Privatization. Some evidence from the world experiences and from research in transition countries

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Agenda

- I. Privatization in OECD countries including some experiences of transition countries
- II. The need for completing privatization in Poland
- III. Comments on Ukrainian privatization discussion

Introductory remarks -broader context of our discussion

- Privatization has to be seen in a broader context of governmental activities shaping institutional conditions for the development of the economy.
- The pace and final effects of privatization depend not only on the privatization regulation but on other regulations creating the business environment and business climate in the country (for example property rights protection, well developed and secure financial sector , transparent and efficient capital market and many others)
- The authors of both types of regulations are parliaments and governments. It is important to remember that all these regulations are interlinked and should be consistent.

Experiences of the OECD Countries

Privatizing State-owned Enterprises. An Overview of Policies and Practices in OECD Countries, Paris 2003

Privatization in OECD countries

- Over the past two decades, close to one trillion US dollars worth of state-owned enterprises have been privatized in more than 100 countries.
- The OECD countries account for nearly 80% of this total amount.
- Since the 70' larger scale privatization took place in few countries (UK, Germany, France, Mexico, New Zealand, Canada), but in the middle of 90' privatization had gained momentum in most OECD member countries. Globalization of privatization.
- Privatization had had major implications for public finances, corporate performance, employment and equity markets.
- Governments have sought to ensure that privatization activities not only contribute to efficient and competitive markets but also support broader strategies and structural reform efforts.

Reasons for privatization

- Generally poor performance of state-owned enterprises and understanding that it stems from the low efficiency of corporate governance exercised by the state. Attempts to reform the methods of state control over enterprises failed in most countries.
- The emergence of a tight fiscal environment and the need to control government spending and debt .The convergence criteria from European Monetary Union (Maastricht Treaty) required to diminish the public debt. Selling state enterprises allowed to have additional proceeds for the state budget and to eliminate future subsidies.
- Technological changes in sectors such as telecommunication and electricity generation) – monopoly in these services disappeared.
- Liberalization of markets within European Union and globalization of financial markets – there was a need to free up companies from the constraints of state ownership and to ease the access to the market
- The changes in understanding what is the appropriate role of the state in the economy.

Privatization in developed countries
Objectives

There are multiple objectives and they differ not only across countries but change over time. We should name some of them:

- Fiscal objectives
- Attracting investment
- Improving corporate efficiency and performance
- Introducing competition into hitherto monopolistic markets
- Capital market development
- Political objectives (employment, distribution effects)

These objectives are at times conflicting thus making it necessary to make „trade offs" between them.

Examples of policy choices within privatization - many questions

- Sequence of privatizing assets: usually competitive sectors first, other sectors after their preparation (regulation)
- Staging of sales: how fast should the company be sold (in stages or all at once)
- Opening up privatization transactions for foreign investors (to remove all restriction or to keep some, how long)
- How to use the privatization proceeds (for example for reducing the government debt or other priorities, like funding public services or supporting social security funds)

How to ensure credibility and public acceptance of privatization?

- Transparence of the process
- Selling methods should rely on open competitive approaches as far as possible
- Decisions are made free from conflicts of interest
- Are there mechanisms in place to ensure accountability ?
- The public should be well informed

Major policy reason for privatization

- One of the most important policy objectives of privatization is to improve the efficiency and performance of companies.
- There is an international evidence that privatization brings about a significant increase in the profitability, real output and efficiency of privatized companies.
- The results on improved efficiency are particularly robust when the firm operates in a competitive market and when deregulation speeds up its convergence to private sector enterprises.

