incidences of x-inefficiency will be transferred to the stockholders Effort-adjusted real employee income, cet par , will fall This, of course, includes the income of management Since, however, the firms concerned are monopolists by assumption, government has great difficulty in establishing what are the cost-minimising input uses, unless management has an incentive to co-operate in the process of privatisation, the likelihood of a successful sale is reduced

Trade union hostility to privatisation as opposed to liberalisation is rational and predictable in the case of most likely candidates A property right change which has little immediate effect on consumers' welfare but lowers the real rate of pay to workers in the firms concerned could hardly be expected to enjoy union support - even from unions unaffected by the proposal Management, however, can rationally expect to retain a share in the rents - even if at the expense of less security of tenure In addition in a competitive privatised firm management can look forward to salaries determined by market

forces rather than public sector pay considerations  Finally, management can expect to be allowed to manage

A government which is anxious to privatise as part of a programme for increased economic efficiency has to treat the above considerations seriously  To secure an increase in consumers' welfare, some increase in competition is necessary  To avoid costly confrontation with unions, re-assurance on worker nett wealth is required  To obtain the co-operation of management with new shareholders and, earlier, in the process of privatisation, the possibility of real income increases has to be held out  The mechanism adopted to privatise much achieve some success in meeting these partially conflicting targets  This in turn means trading off one privatisation objective against another  One cannot expect an economic efficiency maximising disposal strategy, nor can one expect the method of disposal to allocate all the rents, at their market price, to the new shareholders

The tactics adopted by the UK government in privatising Telecom, BAA, British Gas  I believe, can be rationalised on this basis  There has been considerable criticism of the failure of Mrs  Thatcher to liberalise while privatising in the case of British Gas, BAA, Telecom  Most of this has emphasised her presumed desire to maximise the market price so as to "reduce" the PSBR as much as possible  As we have seen  the use of state asset sales to reduce the tax burden is a strategy of doubtful rationality, since in capital terms the taxpayer's nett worth is unaffected unless rents of employees are reduced  But reducing management and worker rents makes a political acceptance of privatisation and a smooth transfer that much less likely

Equally, the view that the price and methods of sale used in the UK were designed to spread share-ownership (Buckland, 1986) suggests that the UK government not only took no notice of overseas experience, but didn't even learn from its own experience  If instead we regard the Government as aiming at using privatisation as a *means* to an end, the methods adopted become sensible, given the constraints

To secure *some* move in the short term towards increased efficiency, with a longer term prospect of a significant shift, privatisation has been accompanied by a limited (but expandable) element of increased competition (in the case of Telecom, Mercury is given rights, in the case of BAA, Manchester and some other airports are left outside BAA)  To ensure some rents remain, competition is restricted, these rents are then distributed between workers, management and shareholders by allocating shares at below market price to workers and managers  This serves to reduce trade union and management obstruction of the privatisation process  In other words, the Government's behaviour is explicable in terms of an attempt to maximise an objective - economic efficiency - subject to the constraint of a limited ability de facto to redistribute property rights  I find it easier to believe that Governments will, on

balance, attempt to behave rationally than that in general they (a) pursue self-contradictory policies, (b) never learn from their mistakes

## PART IV THE IMPLICATIONS FOR IRELAND

To date privatisation in Ireland has been very limited Under EC competition rules, dairy marketing has been removed from the state sector, NET has in effect been merged with ICI's Northern subsidiary to avoid closedown, there has been a sell-off of a substantial number of council houses As an unintended consequence of Government health policies (which has steadily raised demand by extending entitlements while holding publicly funded supply under control) a parallel private health service seems to be emerging - and causing much public resentment The proposed privatisation of Great Southern Hotels has been shelved Formally, very little has been done

The state sector, however, is clearly being *commercialised* In the context of a (presumed) competitive market environment this must improve resource use efficiency, and ought to increase market responsiveness and therefore consumer satisfaction The key factors here are the credible threat of bankruptcy (the Gorbachev weapon) requiring profitable current operation, and the withdrawal of the Exchequer from its role as provider of "free" equity capital B & I, Aer Lingus, the Sugar Company parts of CIE, Aer Rianta, the Post Office and even the universities are being asked to live in what economists have been calling the "real world" The fates of Ceimici Teo and Irish Shipping have had a salutary effect on what used to be referred to as 'semi-state bodies'

