

CHAPTER III

Privatization in Developed Countries

3.1 Introduction

In the previous chapter we examined the theory of privatization: the concept, its rationale, the methodologies and mechanisms used to bring about privatization, and its consequences. In the present chapter we look at the experience of privatization in developed countries, specifically in UK. This is because UK was a sort of pioneer in introducing and implementing privatization, and also because it has been the British model that has motivated several other countries to try and adopt privatization as well. It is therefore imperative to analyze the British experience in some detail to see if the British model is suitable for adoption in other countries that may be radically different in terms of economic development.

3.2 Background

It is generally accepted that the policy of privatization now sweeping the world commenced in Britain in the early 1980s (Clarke, 1993: 205). The UK experience in privatization is also considered by many as a success story, providing a role model to other countries to follow (Ganesh, 1999: 17). As Vickers and Yarrow observe, privatization may be in progress in many countries of the world, but nowhere were they carried out as vigorously and extensively as in Britain (1988: 1). Ganesh points out the divestiture programme in UK has been large, both in absolute terms (involving over 6% of the GDP), and in terms of the enterprises

divested, which included major utilities such as British Airways, British Telecom, British Gas etc. It was seen that the range of assets divested was wide, including such diverse activities as housing, manufacturing industries, transport services, energy, telecommunications, and catering services among others. Besides, as Yarrow (1993) indicates, the British privatization programme was developed and implemented with remarkable speed. It was also notable both for the relative absence of major constraints and for the vigour with which the government tackled the constraints which did exist. Finally, privatization in UK was accompanied by deregulation and introduction of several innovations in regulatory structures.

Vickers and Yarrow indicate that when Mrs Thatcher came to power in 1979, about 11.5 percent of the gross domestic product was accounted for by state-owned enterprises. By the time of her third election victory in June 1987, however, that figure had come down by over a third to about 7.5 percent. They point out that in the process, over half a million employees were transferred to the private sector, of whom around 90 percent acquired shares in their companies, and the total number of private shareholders in Britain roughly trebled (1988: 1).

Clarke states that although privatization in UK began as a limited programme of returning some major utilities to private ownership, it quickly gathered pace and became an apparently unstoppable movement to restore the market system and 'roll back the frontiers of the state'. Nevertheless, he points out that though the scale of privatization in the UK since 1979 under four consecutive Conservative governments proved to be massive, there was little

evidence of any initial declared policy commitment to this goal. According to him, it was only in the second and third Thatcher governments that the commitment to sell major public enterprises was made (1993: 206). However, before going into an analysis of the privatization strategy itself, it is necessary to examine the origins and development of the public sector in UK.

3.2.1 Origin and development of the public sector

As Paul Cook indicates¹, prior to 1979 the UK possessed one of the largest public enterprise sectors in Europe. He mentions that although it was the Labour Government which created most of the larger public enterprises between 1945-51, successive governments of either political complexion continued to nationalize. This included, among others, the steel, automotive, shipbuilding and aircraft industries. As Naib points out, apart from operating a number of enterprises which were natural monopolies such as gas distribution, electricity generation and supply, rail transport and water supply, which in most countries happen to be in the public sector, the government-owned enterprises in UK manufactured a plethora of products ranging from ships, airplanes and automobiles to steel, computers and electronic goods. It provided services by operating buses, airlines and railways, running coal mines, ports and post offices, and managing health and education services. Thus it would be seen, as Naib indicates, that the scope of the government's interests within the economy in UK was quite wide (2004: 163).

According to Yarrow (1993: 64), in 1979, the year which marks the beginning of the UK privatization programme, the public corporations' sector of

¹ Cook, Paul, "*The Evolution and Performance of UK Privatization*" [<http://www.britcoun.org/governance/briefing/iss2int.htm>]. All references to Cook in this chapter are from this article.

the economy accounted for around 10.5 per cent of gross domestic product, 8 per cent of the labour force, 17 per cent of the industrial capital stock and 15 per cent of gross investment. The importance of the nationalized industries in 1979, according to Cook, can be gauged from the table given below.

Table 3.1 Public Corporations in 1979

	Number	Amount (£) billion	% of UK total
Number of public enterprises	47		
Gross domestic product		18.0	10.5
Numbers employed		2.1	8.1
Net capital stock		104.0	17.2
Gross domestic capital formation		5.6	15.2

Source: National Income & Expenditure (1984 edn) [cited in Vickers and Yarrow, 1988]

According to Ganesh, in the UK there were three main types of public ownership, namely:

1. An enterprise that was operated as a department of the state, directly controlled by the government as part of the civil service;
2. An enterprise that was organized in the form of a company but with all shares being owned by the government; and
3. An enterprise having the status of a public corporation, owned wholly by the state but being a legal entity in its own right.

Ganesh clarifies that a public corporation differed from a civil service-controlled entity in that the former is allowed to borrow from private sources on its own account and to maintain its own resources. As in India, in UK too, the public corporation is answerable to the Parliament and through it to the public.

Cook points out one more aspect to the public sector in UK when he makes a distinction between the 'public market sector', i.e. the public or state-owned enterprises, and the 'public non-market sector' commonly referred to as the welfare state. Generally the distinction relates to institutions, reflecting past political choices about financing, and the characteristics of the goods and services supplied (Heald, 1988).

Finally, it is also important to note, as Clarke perceptively observes, that in Britain and other West European countries the public sector was not the result of the oppressive intervention of a malign highly centralized state apparatus. On the contrary public intervention occurred in a widespread, decentralized way in recognition of the inadequacies of market provision (1993: 207). He goes on to state that the post-1945 expansion of the nationalized industries was pursued by a Labour government which stressed the essential irresponsibility of private capital, the failure of the market system to provide the investment necessary to sustain the efficiency of industry, or to provide even essential services (such as health care) to those who could not afford to pay (1993: 207).

3.2.2 Performance of Public Enterprises

As in other countries, in UK too, the performance of the public sector was poor. Yarrow (1993: 66-67) points out that in the period up to 1975, the profitability of the public corporations was significantly below that of private industry and that the state sector showed a persistent and substantial financial deficit. Moreover, the trend in profitability between 1965 and 1975 was downwards – coming down from 6.5 % in 1969 to 2.4 % in 1974.

Cook too admits that on the whole, the financial performance of public corporations prior to 1979 had been weak. It was seen that rates of return for public corporations were substantially below that in the private sector. Cook points out that detailed analyses of pricing behaviour of individual nationalized industries indicated that efficiency objectives had not been met and this was attributed to a combination of over-investment and internal inefficiencies. He is of the opinion that the lack of clearly defined objectives was a major reason why there was a perception that public enterprises had failed in the 1970s.

Clarke points out that as the scale of the public sector continued to grow in the 1970s and public expenditure consumed a higher proportion of gross national product, criticisms of the performance of the public sector began to increase. According to him, these were inevitable, since the public sector was providing goods for which there was an ever-expanding demand, for example in education and health care, which it was impossible to fully satisfy. Apart from this, the centralized bureaucratic mode of the public sector also began to be recognized as not only inefficient and inflexible but as oppressive and unresponsive to both employees and consumers alike. He indicates that managers in the public sector complained of tight control of their finances and of recurrent, undue political interference which made strategic planning difficult. Necessary investment in public industries was denied by governments faced with external constraints upon their growing borrowing requirements, and mounting losses were experienced by industries which found they were increasingly unable to compete with the private sector due to lack of modern infrastructure (1993: 208).