Privatization and growth in transition countries

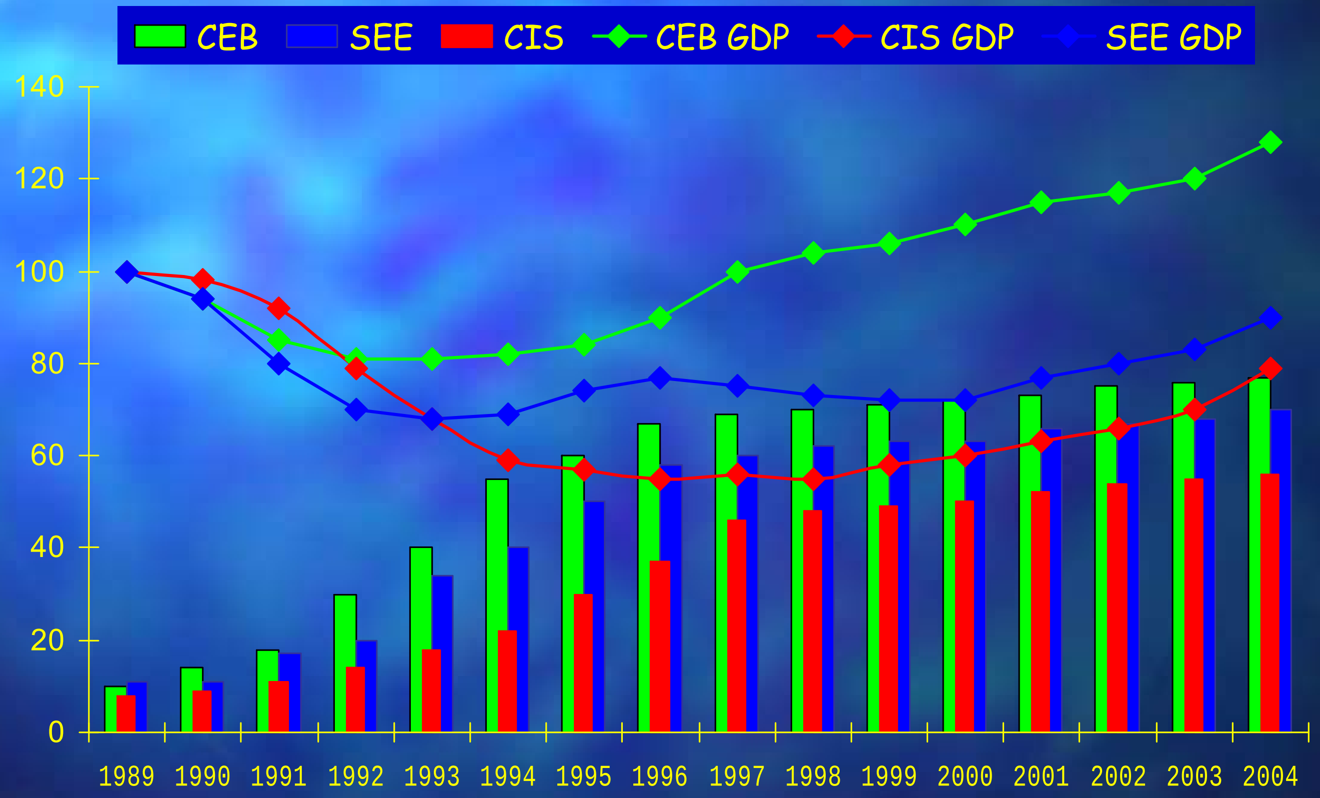
- The scale and pace of privatization has an indirect impact on the growth of the economy. Early and consequent privatization is beneficial (EBRD).
- Delays in privatization cause high costs for the economy resulting among others from :
  - lower productivity of state owned enterprises
  - the frequent need of subventions for state owned companies. (Research of CASE in 2003, 2005)

Privatization and growth

Evidence from groups of countries

CEB= Central Eastern Europe and Baltic States; SEE= South Eastern European States; CIS= Commonwealth of Independent States

The share of private sector (columns), *GDP growth* 1989=100 *(lines),*



Source: Transition Report, EBRD 2004

Other evidence from world research on privatization

„Privatization: What Have We Learned?" S. Guriev, W Megginson, Annual Bank Conference on Development Economics,(ABCDE) 2006

- Privatization is complementary to institutional reforms, strengthening the rule of law, implementing hard budget constrains, improving investor protection, developing of competition and good regulation.
- Management contracts, corporatization and hard budget constrains are not efficient without privatization.
- Restructuring of firms before privatization, in many cases, has not given good results (the governments are not competent in restructuring of firms)
- Privatization has, in many countries, significantly developed the capital markets and their capitalization.
- The openness for all investors in privatization process was crucial for its success.
- Dilemma: countries that need privatization most, have governments both unable to conduct it in an efficient way and unable in introducing institutional reforms.