There is little stomach, however, for taking privatisation seriously either as a means or an end - the PD's being an honourable exception (Holman, 1986) There is even less for liberalisation, and there is no evidence whatsoever of any acceptance of radical thinking or restructuring markets by any form of anti-trust divestiture to achieve efficiency within the state sector Indeed, recent developments suggest the opposite - the vertical integration of gas supply, while administratively convenient was in *no* way required for economic viability and has in effect resulted in an inevitable further loss of economic efficiency through cross subsidisation and barriers to entry

The State persists in enforcing a cartellised retail petrol market in order (a) to protect a quite unnecessary refinery in Whitegate for what it is pleased to call "strategic" reasons, (b) to *ensure* that cross subsidisation of rural/remote consumers of oil products by those in more populated areas continues It appears that were it not for political discontent with political views within RTE we would be faced with regulations to protect the public from "uncontrolled" broadcasting - a cause espoused by the newspapers, who envisage eliminating advertising rivals while obtaining broadcasting rents to cross subsidise their existing over-manned organs The experience of Ryanair attempting to enter the market dominated by Aer Lingus showed clearly the

degree to which the state's regulatory powers can and will be used to prevent rather than encourage competition when a viable state-owned monopoly is threatened

In the UK, 'sponsor' departments of the civil service appear actively to have encouraged privatisation of state firms in their areas of responsibility There is no evidence of any equivalent attitude in Irish civil service departments which give the strong impression of being more anxious to ensure collective "control" of economic and social activity than to ensure that it is motivated by efficiency in resource use and responsiveness to market pressures Civil servants have more faith in their own ability to guide the economy than in that of market forces There is, it seems, no social consensus that market forces should be permitted to guide resource allocation Political, EEC and unavoidable financial circumstances have led governments in Ireland to espouse the cause of economic efficiency only as a policy of last resort The fact that these circumstances are unlikely to change, however, suggests that further commercialisation, liberalisation and even stealthy privatisation will be seen

Most of the remaining state-owned "commercial" concerns are either hopeless cases (Irish Steel) or are seen as natural monopolies or act as subsidised suppliers of services (the ACC) In the case of the first type, the possibilities for privatisation are close to zero No-one in his right mind would buy Irish Steel, Bord na Mona exists only by courtesy of the ESB, so that a fully commercialised and/or liberalised energy sector would make its demise certain In the case of the (presumed) natural monopolies, however, there is considerable scope for efficiency inducing change Privatisation however can hardly be seen as a serious possibility, nor, given the considerations of the previous sections, is there any case for believing it ought to be In some cases, the natural monopoly characteristic of an industry applies to only one portion of its activities electricity, for example, is *not* a natural monopoly as far as generation, or even system security, is concerned The same is true of gas production There *are* natural monopoly characteristics in distribution of gas or electricity, however There exists, therefore, a prima facie case for treating generation and distribution of electricity separately, rather than vertically integrating production and distribution into a single monopoly supplier

It is already being suggested that in the UK the proposed privatisation of electricity should take this into account (Financial Times, September, October 1987) The logic applies here, too There is no reason *in principle* why electricity *generation* could not be undertaken by competitive (private?) power companies Competition could be introduced by making electricity generation a contestable market even if existing power stations remained state-owned, a separate distribution system would enable private suppliers to complete with the state-owned suppliers

As far as commercialisation goes, the most obvious remaining candidate in Ireland is forestry Union objections to suggestions that state forests should be privatised have been vociferous and misleading It is hard to avoid the conclusion that their objective is simply forestry job protection - a natural objective for a union The level of investment, however, and the location of plantations, suggest that a commercial rate of return is not the main determinant of afforestation Less obviously, and arguably with considerably greater scope for efficiency improvement, is the possibility for vertical disintegration of public sector production to permit *either* commercial public provision, or competitive private production, or competitive franchising of local monopoly production (Cubbin, Domberger and Meadowcroft, 1984)