This point is highlighted by Yarrow too who mentions that the Conservative governments of the 1980s sought to increase the competitive pressures operating on a number of the nationalized industries. In this direction, several pieces of legislation were introduced which were designed to reduce entry barriers and facilitate the emergence of privately-owned competitors to incumbent state-owned firms in road transport, telecommunications, gas and electricity (1993: 69). All this put additional pressure on the public sector enterprises.

According to Clarke, successive governments recognized the need to improve the efficiency of the public sector, and introduced a series of reforms to attempt to ensure efficiency and value for money in the public sector. These included applying strict cash limits to the expenditure of public sector industries, rather than allowing them to draw indefinitely on the public purse; limiting employment levels within public companies; introducing the assessment of staff at regular intervals; establishing periodic reviews of functions and organizations; having regular internal and external audits; regular studies of comparative costs and outputs; contracting-out work to competitive tender which could not be done efficiently in-house; and setting performance indicators and performance measurement (Pliatzky, 1988).

Yarrow (1993) points out that the second half of the 1970s witnessed a major shift in public policy towards the nationalized industries. He indicates that starting with the sterling crisis of 1976, governments began to place much more emphasis on financial performance in general, and upon the implications of public enterprise behaviour for the central government public sector borrowing

requirement (PSBR) in particular. Of special concern was the fact that the PSBR had grown substantially during the first half of the decade in both absolute terms and as a proportion of gross domestic product (Ramanadham, 1993: 68-69).

However, Clarke does not agree. He mentions that during Mrs Thatcher's first term the government experienced a series of disappointments in economic policy: unemployment rose, the recession deepened, inflation increased, manufacturing output declined, interest rates rose, and public expenditure continued to grow (1993: 207). In this context, privatization was seized upon by a government in economic difficulties as a way of apparently reducing the public sector borrowing requirement, without engaging in politically unpopular serious cuts in public expenditure (Marsh, 1991: 460-1). Thus, according to Clarke, privatization was pursued for political reasons related to the government's troubled attempt to manage the economy and stay in power, rather than to the economic pursuit of efficiency in the industries concerned (1993: 207).

3.3 Objectives

Vickers and Yarrow (1988) observe that in the British privatization program no one has defined a comprehensive list of goals ranked by priority or weight. However, they indicate that the following list summarizes what appear to have been the principal aims:

- (i) Improving efficiency;
- (ii) Reducing the public sector borrowing requirement (PSBR);
- (iii) Reducing government involvement in enterprise decision making;
- (iv) Easing problems of public sector pay determination;
- (v) Widening share ownership;

- (vi) Encouraging employee share ownership;
- (vii) Gaining political advantage.

They suggest that while the last of these objectives has only been implicit, nevertheless it has shaped a number of key policy decisions (1988: 158). This is supported by Clarke who believes that the drive of the three Thatcher governments of the 1980s towards the commercialization and privatization of the public sector had much more to do with ideological belief than economic analysis and comparative assessment of performance (1993: 209). According to him, the government regarded privatization *a priori* as serving a multiplicity of self-reinforcing objectives. *Economic freedom*: the management of the privatized corporations would be free to invest in market opportunities and the consumer free to choose; *efficiency*: the disciplines of the product and capital market and the profit incentive would enhance the pursuit of enterprise efficiency; *wider share ownership*: privatization would promote popular capitalism by dispersing shares widely. However, he points out that though the government confidently proclaimed the achievement of each of these objectives, when the results of privatization are examined more closely, serious questions begin to emerge about what exactly had been achieved (1993: 209).

According to Ganesh, privatization in UK was seen as having two important components:

- a) Denationalization or divestiture, and
- b) Liberalization i.e. exposing enterprises to more competition.

However, Vickers and Yarrow are of the view that *privatization* (the transfer of ownership) and *liberalization* (the opening up of competitive forces) are logically quite distinct concepts. They feel that public ownership does not imply state monopoly, and private ownership does not entail competition. Nevertheless they admit that privatization and liberalization are frequently intertwined in policy debate and public perception. They observe that the political presentation of privatization policies has emphasized the stimulation of competitive forces, and the privatization of companies such as British Telecom was indeed accompanied by some important liberalizing measures. Although there is no logical connection between public enterprise and the absence of competition, it was held that there were several practical reasons why the two have often gone together (1988: 45).

Ganesh goes on to indicate that over time the Conservative governments and politicians developed many of the following justifications for privatization:

1. expanded freedom of choice for consumers
2. increased economic efficiency
3. breaking the power of the trade unions
4. improving government finances
5. wider share ownership, and
6. increased employee welfare.

However, the principal aims of privatization in the UK, according to Ganesh (1999: 23) could be described as follows:

1. improving efficiency and productivity

2. reducing the public sector borrowing requirements (PSBR)
3. introduction and promotion of competition
4. [increasing] government revenue
5. exposure of management to market discipline
6. reducing government involvement in enterprise decision-making
7. easing problems of public sector pay determinants
8. widening share ownership
9. encouraging employee share ownership
10. monitoring by stock exchange and shareholder accountability
11. strengthening capital markets, and
12. gaining political advantage

In the subsequent sections, we shall analyze to what extent these objectives were met.

3.4 Process of Privatization

According to Cook, the privatization programme which began in 1979 evolved through several phases. In the first phase of privatization, which occurred between 1979 and 1983, the government sold public sector assets and public enterprises that were small and largely operated in competitive markets (Bishop and Kay, 1989). He points out that in this phase, the sale of publicly-owned property was more significant than the sale of shares. In this period over one million publicly-owned houses, fetching £ 15 billion, were also sold under the 'right to buy' scheme.

The second phase of the privatization programme, according to Cook, concerned the extension of denationalization into the public utility sector. This consisted of a mixture of attempts to liberalize monopoly markets and denationalize the large public sector monopolies. It began with the sale of British Telecom, and continued with privatization of the railway industry. He states that this phase was distinguished from the first because separate regulatory offices were established for each of the major privatized utilities.

The third phase, he believes, overlaps the second but represented a new direction for the privatization programme. It gained momentum when a significant number of publicly-owned companies had already been sold and those remaining were proving to be difficult to sell or were unlikely to generate large sums of revenue. Faced with this situation, the government switched attention to new areas for privatization which principally involved contracting out, the imposition of user charges, and the introduction of consumer-driven initiatives to simulate market controls on state-owned bodies (Curwen, 1995). According to Cook, it also involved to a much greater extent new inroads into the 'public non-market sector' referred to earlier in section 3.2.1.

According to Ganesh, there had been over 50 cases of privatization in the UK since the 1977 offer of government shares to the extent of 49 per cent in British Petroleum, with total market capitalization, in current prices, of over £ 45 billion (1999: 26). Vickers and Yarrow (1988) point out that while during the Conservative Government's first term in office, the proceeds from the sale of state assets were below £500 million per annum, after Mrs Thatcher's re-election in

June 1983 the privatization programme accelerated dramatically, as may be seen from the table below.