How to make privatization effective? OECD recommendations:

- Strong political commitment to privatization at the highest level of the government
- Clearly identified objectives and priorities
- A transparent process to gain credibility of potential investors and political support from the public
- An effective communication campaign to explain the policy objectives of privatization and its methods, in order to gain support for the policy
- Allocation of adequate resources (including human and financial resources), in order to ensure proper skills and experience.

II. The Need to Complete Privatization in Poland

- The ownership structure of the Polish economy in the entire transition period shows dramatic changes from domination of the state sector to its' much smaller role. The public sector is already smaller than the private and the prospects of achieving an ownership structure similar to Western European countries is not so far as it was at the beginning of 90'.
- But in all these countries a big wave of privatization took place too, in the 80-90'. In effect, the share of the public sector in the economy (in producing GDP, in employment) in these countries is usually less than 10%.

The share of the state sector in GDP and in employment i European (15) countries (2003)

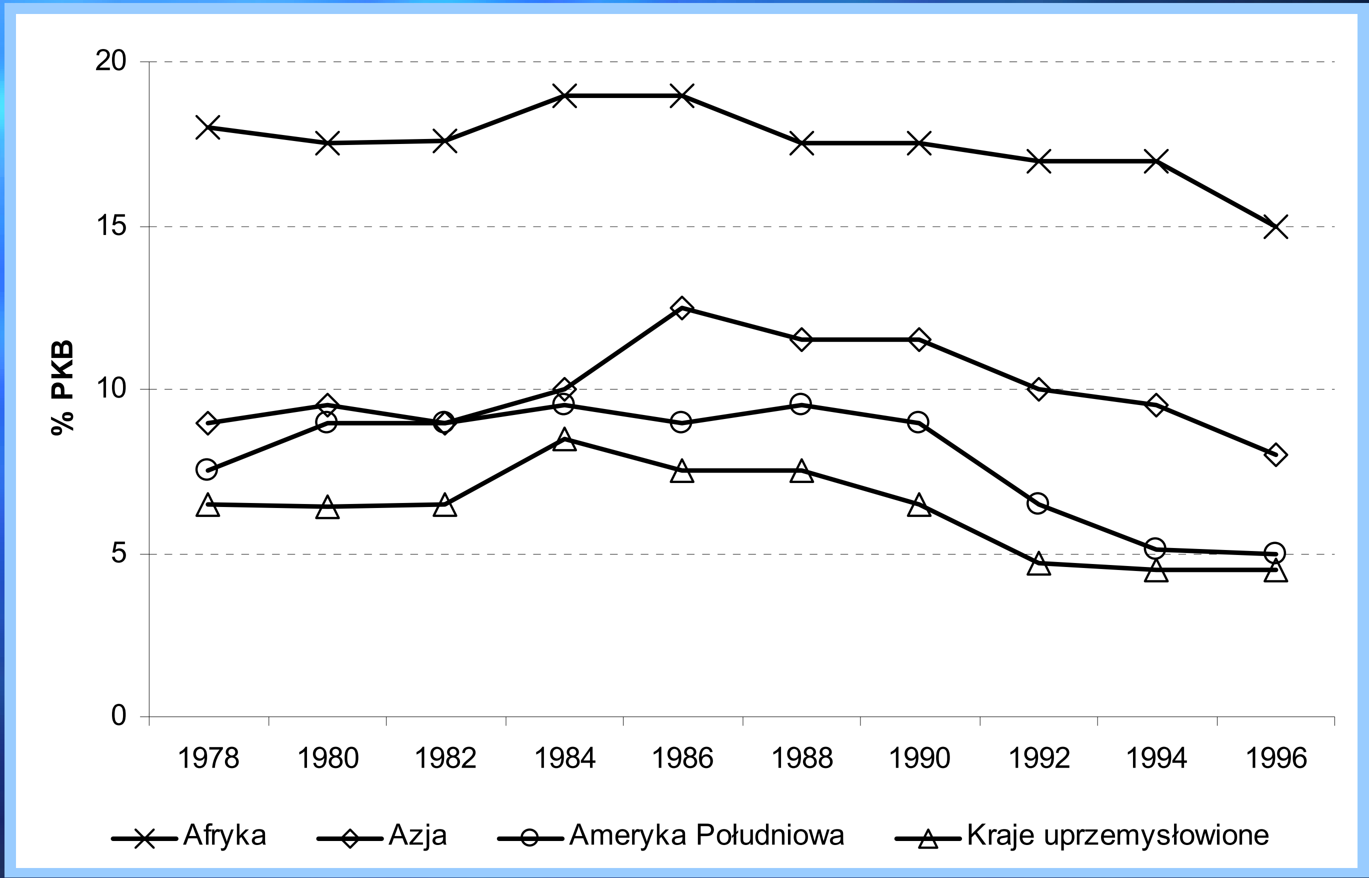
Source:European Centre of Enterprises with Public Participation and of Enterprises of General Economic Interest: „The development of enterprises of public participation and of general economic interest in Europe since 1996. Their economic impact in the European Union", (2005),

