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Research paper

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Privatization of Public Assets in Developing States

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Terms

Privatization – transfer of productive assets from state sector to the private sector

Complement - something that is almost useless on its own, but in a combination other complements they contribute to creation of something great, wheel is a complement to tires, together with other complements they make the perfect combination called car

Horizontal Integration – privatizing the asset to hands of a strategic partner from the same sector, a state-owned company producing apples is sold to a function private company producing apples

Vertical Integration – privatizing the asset to hands of a strategic partner from the complimentary sector

Speculation - buying or selling something with premise of making many of buying it or selling it at more profitable price, this effectively means that the current price of given good is not representing its current market value, because speculators are calculating with the future of the good, on the other hand, if there were to be damage done in future and the speculators foresee it becomes projected in the current price leading to less devastating effects in the future, this a common thing on the market of commodities such as grain

Golden share – the decisive share in a company, usually over 50% in the given company

CSR - Corporate Social Responsibility – company having good a name with the community, for example building houses, supporting sporting clubs etc.

Liberalization – making more liberal legislation for the purpose of economic growth in the model of classical economic theories. However, some experts interpret privatization as part of liberalization. The economic field is divided on this issue of terminology.[1]

Public expenditure – government spending

Allocative efficiency – is the quantity and the corresponding price, where Marginal Cost equals Marginal Utility (MC = MU). Meaning if the Producer is producing at allocative efficiency and decided to produce one more apple he would need 2 dollars for production and he would sell it for 1.5 dollars. However, if this producer, who is currently producing at allocative efficiency decided to produce one less apple he would safe for example 1.8 dollars for the lack of production of the one apple, but, because he did not produced it, he would not be able to sell it and the selling price is 1.9 dollars. <u>Thus for producer to maximize profits he should produce apples at allocative efficiency levels</u>. (delegates are not expected to know allocative efficiency)

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[1] https://pdfs.semanticscholar.org/e5b3/b84cb669cc2f945c08762c19ad2cc876a370.pdf, page 610 closing remarks

Productive efficiency – the company producing at productive efficiency levels produces as much of the good as they can without making a loss (Average cost = Average revenue)

Quantity of output / **Output Quantity**– the amount of the good/service the company offers, at higher prices the output is larger (merit is in the Law of Supply, the delegates can research Supply and Demand however, they are not expected to do so)

General Overview of Privatization

Privatization is the process of shifting the state-owned assets to private owners. The governments do such action, because of either political reasons or conviction that the asset (usually company) will be better organized when controlled by a private owner. Both theories and data confirm that these assets are more efficient in the hands of private owners.

Theory of Privatization

"As firms move from public to private ownership, their profitability should increase. In response to shareholders' wish to maximize profits, the managers of newly privatized firms can be expected to place greater emphasis on profit goals." [2]

Further Analysis

As this topic often gets ideological overtones, it is very popular to review the economic impact of privatization and thus numerous papers evaluating the impact have been written especially in the last two decades. Prior to this research boom, the general consensus was that privatization helps to improve the efficiency of the privatized asset and as such the entire economy. This attitude has roots in advocating for the neoliberal world (or if you wish liberal capitalist). Since the end of the last century (the time of privatization boom) is heavily marked by the overcoming of communism by capitalism this evolution of privatization seems natural. However, the conducted researches proved that such evaluation of privatization is oversimplifying. To the development of the economy it does not matter who possesses the given asset, far more important is the environment in which the holder of the asset is present. Competition and regulations are significantly more important for the success of the asset than the ownership.

However studies have shown that the private ownership has one advantage the governments lack. Assets (in this case almost only companies) have a larger tendency to grow their network in the hands of private owners rather than in the hands of the states.

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https://openknowledge.worldbank.org/bitstream/handle/10986/11529/multi_page.pdf?sequence=1&isAllowed=y

Types of privatization

Selling to a strategic partner

Same sector (horizontal integration), complementary sector (vertical integration)

The golden share

Selling to a financial investor (fond, private equity)

Investor's ultimate goal is profit

Often reconstruction is followed by another selling of the company

Introduction of the company's shares to a stock market

More investors, the state can easily remain as the company's controller

Danger of speculation

The earned profits are "wasted" to generate dividends, thus not being reinvested

Giving off the company's shares to the habitants free of charge

The problem of too many owners can lead to problems with deciding company's strategy/future

Danger of speculation from influential groups formed by the habitants

Democratic solution

Often weak flow of the capital, because of the weak leadership

The interested public often leads to a rise in the consumption of the company's product/service and pushes the company towards CSR

Transfer to a local autonomies/governments

Forms of the selling process

Offer from the buyer

Merging or Acquisition

Token/Coupon privatization

Shift to Public Limited Company (Stock Corporation)

Privatization in both Developed and Developing Countries

Privatization in the sort-run usually decreases public expenditure. This is also the many times repeated pro-reason of IMF regarding privatization.

When a company is privatized there are two possible difficulties for the countries' habitants that may occur. Firstly, after the privatization the new company owner can go bankrupt or may have a reason to lay off workers. Secondly, in terms of social services of public nature (such as transportation, education, healthcare) the company may realize that some part of the previously government-provided service is making a loss (such as transport in rural areas or basic healthcare for people under the poverty line) and thus may decide to let go off this activity. The first issue is far less common than the second.

The privatized companies have no reason to work at productive efficiency levels if the external factors do not push them to do so. On the other hand, in order to achieve technological or efficiency progress the companies are motivated by the profits and the largest profits are not at the productive efficiency quantities. In addition, since the company present in the private sector is expected to work more efficiently the quantity of output is expected to be higher at every price of the product.

Owners of the privatized asset may or may not have a reason to keep the capital within the country of the initially privatized company. The outflow of capital is very common especially for the cases of company holding finding grounds of natural resources.

Privatization in Developing Countries

Privatization has been promoted in developing countries since the 1980s. Although recent reviews of the international effects of privatization have been generally favorable to privatization, the consequences of privatization within developing countries remain controversial.
Large-scale privatization may have an effect on an intangible balance of power between the private a public sector.

Privatization in Developed Countries

Large-scale privatizations in developed countries are not very common however; privatizations of single companies take place frequently.

Sources

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