Table 3.2 Privatization proceeds

Financial year	£ million
1979-80	377
1980-81	405
1981-82	493
1982-83	488
1983-84	1142
1984-85	2132
1985-86	2702
1986-87	4750
1987-88 to 1989-90	5000 annually

Source: HM Treasury [cited in Vickers & Yarrow, 1988: 155]

Vickers and Yarrow mention that apart from an expansion in the scale of the privatization programme, there was also a fundamental change in its nature. They point out that before 1984 the firms that were privatized mostly operated in reasonably competitive industries. Firms like British Aerospace, Britoil, Cable & Wireless, and Enterprise Oil are important and sizeable companies, but they did not enjoy such market power as to pose major regulatory problems. According to them, the privatization of British Telecom, which was the first in a series of utility companies with great market power, therefore represented a radical shift in policy (1988: 155).

Besides the sale of public enterprises which, according to Vickers and Yarrow, had been one of several components of policy designed to reduce state involvement and enhance private enterprise and ownership, another important

element was *contracting out*, that is the private supply of publicly financed services.

The sale of public sector *housing* after 1979 was held to be another major policy measure to enhance private ownership in Britain. It is pointed out that nearly 600,000 housing units were sold by local authorities between 1979 and 1983, the receipts of which amounted to almost £ 2 billion in 1982. Vickers and Yarrow believe that just as the privatization programme was used to promote wider share ownership, public sector housing sales were used to extend private property ownership. They observe that both measures were at the center of the Conservatives' desire to enhance 'property-owning democracy' in Britain (1988: 156).

Alongside policies to promote private enterprise and ownership, it is observed that the Government introduced measures to stimulate *competition* in several public sector activities. Vickers and Yarrow refer to legislation brought in by the government that was designed to remove some barriers to competition in nationalized (and sometimes in to be privatized) industries. For example, the 1981 British Telecommunications Act, the 1982 Oil and Gas (Enterprise) Act, and the 1983 Energy Act sought to introduce some competition into parts of the telecommunications, gas, and electricity supply industries, while the Transport Acts of 1980 and 1985 radically deregulated the markets for coach and bus services (1988: 157).

According to Clarke (1993: 209), the different forms privatization has taken in Britain include:

1. Asset sales, which may involve denationalization, as in the case of British Gas, British Airways, and British Telecom; the sale of public sector companies earlier transferred from the private sector such as Jaguar and Rolls-Royce; or the sale of government holdings in private companies such as BP.
2. Deregulation, or the relaxing of state monopolies, which exposes public sector industries to competition as in bus deregulation and the parcel delivery service.
3. Contracting out work, previously done in-house by direct labour, as in local government, the NHS and the Civil Service.
4. The private provision of services, allowing the private sector to provide services to the public, as in nursing homes.
5. Investment projects designed to encourage private sector involvement, as in projects in deprived areas, and special units in public sector organizations devoted to commercial returns.
6. The reduction of subsidies and the increase in charges for public sector services such as health and welfare (Young, 1986: 238-44).
7. Council house sales (Forrest, 1988).

In the subsequent section we shall focus on how the privatization programme in the UK progressed.

3.4.1 Progress of privatization in UK

Yarrow (1993) points out that the programme of privatization of state-owned enterprises in Britain commenced in 1979 with the sale of a tranche of stock in British Petroleum (BP), a company that was already in part privately owned. According to him, this sale followed a precedent that had been set by the previous Labour administration which had likewise sold a tranche of stock in the company,

largely as a funding exercise stimulated by what at the time was a relatively large public sector fiscal deficit. However, from 1979 onwards, privatization of state-owned enterprises was quickly established as a major component of the government's economic policy and a whole series of flotations followed the BP issue (1993: 71).

Clarke is of the view that the privatization programme in Britain began in a tentative way, with the postponement of the privatization of British Airways, British Shipbuilders, and the National Freight Corporation in the early 1980s due to recession and the poor state of the finances of the companies concerned. He indicates that only after the further injection of public funds and the restructuring of these companies were they offered for sale (1993: 210). According to him, instead the most successful companies of the public sector were privatized, including British Aerospace and the high technology company Amersham International. He says that the price of the shares was set so low by the government that the sales were oversubscribed many times and speculators made quick profits from immediately selling the stock they bought.

As Clarke points out, by 1984 privatization revenue was over £1 billion per annum, but with the sale of British Telecom more than £ 2.5 billion was expected to be realized. The government therefore looked to two new markets for selling the shares: the wider population, and overseas investors. He indicates that shares were acquired by 2.3 million people in the UK, encouraged by a subsidy of their telephone account, and 230,000 British Telecom employees. However, he also notes that a substantial tranche of the shares went overseas, and when trading

opened with the shares at a 90 per cent premium above the price they had been sold by the government, overseas speculators were in a position to make a killing (1993: 210).

According to Clarke, another weakness in the government's privatization strategy was revealed in 1987 with the attempt to sell the remaining 31.5 per cent government stake in British Petroleum valued at £ 5.7 billion, the world's biggest stock-market sale. He points out that all the former privatizations had succeeded in a bull market in which investors assumed they would receive an immediate gain, but the BP sale coincided with the biggest global stock-market crash since 1929. Nevertheless, the privatization programme continued, and by 1992 sales of state assets had reached £ 44.5 billion (as may be seen in the table given below), together with a further £ 36 billion from council house sales.

Table 3.3 Public asset sales in the UK, 1979-91

<i>Company</i>	<i>Year of flotation</i>	<i>Golden share</i>	<i>Net proceeds (£ millions)</i>	<i>Times over-subscribed (under-sub)</i>	<i>Discount on share price (%)</i>
British Petroleum	1979/80	No	6,149	n/a	--
British Aerospace	1980/81	Yes	390	n/a	--
Cable & Wireless	1981/82	Yes	1,024	5.6	17
Amersham International	1981/82	Yes	60	24.0	26
Britoil	1982/83	Yes	53	(0.3)	n/a
Associated British Ports	1982/83	No	97	34.	21
Enterprise Oil ²	1984/85	Yes	382	(0.4)	n/a

² Subsidiary of British Gas

Jaguar ³	1984/85	Yes	--	8.3	6
British Telecom	1985/86	Yes	3,681	3.0	21
TSB	1986/87	No	--	--	--
British Gas	1986/87	Yes	7,71	4.0	11
British Airways	1986/87	Yes	850	23.0	29
Rolls-Royce	1987/88	Yes	1,028	9.4	25
British Airports Authority	1987/88	Yes	1,183	8.1	12
10 water companies	1989/90	Yes	3,480	2.8	17
Electric companies	1990/91	Yes	5,200	10.7	21
2 electricity generating companies ⁴	1991/92	Yes	2,000	4.0	37

Source: Marsh 1991 [cited by Clarke, 1993: 211]

3.4.2 Preparatory steps to privatization

Ganesh points out (1999: 27) that most of the privatizations in the UK were preceded by some kind of preparatory measures, such as:

- a) Enterprises were brought under the rigorous impact of market discipline with targets, performance objectives, and external financing limits;
- b) Redundancies of labour were consistently and systematically dealt with, as for example, in British Airways; and
- c) Enterprises were financially restructured through capital write-offs and fresh infusion of capital.

According to Ganesh, this was done to demonstrate to the potential investors that the company was sound and worth investing in. As examples, he mentions that British Airways had a loss of £ 541 million up to March 31, 1982

³ Subsidiary of British Leyland

⁴ PowerGen & National Power

which was converted into a profit of £ 181 million by March 31, 1986. Similarly, in British Steel the workforce was reduced from 200,000 to just over 50,000.