European Union Countries (15)	The share of the state sector in GDP production, in %	The share of the state sector in employment, in %
Greece	14,2	4
Sweden	13,1	5
Austria	12	. a/
France	11,8	5,2
Germany	10,9	1,3
Belgium	10,9	10,4
Finland	10,9	. a/
Ireland	10,1	. a/
Italy	9,6	2,2
Portugal	8,5	3,9
Denmark	7,9	1,7
Luxemburg	5,7	. a/
Netherlands	4,6	3-4
Spain	4,1	5
U.K.	2,3	. a/

The size of public sector in Poland at the background of other groups of countries

- In industrialized OECD countries the share of state sector in producing GDP dropped from 1980 to the end of 90' in average up to 5%, in Latin American countries up to 6% and in Asian countries up to 8%. Only in African countries it amounts to 15%.
- The share of employment in state sector dropped in middle income countries from 13% to 2%, and in low income countries from 20 to 9% (OECD and World Bank data)
- In Poland the share of the state sector in producing GDP was in 2005 still over 20% and its share in employment was over 28%.
- It is to conclude that the size of public sector in Poland is more similar to its level in African countries then in developed industrialized countries.

The share of public sector in producing GDP (different groups of countries)

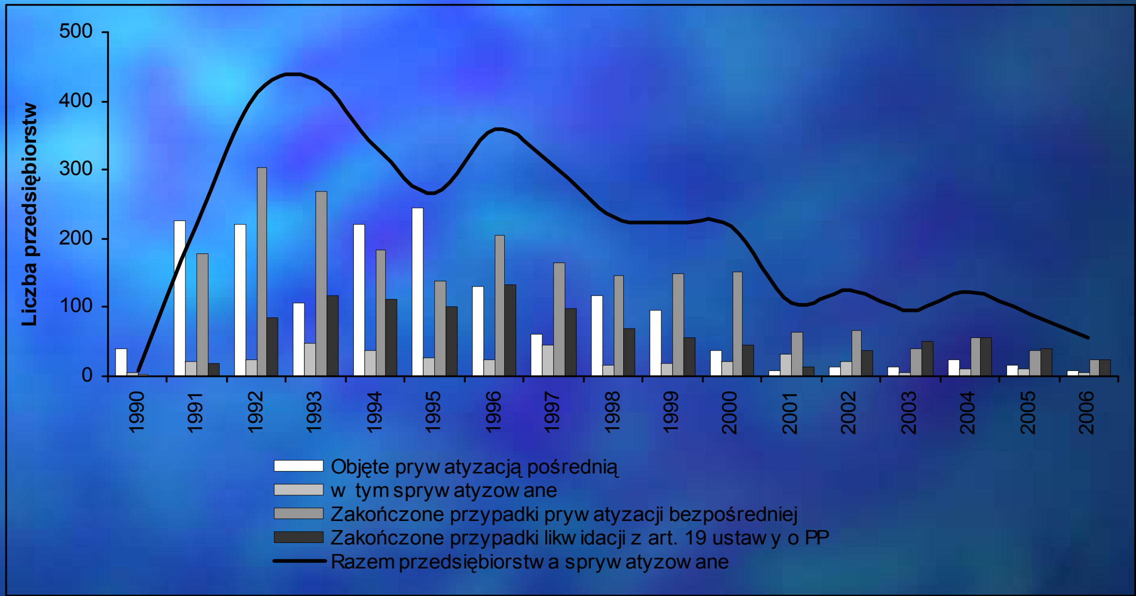


The share of the public sector in economic aggregates in Poland, as of 2005

Sector of economy	Employment	Sales	Value added
Total economy	**28,3**	.	**24,8**
Agriculture, forests and fishing	1,8	50	8,9
Industry, total, including:	17,1	21,9	24,4
Mining	**80**	**67,3**	**68,8**
Manufacturing	6,5	8,6	6,6
Energy gas and water	**85,7**	**76,6**	**82,7**
Construction	4,2	4,6	3,5
Trade	0,8	4,4	0,7
Hotels and Restaurants	7,6	9,5	6,3
Transport, communication	**45,1**	**28,7**	**25,9**
Financial intermediation	**24,7**	**16,9**	**14,6**
Immobilities and services for firms	15	18,2	9,8

