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## **THE ROLE OF SERVICES OF ECONOMIC GENERAL INTEREST WITHIN THE FRAME OF INTERNATIONALIZED ECONOMIES**

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***Workshop 1 – Services of General Economic Interest***

## **1. THE RISE AND CRISIS OF PUBLIC ENTERPRISE**

It is well known that public enterprises have been the subject of great disputes in recent years and have had to abandon previous conquests. The change arrives after a long period of progressive increase in public ownership that started at the end of the nineteenth century and affected almost all countries.

The presence of public enterprises was initially confined to local public services, but at the beginning of the twentieth century it extended to national contexts with the progressive and growing increase in the public ownership of large grid or network type public services starting with the railways. They were initially thought of as a practical instrument for public services that operate under conditions of natural monopoly where the intention was to appropriate the monopoly rents for the public sector. However, with the passage of time public enterprises moved into the manufacturing sector - often to prevent the bankruptcy of private sector companies - and started to become significant quantitatively in terms of national production in the period between the end of the First World War until at least the middle of the 1970's.

In the late fifties and early sixties public enterprise enjoyed its greatest splendour and this occurred both in Europe and developing countries. In England the Labour party pushed a number of nationalisations through on the basis of Morrison's theories which the following conservative governments did not question. In France, public enterprise taking its lead from Cobertian tradition became increasingly important not just in size but also as an instrument of national planning. In Italy the system of state owned joint stock companies became popular and developed very rapidly. It was studied and imitated abroad during the 1960's because it was considered particularly efficient, combining the advantages of both public and private sectors. The United States was the only developed country to constitute an exception. It preferred to provide public services by regulating private providers rather than public ownership.

The instrument was also widely used in less developed countries. In this period, mixed economies - except for those based entirely on the socialist model - were the prevalent type almost everywhere. Alongside the private sector, the public sector and public enterprises, publicly owned companies that is, took on an important role in the functioning of the system. Even the international bodies created by the Bretton Woods agreements (the International Monetary Fund and the World Bank) pressed countries, with regard to the programmes they financed, to adopt measures in which the public sector and public enterprises worked actively to solve development problems and to overcome difficulties with the business cycle. The process of expansion continued, if not uniformly, until the middle of the 1970's when the forces behind public sector growth seem to lose impetus (one important exception to this was France where they proceeded, under Mitterand at the beginning of the 1980's, with the nationalisation of

many companies; this episode was, however, brief and remained isolated among industrialised countries).

After the first oil crisis, following the Yom Kippur War, the climate towards public sector enterprises was less favourable. Its capacity to perform its tasks well was questioned and the criticism was made that public enterprises often failed to reach acceptable levels of efficiency and presented losses on their balance sheets that were not always justified by optimal price theory. A debate started in the United States on deregulation, while, under the premiership of Mrs. Thatcher, a massive privatisation programme was launched in England. At the beginning this involved companies in manufacturing industries only, but later it also involved public services. Little by little, the “revisionism” started to spread on an international scale, affecting not just industrialised economies but developing countries too. The figures for the sales of public enterprises are impressive for both developed and developing countries. In 1997 alone, for example, sales of public sector enterprises came to 162 billion dollars, 0.5% of gross world product <sup>1</sup>. Even if in many cases government (local or central) would maintain control over a company selling only a share of it, the reduction in size of the public sector is truly impressive.

Privatisation processes, obviously follow paths that are determined by the history and institutions of each individual country, and this creates a plurality of privatisation models. It is nevertheless interesting to note that just as nationalisation or “publicisation” in the previous period was performed by all governments, both conservative and progressive, although with differing intensities, today the reverse process of privatisation is being carried out again by both conservative and progressive governments, without any great distinction between the policies of the two political forces. Obviously there are underlying judgements shared by the public which characterise the cultural climate of a determined period and which influence the behaviour of all the political parties in a system.

In the first three quarters of the last century these shared values led, in the more developed countries, to a progressive enlargement of the public sector, with continuous growth in public spending and taxation and the creation of an ever increasing number of publicly owned companies. There has been a considerable change over the last twenty five years: confidence in the capability of the state to manage enterprises has been shaken, decisions to change direction have been taken and opposing policies have been planned. Concerns over the efficiency of public enterprises seem to have become widespread at the expense of redistribution policies and the pursuit of “social” objectives; privatisation policies are accompanied by a renewed support for “liberal” economic doctrines and for economic policies that move the borderline between private and public to expand the private sector.

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<sup>1</sup> See Schipke A.82001) page 1

A phenomenon of this magnitude cannot, in our opinion, be explained by the revival of well known theories alone. A search for other factors must be made, for institutional and/or technological and macroeconomic factors which have changed the context in which public enterprises operate and which would therefore justify changes of such magnitude.