Clarke also points out that in several cases, a process of pre-privatization restructuring prepared the ground for the eventual privatization. He too gives the example of British Steel where a cut in the number of workers from 166,000 to 52,000, and a reduction in government external funding from £ 1,119 million to £ 2 million, helped to achieve a net profit of £ 178 million instead of a net loss of £ 1,784 million on a similar £ 3,000 million turnover (1993: 212).

Ganesh indicates that certain ad hoc measures calculated to improve the prospect of success of the privatization were also taken by the government. For example, he mentions that in the case of British Aerospace, the government decided that £ 55 million, which was due from the company, need not be paid 'as any reduction in distributable reserves would diminish the attractiveness of the company in the stock market' (1999: 28). Similarly, in the case of National Freight Corporation, the government offered to meet £ 47 million towards the Pension Fund liability. According to Ganesh, this reduced the net cash income to the public exchequer from £ 53.5 million to £ 6.5 million and thus made the 'management buy-out' easy.

Ganesh gives several other examples of capital restructuring carried out by the government prior to privatization (1999: 28). He mentions that in British Telecom, equity was increased by £ 1.3 billion and debt to equity ratio was reduced from 60% to 48%. A decision was also taken not to transfer the long-term pension liability of £ 1250 million from the corporation to the new company.

He states that in British Gas, net assets were reduced prior to privatization. In the case of Associated British Ports where the debt to equity ratio was very high, £ 81 million worth of loans were written off prior to its sale.

He indicates that accounting adjustments were also carried out, wherever necessary, to show that the company was in good financial position before privatization. He gives the examples of British Telecom whose profits went up by £ 130 million over the five year period preceding privatization as a result of extensive depreciation, and British Gas where asset lines were extended, resulting in write-back of depreciation of £151 million for 1982, £156 million for 1983, and £181 million for 1984 (1999: 29). According to him, British Gas was also able to release deferred taxation of £ 170 million over the three year period.

Clarke too mentions that much of the restructuring of the corporations took place as a preparation for privatization with the injection of massive amounts of public money (1993: 216). For example, he points out that the water authorities had £ 5 billion of debts written off and received a further £ 1.6 billion 'green dowry.' He quotes from a report of the National Audit Office which states that 'the Department [of Environment] took considerable care to establish financially stable companies that would achieve the profitability and cash flow requirements necessary for flotation' (National Audit Office, 1992: 8). In addition, it is stated that the privatized water companies received costs-pass-through concessions relating to new legal requirements including EEC Directives, the possible costs of installing domestic water meters, and beneficial corporation tax treatment which meant that no water company was likely to pay mainstream

corporation tax over ten years because of the billions of pounds of unused capital allowances available to offset against pre-tax profits (Richardson et. al., 1992: 171).

In addition, Ganesh indicates that several organizational and operational changes were also effected which resulted in smoother transfer of the enterprises to the private sector. Certain legal measures were also taken to convert the public corporations into companies with an equity structure before flotation (1999: 29).

3.4.3 Techniques of sale

As Vickers and Yarrow indicate, there were principally two types of sale:

- a) offer for sale at a fixed price, and
- b) sale by tender, with a minimum price fixed.

The first method was followed in the case of the Associated British Ports' first issue in 1983, British Telecom's issue in 1984, and British Gas in 1986, while the second method was adopted for the Associated British Ports' second issue in 1984, British Petroleum in 1983, and Enterprise Oil in 1984. In the case of tender offers, the government invited bids for shares above a given minimum price. In the event of oversubscription, shares were allocated to those who entered the highest bids, and the share price became the 'striking price.' However, if the tender offer was undersubscribed, the underwriters would pick up the remaining shares at the minimum tender price.

The privatization of the British Airports Authority in 1987 combined both methods in so far as three-quarters of its 500 million shares were offered for sale

to the general public and institutions 'in the normal way' (to use Vickers and Yarrow's phrase), while the remaining 25 per cent were sold by tender. They indicate that while most tender offers are operated in which successful bidders pay the striking price at which supply equals demand, the BAA tender was different. Tenderers were committed to pay the price that they offered, and some therefore acquired their shares more cheaply than others (1988: 173).

According to Ganesh, there were certain other distinct characteristics in the share allotments. He mentions that importance was given to allotment of shares to 'small' applicants, in accordance with the government policy of encouraging wider ownership (1999: 30). Limits were also placed on individual shareholdings. For example, not more than 15% of the voting shares could be owned by any individual in Amersham, BAA, British Gas, British Telecom, Cable and Wireless, and Jaguar. Similarly, foreign-held shares could not exceed 15% of the voting shares in British Aerospace and Rolls-Royce, while in British Airways, no more than 25% of the shares could be owned by non-UK nationals.

Ganesh indicates that special terms of offer were formulated for the employees and pensioners of a privatized enterprise. These included 'free shares' or 'matching shares.' For example, in the British Telecom sale of 1984, 54 free shares were given to each employee apart from matching shares and a 10% discount. The idea of loyalty bonus was also introduced according to which a free share would be given in case a specified number of shares were held continuously for three years. This was done in the case of British Airways sale in 1987. Bonus shares were also issued in Britoil, British Gas and British Telecom.

The concept of 'golden share' was unique to the British privatization programme and is worth elaborating upon. While selling a public enterprise, the government retained a 'golden share' or 'special share' in some cases. According to Naib, this would entitle the government to intervene in cases where public interest is involved, such as circumstances that appear to violate restrictions on shareholding or disposal of a material part of the assets or voluntary winding up of the company (2004: 167). The enterprises in which the government holds 'golden share' are indicated in *Table 3.3*.

According to Ganesh, the government also came up with a buy-back arrangement with the Bank of England when the shares of BP plummeted below the flotation offer price in October 1987. Vickers and Yarrow also refer to the 'claw-back'⁵ provisions that were invoked when British Gas was privatized to allocate 64% of the shares to the general public instead of the original 40% (1988: 177).

3.5 Criticism of the privatization process

As Ganesh mentions, economists have found serious and very expensive flaws in the UK government's policy of selling state assets (1999: 38). Vickers and Yarrow, for example, point out that the techniques of sale used by the Government in the privatization program were 'seriously flawed' (1988: 184). Though researchers have found fault with virtually every aspect of the privatization policy, criticism has been particularly strident on the issues relating

⁵ 'Claw-back' refers to a provision in the sale of shares so that when the shares are resold by the FIs/MFs to the general public, a fixed percentage of the gain on such sales is transferred to the exchequer.

to: (a) underpricing of shares, and (b) high cost of sales. In this section, we shall attempt to examine these two issues.

3.5.1 Pricing of shares

According to Naib, one of the most controversial aspects of the privatization programme in UK has been the underpricing of shares in most privatizations (2004: 169). According to him, the techniques of sale used by the government in the privatization programme were seriously flawed. As already discussed in the previous section, three principal methods were used for the sale of shares, namely, offer for sale at fixed price, tender offer, and a combination of both. Vickers and Yarrow indicate that broadly speaking, there were three classes of applicant for shares: individual investors, financial institutions in the UK, and overseas institutions. They also say that a proportion of the shares would usually be placed with institutional investors in advance, who were typically clients of the stockbrokers and merchant bankers handling the issue for the government (1988: 177). The following table shows the pricing of shares in the privatized companies along with the methodology adopted for the sale.