Źródło: obliczenia własne na podstawie Rocznika Statystycznego GUS 2006, str.237-238,568-579,679-680.

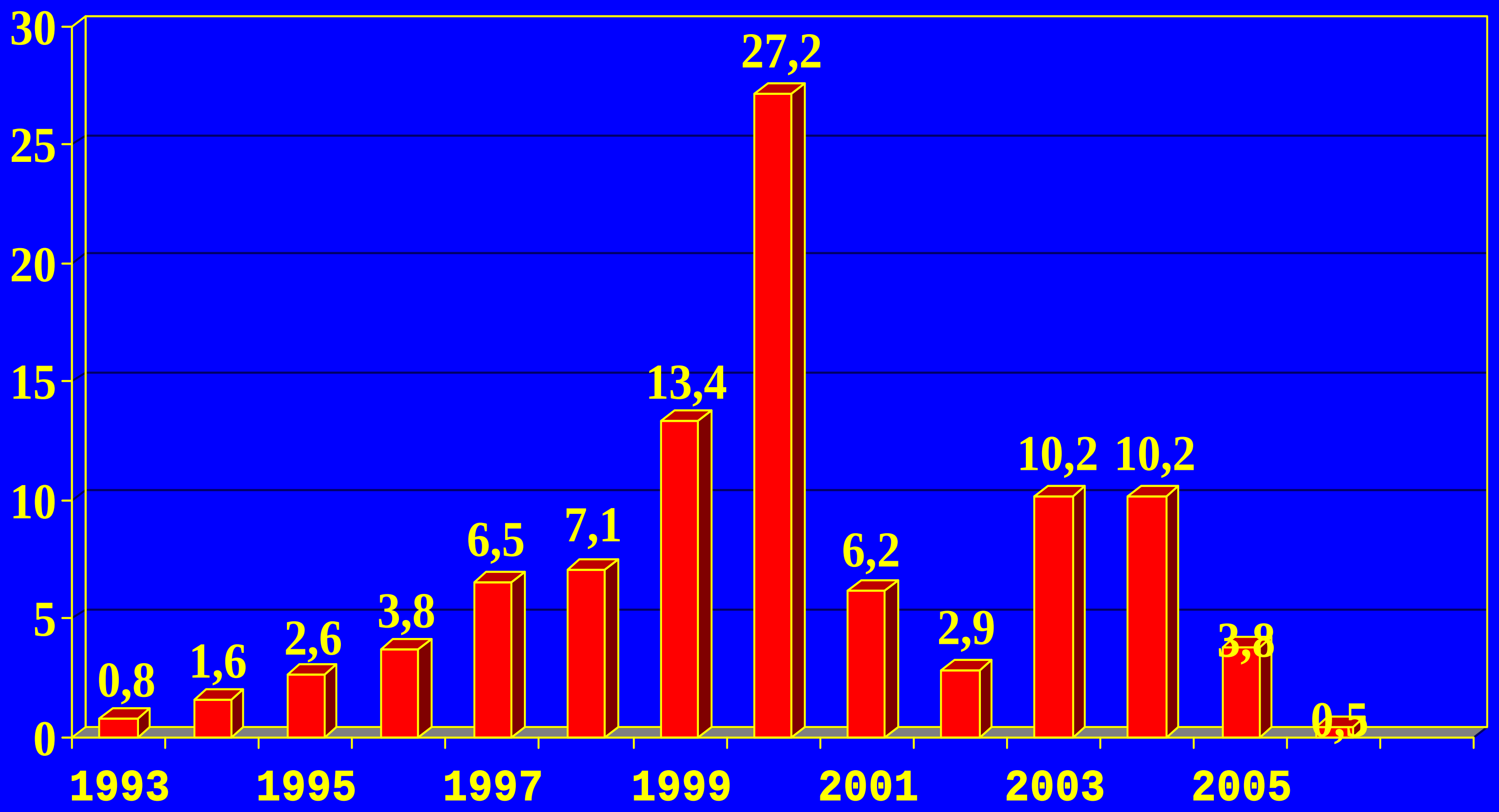
The declining pace of privatization in Poland



Źródło: Ministerstwo Skarbu Państwa (2007b), obliczenia własne.