For example, consider the activities of Comhairle na n-Ospideal in supplying services to hospitals it is hard to see how strong competition from private sector suppliers would not improve efficiency Could not the health-boards consider a competitive franchise to operate ambulance services? After all, private school buses exist County councils have recently been required to extend competitive tendering opportunities to ensure increased competitiveness of direct labour provision of construction output Doubts remain as to whether this will be effective those charged with deciding on project allocation may well have a vested interest (or be subject to union pressure) in awarding contracts to local direct labour It is in this type of reform that the greatest scope for increased productive efficiency and consumers' welfare in Ireland is to be found The great majority of state companies are either already commercialised and competitive (ICC, ACC, Irish Life ) or are lame ducks (Irish Steel, B & I, CIE ) or depend heavily on Irish or EEC policies to restrict competition (Sugar Company, INPC, Bord na Mona ) No-one in his right mind would invest in either of the last two categories in a fully competitive environment, and externally imposed market competition or withdrawal of subsidies will mean an end to their activities before the end of the century The number of state concerns for which liberalisation and privatisation are serious possibilities are few in number Liberalisation coupled to restructuring might be considered for the ESB, Bord Gais and CIE rail services, liberalisation via permitting competition would certainly be as good where Telecom and An Post are concerned, it is hard to see why it should not also be applied to the VHI in the health insurance market It is hard to think of a *single* case where privatisation on its own would serve any significant purpose - and given the *political* objections to privatisation there seems to be little point in stirring up opposition to liberalisation and commercialisation by combining it with controversial - and in the end ineffective - proposals to extend private ownership as an empty gesture of ideological principle

It should also be noted that some of the estimates of the possible proceeds of privatisation in Ireland are deeply suspect, unless, that is, it is proposed to create private monopolies to replace public sector firms (admittedly, this is not exactly foreign to the philosophy which lies behind the recent proposals to

"liberalise" commercial radio)  I find it hard to believe that Aer Lingus would fetch £150m (compare with B Cal!) if it didn't "own" access rights to some lucrative markets  Bord Telecom would hardly command a price of £500m suggested recently if it were seriously exposed to competition  The game is really given away, of course, by the estimate of £500m plus for the ESB - supposedly a non-profit organisation  The reality is that the ESB is a monopoly in which the surplus is partially concealed by a government imposed bizarre accounting procedure, and partially absorbed by higher-than-necessary production costs - much of which have been inflicted on the ESB by government intervention

Any sale of these or similar concerns to the private sector would *either* reveal the dependence of the state sector on market restrictions, *or* reveal the true level of implied state monopoly profits existing at the moment  Liberalisation of the market into which they sell would make survival unlikely for those depending on restrictions and dramatically reduce the profitability of those enjoying monopoly power

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## DISCUSSION

**Donal de Buitleir** I agree very much with Moore McDowell that ownership of state assets is largely immaterial and that the real issue that we should address is how do we increase the efficiency with which these assets are utilised

There is one problem to which privatisation may be the answer but it is not the only answer That is how do we distance large organisations from the controls imposed by the political/administrative centre which tend to stifle initiative

My experience over the last three years has being in trying to manage part of the Office of the Revenue Commissioners This is an organisation which few people are satisfied with and faces a period of radical change over the next few years Every day I am struck by the scope for improvement and the great difficulty of bringing it about For example, in the Revenue we are subject to a cash limit, a numbers limit and an inability to substitute pay for non-pay expenditure or vice versa even if we can show that this is cost-effective This seems to me to be self-defeating in that it makes local management, who are the only people able to bring about improvement, effectively powerless It seems very much like taking a taxi and trying to drive from the back seat

I would urge my colleagues in the Department of Finance, many of whom are here, to give serious thought to devising effective controls which preserve the ability of local management to achieve greater efficiency Central controls are essential to make local management accountable However, in my experience the existing controls are self-defeating in they make it much more difficult to meet the objectives set down by Government In short, Central Departments should set down clear objectives, give local management a freer hand in choosing the means to achieve these objectives and make them accountable for the results If privatisation is necessary to achieve this then I will go along with it but I do not believe that it is