Table 3.4 Pricing of shares in privatized companies

Company	Gross proceeds of sale (£ million)	Offer/tender price (p)	Price at first day of trading (p)	Percentage rise (fall) in price relative to offer/tender price	Under (over) valuation (£ million)
<i>Offers for sale</i>					
Amersham	63	143	188	32	20
Associated	22	112	138	23	5

British Ports (1983)					
British Aerospace (1981)	149	150	171	14	21
(1985)	550	375	420	12	66
BAA*	919	245	291	19	173
British	900	125	169	35	315
Airways British Gas	5603	135	147.5	9	519
British	290	363	367	1	3
Petroleum (1979)					
British	3916	130	173	33	1295
Telecom Britoil	450	185	207	12	54
(1985)					
Cable & Wireless (1981)	224	168	197	17	39
(1985)	602	587	590	0.5	3
Jaguar	294	165	179	8	25
Rolls- Royce	1360	17	232	36	496
TSB	1360	100	135.5	35.5	483
<i>Tender offers</i>					
Associated	52	270	272	0.7	0.3
British Ports (1984)					
BAA*	362	290	291	0.3	1
British	565	435	441	1	8
Petroleum (1983)					
Britoil	548	215	196	-9	-49
(1982)					
Cable & Wireless (1983)	275	275	273	-1	-2
Enterprise	393	185	185	0	0
Oil					

* Shares in BAA were sold by a combination of an offer for sale and a tender offer

Sources: National Audit Office & Mayer and Meadowcroft [cited in Vickers & Yarrow, 1988: 174]

According to Vickers and Yarrow, it is obvious that there was underpricing of shares in most privatizations. They estimate that the sum of this would be about £ 3 billion (excluding TSB). They find that the size of undervaluation varies according to how the issue is sold. It is seen that while the average price change for offers for sale was 21.1 per cent of the gross proceeds, for tender offers it was -1.9 per cent. This is because tender offers lead to reasonably accurate pricing since price is set by the forces of supply and demand, and circumstances make it impossible for bidders for shares to collude (1988: 178). In contrast, in the case of offers for sale, they felt there were numerous reasons why members of Government and their financial advisers had an incentive to set prices lower than their equilibrium values (1988: 178). These reasons include using underpricing as a tool to encourage wider share ownership. Vickers and Yarrow also found that glaring examples of underpricing occurred where a company was entirely new to the market, as were BT, British Gas, and British Airways. According to them, the fact that there were no companies quoted on the UK Stock Exchange that were comparable with these firms made pricing especially difficult since price had to be 'set somewhat in the dark.'

Clarke also states that privatization shares were consistently deliberately undervalued at the launch, and the moment the shares began dealing the government recorded losses, which amounted to billions of pounds, including an immediate loss of £1,300 million on the day of the British Telecom sale (1993: 216). In his view large discounts on share prices were consciously provided by

the government to entice subscribers, but this was done in an ‘unnecessarily extravagant way’ as successive sales were consistently subscribed several times over, as would be evident from *Table 3.3*.

Because of initial underpricing of shares, subsequent profits were enormous in major privatizations, as may be seen from the following table.

Table 3.5 Pricing of shares (£)

Company	Gross proceeds	Offer price	First instalment	Opening price	Percentage gain	Value of gain
British Telecom	3,900 m	1.30	0.50	0.93	86%	1,290 m
TSB	1,360 m	1.00	0.50	0.85	70%	476 m
British Gas	5,600 m	1.35	0.50	0.62	25%	518 m
British Airways	900 m	1.25	0.65	1.09	68%	317 m
Rolls-Royce	1,360 m	1.70	0.85	1.47	73%	496 m
BAA	920 m	2.45	1.00	1.46	46%	172 m

Source: Yarrow (Ramanadham, 1993: 73)

It is not as if the underpricing could not have been avoided. According to Vickers and Yarrow, market forces could have been used to a far greater extent in the setting of prices. They point out that tender offers lead to much more accurate pricing than offers of sale and feel that an element of tendering could have been employed even when an offer for sale was the chosen method. Moreover, they suggest that it would have been ‘manifestly sensible to sell portions of equity over time rather than all at one go’ (1988: 184). This is because once the first tranche is sold, a well-established market would exist and further tranches can then be priced with better accuracy. They admit that this practice was followed in the case of BP and BT, but on the other hand massive companies like British Gas,

British Airways and TSB were all sold in one chunk, which was felt to be unnecessary since according to them, selling in stages would not have affected the cash flows to the Government (1988: 184).

3.5.2 Cost of sales

Apart from undervaluation, Vickers and Yarrow also commented on the cost of sales which they felt was disproportionately high. The cost of major asset sales in the UK is given in the following table.

Table 3.6 Cost of major asset sales

Company	Date of sale	Expenses (£ million)	Expenses as percentage of proceeds
Cable and Wireless	1981	7	3.1
British Aerospace	1981	6	3.8
Amersham	1982	3	4.6
Britoil	1982	17	3.2
Associated British Ports	1983	2	11.2
Enterprise Oil	1984	11	2.8
British Telecom	1984	263	6.8
British Gas	1986	360	6.4
British Airways	1987	42	4.7

Source: National Audit Office [cited by Vickers and Yarrow, 1988: 181]

It is mentioned that the figures exclude the costs borne by the companies themselves, which include the value of marginal time and effort, and other advisory and promotion expenses. For example, BT was estimated as having paid more than £ 8 million to its own advisers, and to have spent some £ 25 million on its own pre-flotation advertising campaign.

According to Vickers and Yarrow, the most expensive asset sales were those of BT and British Gas. They mention that the two largest components of the expenses on selling BT were small-shareholder incentives (£ 111 million) and

fees and commissions associated with underwriting and placing shares (£ 87 million). Besides this, they indicate that millions of pounds were spent on professional and advisory fees. Apart from the sale of BT and BG, where the expenses came to 6.8 and 6.4 per cent respectively, and Associated British Ports where it was an unusually large 11.2 per cent, the costs were felt to have been generally in line with expenses on large private issues, which Dimson (1985) estimated to be approximately 4.5 per cent in the UK (1988: 183).

Clarke too believes that the government paid hundreds of millions in fees to the merchant banks, accounting firms, stockbrokers, and advertising agencies who prepared the companies for privatization, as may be seen from the table given below. He indicates that the National Audit Office calculated that by the time of electricity privatization in 1991, the process would have cost the government £ 2,375 million, more than half of which was spent on the electricity and water privatizations. Clarke quotes Buckland to observe that, ‘by every yardstick, [this] policy has been costly to the taxpayer’ (Buckland, 1987: 255 – cited by Clarke, 1993: 216).