Low and declining receipts from privatization

The proceeds from privatization to the state budget (in bln zloty) in 1993-2005



The receipts from privatization and the dividends from state-owned companies

	2005	2006	2007 (Forecast by the Ministry of Treasury)
Planned receipts	5,7 bln zł	4,2 bln zł	3 bln zł
Real receipts	3,8 bln zł	455 bln zł	1,3 bln zl ? (October)
Dividends from State-Owned Companies	2,1 bln zł	3 bln zł	?

The space for privatization:

Is there anything left to privatize ?

- The government started privatization in 87% of former state-owned companies, but completed it in only 60% of them.
- There are still 2,500 companies in entire or partial state ownership and among them 1,300 are active.
- Recently, the government privatized yearly only 30 to 50 companies.
- The state owned companies (excluding few very large giant companies) are in a deteriorating economic state. This has negative influence on the remaining economy.
- Large state aid has been spent for the state sector

The need for privatization
Experience of the developed world:

- Most countries realized that the role of government as the owner of businesses is anachronistic and the ineffectiveness of corporate governance in state-owned companies is a problem which cannot be rationally sold (World Bank). For this reason government ownership should be limited to a minimum.
- Privatization brought about improvement in business performance, increased competition, decreased prices, unburdened the government and the public finance (OECD 2003)
- But these processes often meet political and social opposition, especially by groups that are interested in conserving state ownership and the privileges gained there.

Need for Completing Privatization, cont.

- Similarly, privatization processes in Poland were strongly opposed by certain social groups and political parties and still are politically difficult.
- Privatization had a very uneven course in time and in various sectors (so called „strategic sectors").
- Coal mining, railways, the greatest part of the energy sector (Electricity, gas, oil), shipyards and large parts of the „heavy" manufacturing sector and communication sector remain state-owned.
- Privatization in other sectors (like chemicals, sugar, spirits) was delayed for many years.
- This delay resulted in high economic costs, on the level of business as well as the entire economy
- Recently (since 2 years), privatization has been almost completely blocked
- The new government recently promised to fast restart privatization

Conclusion

- Poland needs further privatization and development of the private sector,

in order to change the ownership structure in the economy to a more efficient one.

III. Few comments on Ukrainian discussion on privatization

- Legitimization trough any kind revision of privatization
- Legitimization through new channeling of privatization proceeds
- Clarifying of land property rights of enterprises
- How to involve foreign investors ?

Legitimization trough any kind revision of privatization

- Are the views of people willing to revert the privatization process really a sufficient reason to revise it ? Doubts - since the main goal of privatization is not directly satisfying people but giving a better chance to enterprises.
- Even very “soft” methods for “punishing” the former investors can result in destabilization of property rights and may be detrimental for attracting new investors.
- I strongly recommend that the government makes a clear signal about the new “fair” rules in privatization in the future without revision of past privatization.
- Public campaign for explaining what are the new, fair privatization rules and how this can be assured.

Legitimization through new channeling of privatization proceeds

- Explaining to the people for what the privatization revenues will be spent:
- Important social tasks
- Important reforms (like pension, health sector reform, education)
- Diminish the growing public deficit - burden for next generations

Clarifying of land property rights of enterprises

- I would strongly recommend to make efforts in order to make the companies owners of the land plots, they are located on, maybe not immediately but in a near future. Legal and economic procedures.
- Reasons: such companies are much more secure and their credibility is higher (collateral). The local governments need these regulations, too.
- Possible ways out - installments and other forms of long term payments.

How to involve foreign investors ?

- OECD best practices: to remove all general restrictions against foreign investors with some small exclusion and address issues of national security and strategic interest using a case by case mechanism.
- Even more important: remove all other impediments in the regulatory environment of business that discourage foreign investors.

Thank you very much for your attention !