Table 3.7 Five UK companies: the costs of privatization, 1984-87

(in millions of pounds)

	<i>British Telecom (1984)</i>	<i>British Gas (1986)</i>	<i>British Airways (1987)</i>	<i>Rolls- Royce (1987)</i>	<i>British Airports (1987)</i>
<i>Direct costs:</i>					
Underwriting, broking etc	74	60	7.8	12.5	13.6
Commissions	13	9	2.9	4.2	4.2
Bank costs	20	45	7.5	11.0	13.2
Marketing	14	40	6.2	4.0	10.0

Fees to advisers		5	4.3	2.2	2.4
Total	127	159	28.7	33.9	43.4
<i>Costs of employees' preferential treatment:</i>					
Free and matching shares	51	33	13.1	12.	3.3
Discounted shares	5	4	1.6	2.4	--
Total	56	37	14.7	14.4	3.3
<i>Costs of direct incentives to investors:</i>					
Bonus shares	88	122	13.1	--	53.9
Bill vouchers	23	63	--	--	--
Total	111	185	13.1	--	53.9
<i>Cost of indirect incentives to investors:</i>					
Premium as % of issue price ⁶	91	28	63	7	37

Source: Price Waterhouse [cited by Clarke, 1993: 217]

According to Vickers and Yarrow, there were several reasons why the Government could and should have privatized at a lower cost than a private issue of shares. They refer to the study by Mayer and Meadowcroft (1985) which brought out several important differences between the position of a Government selling state assets and that of a private company raising funds on the equity market. First, the Government does not face the cash flow constraint of a private firm. Secondly, the Government's capacity to bear risk is vastly greater than that of any private firm and, more to the point, that of any underwriter. Vickers and Yarrow indicate that underwriting makes sense only if the underwriting institutions are less risk-averse than the issuer. However, according to them, 'no

⁶ This premium is computed as the percentage in share price from the paid issue price to the closing price after one week's dealing.

institution can be less risk-averse than the Government.’ It is therefore curious that the Government should have spent so much on underwriting fees⁷. Mayer and Meadowcroft (1985) report that underwriting costs of £0.7 million, £ 0.4 million, £ 4.6 million, £ 22.4 million, £ 9.8 million, and £ 4.5 million were incurred in the privatizations of Amersham, Associated British Ports, BP, BT, Britoil, and Cable and Wireless respectively. Vickers and Yarrow conclude by stating that ‘it was inappropriate for the Government to underwrite many privatizations, especially in view of its pricing strategy’ (1988: 184), which, as has been explained in the previous section, was underpriced to begin with. These gave an undue advantage to certain sections of the society such as investors and underwriters at the cost of the government.

3.6 Impacts of Privatization

The privatization programme set out to achieve certain objectives as has been detailed in section 3.3 earlier. However, researchers have questioned whether the different objectives behind the programme were fulfilled or not. In this section, we analyze the impact the British privatization programme had vis-à-vis some of these objectives. This is important since the British model is usually held as a model for other countries attempting privatization.

3.6.1 Efficiency and competition

The effects of ownership on efficiency of enterprises has already been debated in the previous chapter. In the context of British privatization, a central stated objective of policy was, as Vickers and Yarrow point out, to ‘improve efficiency

⁷ These are fees payable to underwriters in case of under-subscription of shares.

by unleashing competitive forces.’ However, it is doubtful if this was achieved. Clarke, for example, categorically states that if competitive efficiency had been the primary objective, then restructuring the nationalized industries into competing corporations and divisions would have been essential, though this may have reduced the attractiveness of the privatized share offers on the stock-market, may possibly have jeopardized some sales, and the government might have received less revenue (1993: 212). However, he points out that the transformation of public monopolies into private monopolies was a safer and easier option, though it undermined government’s claims concerning the future efficiency of the companies, and contradicted the economic theory that the government propounded. In support of his argument, he quotes Kirkpatrick (1988: 240) who held that ‘allocative efficiency is a function of market structure rather than ownership.’ Thus, it was felt that in the absence of competition, denationalization was unlikely to result in major gains in efficiency performance.

Yarrow supports Kirkpatrick’s view by stating that ‘the hypothesis that privatization *per se* will quickly lead to substantial improvements in the performances of inefficient state-owned enterprises is not well supported by the data’ (Ramanadham, 1993: 76). While he admits that it is true that in many cases there had been a history of improving profitability and labour productivity since privatization, it was difficult to find substantial and general performance improvements that could be *directly* attributable to privatization as such.

The problem is further compounded by the fact that many of the enterprises that were privatized were natural monopolies. In fact, according to

Vickers and Yarrow, where monopoly exists the case for preferring private ownership to public ownership weakens considerably since privately efficient profit seeking can no longer be expected to lead to socially efficient results (1988: 426). They point out that it is imperative for privatization to be accompanied by adequate measures to reduce and contain market power. They also suggest that wherever feasible, the scope of competitive forces should be expanded by the effective removal of barriers to entry and by restructuring the dominant enterprise. If monopoly power still remains, the task would be to devise regulatory mechanisms that encourage internal and allocative efficiency and discourage strategic behaviour by the firm towards the regulatory authority. Finally, they warn that unless effective competition and/or regulation are introduced, the privatization of firms with market power would simply bring about private ownership 'in precisely the circumstances where it has least to offer' (1988: 427).

According to Clarke, it is difficult to imagine any advantages that a private monopoly may have as compared to a public monopoly. He categorically states that the subordination of the objective of achieving economic efficiency in the industries to be privatized to the government's immediate political priorities to raise short-term revenue and secure quick sales of public assets, had not only undermined the logic of the government's case for privatization, but had converted vital sectors of the British industry into private monopolies that would prove to be extremely difficult to break (1993: 214). In the absence of competition, the creation of regulatory agencies was seen as the only means to 'rescue the consumer from the possibility of naked exploitation' (1993: 214).

3.6.2 Effect on public finances

As Yarrow indicates, much of the initial impetus for rapid privatization in the UK came from its anticipated effects on the public finances (1993: 78.) However, as Vickers and Yarrow pointed out, in considering the effect of privatization upon the financial position of the Government, it is important to distinguish between the short-term impact on the Government's accounts and the effect on its real economic position in the longer term (1988: 185). It has already been mentioned that reducing the public sector borrowing requirement (PSBR) was one of the main aims of privatization in UK. In this connection, Vickers and Yarrow observe that a major short-term attraction for the Government of selling state assets was the fact that the sale proceeds were deducted from the 'public sector borrowing requirement' (PSBR). In fact, they point out that according to a 'curious accounting practice,' the sales proceeds were treated as 'negative public expenditure.' They mention that Mrs Thatcher's government had always attached great importance to reducing the PSBR and, thanks to accounting definitions, privatization offered a very convenient way of doing so without further cutting public expenditure or raising taxes (1988: 186).

However, Vickers and Yarrow clarify that the short-term impact of privatization on the PSBR has several components. They refer to Mayer and Meadowcroft's analysis (1985: Section III) to state that the PSBR was reduced by the extent of the sales proceeds, the capital expenditure program of the company being privatized, and the company's payments of interest and dividends (1988: 186). However, they point out that the fact that the gross profits of the company

move out of the public sector accounts would eventually increase the PSBR. They also say that the net effect would depend primarily upon the relative sizes of the investment expenditures and the gross profits of the company, as well as the sales proceeds. Nevertheless, in view of the fact that the shares had been underpriced and that transaction costs i.e. expenditures on promotion, professional fees, underwriting charges etc., had been large, they opine that the government's privatization program would 'impoverish' its net worth and end up worsening its long-term financial position (1988: 186).

Subsequently, however, Yarrow seems to have slightly modified his initial stand. For example, writing in 1993, he points out that in addition to receipts from sales of shares and the removal of requirements to finance investment programmes from government budgets, public finances had also been significantly affected by the increase in corporation tax receipts from privatized companies. Though it is true that the state gives up its rights to future income flows in return for lump sum payments from investors, he believes that it does not 'give up *all* rights in relation to those flows.' Thus, with corporation tax for large companies being levied at a rate of 35 per cent, he feels that the state continues to lay claim to over a third of future profit flows, even when the divestiture is complete (Ramanadham, 1993: 78).

Moreover, Yarrow believes that when divestiture is only partial, the state's interest is even larger. He gives the example of British Telecom where between 1984 and 1991, the government continued to hold a shareholding of nearly 50 per cent. Combining this with the corporation tax factor, he says that it can be seen

that approximately two-thirds of British Telecom's profits over the period were claimed by the state (1993: 78). Further, in the case of the utility industries, which were monopolistic in nature, it was seen that the post-privatization periods were marked by rapidly increasing profits.

However, other researchers are not so convinced. Clarke, for example, states that the impression that privatization has proved a spectacularly successful means of raising government revenue must be contested (1993: 216). He points out that virtually all the privatized concerns have a subsequent market capitalization that is far greater than the amount raised by the government in the sale of assets. He says that it can be argued that this difference represents a significant loss to the public purse of valuable assets, which were sold off cheaply, in order to ensure the privatization programme succeeded. Though the government might insist that the higher value of the privatized industries subsequent to privatization represents the results of a remarkable transformation in these companies' commercial performance, according to him, such a view would overlook some important considerations. These include the fact that much of the restructuring of the corporations took place as a preparation for privatization with the injection of massive amounts of public money, and that privatization shares were deliberately undervalued at launch. Also, improvement in profitability, he argues could be on account of increase in prices, sale of assets, reduction in manpower, and cutting unprofitable services and not necessarily due to reduction in costs, improvement in quality and expanding sales. He quotes Marsh (1991: 469) to emphasize that 'a common consequence of privatization is

increased prices to customers.’ Clarke points out that if the former public corporations had abandoned their commitment to social responsibility, they could have recorded higher profits, though whether this would have benefited the wider economy or society is open to question (1993: 217).

3.6.3 Wider share ownership

According to Vickers and Yarrow, an important objective of Mrs Thatcher’s government had been to promote wider share ownership, and especially share ownership by employees of companies, as part of the desire to extend ‘property-owning democracy’ in Britain (1988: 188). However, in their view privatization, by itself, ‘does little or nothing to promote wider share ownership.’ This is because individual’s investment decisions depend upon the information that they have and their incentives. In the case of privatization in UK, they point out that the principal incentives have been the prospects of immediate capital gain due to generous pricing, and rewards in the form of vouchers and bonus shares for shareholders who keep their shares for some time. According to them, these measures have had a large impact on the pattern of shareholding in Britain.

Nevertheless, it cannot be disputed as Clarke says, that the privatization programme did in fact initiate a huge and unprecedented expansion in the number of shareholders, which the government claimed created the foundations of a ‘shareholders’ democracy.’ Vickers and Yarrow indicated that before the privatization programme began there were approximately two million individual shareholders in Britain, which worked out to about 5 percent of the adult population. In their view the privatization of BT in 1984 gave the first major

boost to individual share ownership while further impetus came from the sales of the TSB and British Gas in 1986 (1988: 189). They further point out that early in 1987, after the TSB and British Gas had been privatized, a survey by the *Observer* suggested that 23 per cent of adults in Britain – some 9.2 million individuals – owned shares. Other surveys (Grout, 1987) also suggested that around 20 per cent of British adults owned shares. According to Vickers and Yarrow, all these things showed ‘the overriding importance of privatization in promoting wider share ownership’ (1988: 189).

According to Clarke, other incentives in the form of subsidies in respect of telecom, gas and electricity, over and above the immediate premium on privatization shares, also contributed to the explosion in the number of shareholders in Britain (1993: 218). However, he points out that the massive inflation of the number of shareholders was only ‘a very temporary phenomenon.’ This is because most shareholders did not hold on to their shares for long but sold them for immediate gain soon after acquisition. As the table below reveals, the percentage of original shareholders who retained their shares was significantly below the 66 per cent claimed by the government, and since this data had been compiled by Bishop and Kay in 1988, had further decreased towards 40 per cent retention overall (Clarke, 1993). As mentioned, the majority of these new shareholders quickly disposed of their investment having secured the benefit of the initial discount. However, prescribing a minimum lock-in period for sale of shares could have prevented this.

Table 3.8 Size of privatized company share registers in the UK

<i>Company</i>	<i>Successful applicants</i>	<i>Number of end first year</i>	<i>shareholders: latest</i>	<i>% of original number</i>
Amersham	65,000	8,601	6,048	9.3
British Telecom	2,300,000	1,692,979	1,311,139	57.0
BAA	2,187,500	1,064,815	1,064,815	48.7
British Gas	4,407,100	3,111,872	2,903,416	65.9
British Airways	1,100,000	420,526	347,897	31.6
Jaguar	125,000	54,104	42,790	34.2
Britoil	35,000	39,558	*	*
Asso. Brit. Ports	45,000	15,500	n/a	n/a
Enterprise Oil	13,700	14,146	10,714	78.2
Rolls-Royce	2,000,000	924,970	924,970	46.2

Source: Bishop and Kay (1988), *Does Privatization Work – Lessons from the UK*, London Business School [cited by Clarke, 1993: 219]

Other researchers have come up with similar findings. Vickers and Yarrow, for example, point out that while there were 2.3 million shareholders in BT immediately after it was privatized, this number fell by just over a quarter in the year after privatization, and at 31 March 1987 there remained only 1.4 million shareholders. Similarly, they indicate that while more than a million applicants received shares in BA, the number of shareholders fell to 420,000 in May 1987, only three months after the sale (1988: 190).

According to Vickers and Yarrow, the pattern of wider share ownership associated with privatization in Britain had certain other characteristics. For example, they point out that although the number of shareholders increased, the new shareholders typically owned very few shares. Most owned shares in only one firm, and most had shareholdings worth less than £1000. Thus, according to them, while the ownership of shares did become wider, it was spread very thinly.

* Acquired by BP

They also found that the proportion of shares owned by individuals had not risen in line with the growth in the number of shareholders.

Not only were the investments modest, but also as the table below would reveal, they were mostly confined to single companies.

Table 3.9 Number of companies invested in by individual shareholders in UK, 1987

<i>Shares in</i>	<i>Shareholders (%)</i>	<i>Approximate number</i>
1 company	56	5.4 million
2 companies	22	2.1 million
3 companies	9	0.8 million
4 to 9 companies	8	0.8 million
10 plus companies	3	0.3 million

Source: Dewe Rogerson Marketing Consultants 1986 [cited in Clarke, 1993: 220]

Clarke quotes Howard Hyman of Price Waterhouse (*Observer*, 25 October 1987) to indicate that although the percentage of adults owning shares dramatically increased, the proportion of the total equity market controlled by individuals rather than institutions continued to decline. It is stated that between 1963 and 1981 the proportion of the stock market directly owned by individuals fell from 54% to 28%. It is further stated that statistics available for 1986 indicated that out of a total equity market valued at £368 billion, some £8 billion was owned by individuals or 24 per cent (1993: 219). Clarke maintains that despite appearances to the contrary, the impact of privatization had not served to reverse this trend since the majority of the privatized shares ended up with the financial institutions.

As a result of privatization there had thus been a *widening* but not a *deepening* of personal share-ownership in the UK (Marsh, 1991: 475). Ganesh refers to the Weinberg Committee Report⁸ (1996) which stated that only 2 million out of the 10 million who bought shares initially had reinvested in other shares (1999: 47). Vickers and Yarrow too opine that although privatization had increased the number of shareholders, it would require other measures to deepen share ownership (1988: 190).

3.6.4 Impact on labour

There is no doubt that workers in the enterprises that were privatized were considerably affected by the public policy reforms in the 1980s in UK. However, as Yarrow argues, the major impacts had been the result not of privatization as such but rather as a result of the increased priority attached to financial objectives over this period (Ramanadham, 1993: 79). In fact, he claims that privatization itself can be interpreted as an effect of this change in objectives. He points out that as a result, many of the industries and enterprises concerned reduced employment considerably during the 1980s. These included British Steel, British Coal, British Airways, Associated British Ports, and British Rail. He mentions that although some of this reduction in employment occurred after divestiture, the bulk of it occurred before flotation.

Clarke tries to dispel the impression that privatization led a new breed of happy worker-owners. He indicates that though in most privatizations there were

⁸ *The Committee for Private Ownership* headed by Sir Mark Weinberg was commissioned to find ways of extending direct share ownership but its findings showed that most investors did not understand the stock market well enough to invest directly.

facilities for workers to buy shares which almost all did, the value of their shareholdings was very small. For example, whereas the top five BT executives held 1.3 million BT shares worth £ 5 million, an average employee held 270 shares only, while in British Gas in 1991, the top seven executives owned 1.5 million shares worth £ 3.5 million as against which the average employee held 850 shares worth around £2,000. He points out that though British Aerospace sold 3 million shares to its workforce, this amounted to just 1.3 per cent of the total, while in the privatization of British Steel, workers with 20 years service received just a few hundred pounds of shares each. The net result was that these workers 'conscious of the impossibility of ever achieving any real stake in their companies' would simply sell the shares (1993: 222), as was seen in *Table 3.8*.

However, there was one group of employees who benefited greatly from the privatization of their companies. These were the top company executives. Clarke indicates that salary increases of up to 352 per cent in the income of top company executives had been recorded in the three years after privatization, as would be evident from the table given below.

Table 3.10 Increase in UK directors' salaries after privatization

<i>Company</i>	<i>Before</i>	<i>After privatization</i>				<i>Increase (%)</i>
	<i>privatization</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>	<i>Year 5</i>	
Amersham	£ 30,360	£ 88,983	£130,178			329*
Asso. Brit. Ports	£ 35,196	£ 58,749				67
British Aerospace	£ 44,467	£ 73,378	£ 87,260	£ 100,790	£125,000	181
British Petroleum	£120,385	£158,151	£172,770	£183,134	£241,547	101

* This may be compared to the average increase in earnings which during the period 1980-86 was stated to be 7.5 per cent per annum.

British Telecom	£ 67,900	£111,399	£160,000	136
Britoil	£ 72,000	£ 98,000		36
Cable & Wireless	£ 30,277	£111,952	£136,881	352
Enterprise Oil	£ 28,560	£ 90,000		215
National Freight	£ 51,046	£ 98,292		93
British Airways	£ 52,000	£178,000		242
British Gas		£184,000		68

Source: compiled from various sources by Clarke (1993: 223)

On the issue of contracting-out, Clarke points out that contracting-out had been practiced in the past as well but this was in order to reduce operating costs, minimize the use of capital, meet peak work loads, and provide a specialist capacity not available in-house. According to him, however, the contracting-out practiced as a result of the policy reforms was quite different in so far as the services being contracted-out were those being performed in-house, leading to the risk of redundancies. He refers to a government review *Using Private Enterprise in Government* published by the Cabinet Efficiency Unit in 1986, wherein the following five main reasons were given for promoting contracting out of services: (a) to save money, (b) to save management time, (c) to obtain expertise not available in-house, (d) to retain flexibility, and (e) to re-establish management control (from the unions). However, Clarke indicates that such arguments either ignore or have no concern for the contrary view that in-house services often provide better quality; are more reliable and flexible; that private contractors cut corners to increase profits; private employees often have little training or loyalty

to the job; and contracting-out undermines wages, conditions, and manning levels and trade union rights (1993: 225).

3.7 Assessment of the UK privatization programme

The UK privatization programme is generally considered to be a very successful experiment and has accordingly been emulated by several countries as a model to be adopted. However, in view of the analysis provided in the previous section, which showed that many of the key objectives had not been achieved, it becomes necessary to review the assessment of the privatization programme made by different researchers.

Vickers and Yarrow start by mentioning that the principal stated objectives of the Government had been to maximize sales proceeds and to widen share ownership. In their view, the underpricing of major share issues meant that the first of these aims had not been achieved successfully, while the second had been met in a 'highly expensive and rather distorted way' (1988: 192). 'According to them, however, the improvement of 'industrial efficiency' was the 'primary criterion.' The other goals associated with the privatization programme such as extending share ownership, raising revenue etc., they felt could be promoted by other means as well, and hence are accorded secondary importance.

Vickers and Yarrow highlight the point which has been touched upon in the previous chapter as well, that it is imperative for privatization to be accompanied by adequate measures to reduce and contain market power. In other words, privatization as an efficiency-enhancing tool will only succeed if it is accompanied by competition and not if it fosters monopolistic behaviour.

Accordingly they feel that privatization is appropriate where private ownership works best and therefore agree with the privatization of firms in 'reasonably competitive industries' such as in the case of Amersham, Associated British Ports, British Aerospace, British Petroleum, Cable and Wireless, Enterprise Oil, Jaguar, Rolls-Royce, and TSB. British Airways too, they feel, can be in the private sector if it could be made to operate in a truly competitive environment (1988: 429).

With regard to the utilities, however, they are of the opinion that a more piecemeal approach was warranted. Here what they are recommending is a sort of public-private partnership. For example, in the gas industry they feel that privatization would have been more advantageous if the national transmission system had been kept under public ownership. On the other hand, with regard to privatization of infrastructure, they feel that while there was scope for contracting out some operations such as sewage treatment and pipeline maintenance etc., there was little to gain from privatization. They are of the opinion that in the long run the British privatization programme will be judged in terms of its effect on economic efficiency, and if that is not achieved, it may well be termed a failure.

Clarke, on the other hand, observes that the emphasis upon privatization in recent years has distracted attention away from the possibility of reform and restructuring *within* the public sector. He notes that while clearly 'fundamental transformation of the public sector is necessary, the question is whether the only way to achieve this is through privatization' (1993: p. 228). While admitting that the British economy had become more efficient than it was in the 1970s, he says that this was due to a wide range of factors (including the expansion of North Sea

oil). He quotes Kirkpatrick when he remarked that privatization is a 'confluence of ideology and pragmatism' (Kirkpatrick, 1988: 237), but states that 'despite claims to the contrary, it is not concerned either with economic democracy or efficiency' (1993: 230).

One may or may not agree with Clarke's views that privatization is a 'contradictory policy and the resulting industrial structure is unstable,' but there is considerable merit in his statement that it is 'now comprehended that public ownership is not simply state ownership, but represents a multiplicity of potential forms in which the active participation of producers and consumers is the guarantee of social responsibility and economic effectiveness' (1993: 230). Similarly, if privatization is to yield benefits in any country, and more so in a developing country like India, it would be not by simply supplanting public ownership by private ownership, but through a private-public partnership model that draws upon the strengths of both systems for the common good.