## **2. PUBLIC ENTERPRISES AND EFFICIENCY**

The “rejection” of public enterprises has been explained by claiming that they are “inefficient” compared to private enterprises. This claim is usually made on the basis of the well known theories of property rights and information asymmetries. Clearly, however, no in-depth analysis that assesses the importance and validity of these theories is given here, but let us remember that the fundamental point is that the incentives are insufficient to make public sector management efficient. While these theories have undoubtedly contributed to throw light on important aspects of the functioning of enterprises, they are not totally acceptable. They have in fact probably overestimated the empirical importance of information asymmetries, forgetting, amongst other things, that these also represent an unsolved problem in large private enterprises where ownership is separated from management.

What was considered an expression of inefficiency in public enterprises, due to the inability of principals to control them, is often no more than the consequence of a general objective imposed by politicians who do not consider efficiency a priority. Directives given by politicians are important determinants of the behaviour of public enterprises.

Confirmation of what has been said is given by the observation that at different times in history public enterprises have responded well, both appropriately and efficiently, to the requests made of them. Examples include the municipally owned companies in Italy during their first period of activity and the state owned joint stock companies in their first thirty years of activity, while in France public enterprises are generally considered reasonably efficient organisations. Finally there are the British public enterprises which, following precise directives from government, achieved large increases in productivity before being privatised. Furthermore, the numerous studies that have been performed to measure the relative efficiency of public and private enterprises have not given unequivocal results (obviously the question changes when the entire economy is publicly owned)<sup>2</sup>.

Public enterprises are therefore capable of efficiency but they can nevertheless be called upon by politicians to pursue general objectives, contained in the political agendas of governments, such as for example: income redistribution, employment,

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<sup>2</sup> The literature on the subject is now abundant. For the latest see Megginson W.L. and Netter J.M (2001)

support of national production and/or depressed areas, satisfying particular interests. In this case public enterprises are not bound by the objective of efficiency. It may also be claimed that in recent years a network of corporative interests (politicians, managers, employees, associations etc.) has increased its influence over public enterprises decreasing their efficiency and often reducing what should be general interests to particular interests. We therefore feel that the cause of the current discredit that has fallen on public enterprises must be sought not in some intrinsic incapacity to be efficient but in the fact that in general they perform tasks that are no longer considered acceptable.

Part of the doctrine, however, seems to have underestimated aspects relating to competition and budget constraints. The competitive context in which an enterprise operates is more important than its ownership in the sense that it is the presence of competitors that obliges public or private enterprises to either adopt efficient behaviour or fail in the market place. Therefore, if efficiency is an objective, elements of greater competitiveness must be introduced to the markets in which enterprises operate. Difficulties arise because public services, especially those of the network or grid type, often operate in conditions of a natural monopoly and consequently merely replacing public enterprises with private enterprises does not guarantee the best results.

### **3. THE MANY “WHY”S AT THE ORIGINS OF THE PUBLIC SECTOR CRISIS**

The question nevertheless remains to be asked why distrust and lack of confidence in public enterprise spread so much during the 1970's. We feel that the question cannot be written off by simply putting the phenomenon down to the rise to power of “conservative” and free market politicians such as president Reagan and Mrs. Thatcher or to the popularity of economic theories that favoured market economies. Nor can it be attributed to the break up of centralised planning systems which didn't occur until privatisation programmes had been underway for some time. The success of politicians with particular ideas demonstrates that there were important majorities in society willing to support their programmes. Furthermore, the most extreme free market ideas became popular where “conservatives” came to power and this occurred not just in industrialised countries but also in developing countries (for example, South American countries such as Argentina, Brazil, Chile, etc.).

It should also be noted that the debate on the economic role of the state did not only concern public enterprises, but also the entire question of government intervention. It was not limited to a mere critical evaluation of public enterprises but questioned the current organisation of the welfare state, which may be considered the most far reaching project implemented, although in different forms, by industrialised countries in the twentieth century. The perplexities and doubts concern the ability to maintain

existing levels of services given the demographic changes which have produced an ageing population and substantial increases in spending on health and pensions. Furthermore, recourse to additional funding to meet the increased demand is not easy because the tax burden has already reached very high levels.

Identification of the motives which led to a change in the way public intervention and public enterprises in particular are viewed cannot simply end, in our opinion, in the search for a single cause. A series of concomitant factors explain the current situation of public enterprises and we will limit ourselves to examining some which we feel are among the most important.

#### **4. THE OPENING OF ECONOMIES TO INTERNATIONAL MARKETS AND THE CONSEQUENCES FOR THE PUBLIC SECTOR**

It must first be remembered that public enterprises operate in a changed political institutional context where two elements, which are also connected one with the other, are of prime importance. On the one hand there has been a progressive opening up of national economies to international markets and on the other the relationship between states and markets has changed to produce a new balance of power between the two.

With regard to the first point, the progressive internationalisation of economies is shown by: the increase in exports as a percentage of world GDP (this has increased by two and a half times since 1950, encouraged by the removal of customs barriers and by various international agreements); the freer movement of capital; the expansion of foreign investment; the creation of numerous transnational enterprises (according to a UN study, there were 35,000 transnational enterprises in 1992 with more than 200,000 subsidiaries)<sup>3</sup>; the considerable population migration that has occurred over the last twenty five years.

The novelty of the phenomenon has been questioned with the claim that in some ways economies were just as internationalised at the end of the nineteenth century and at the beginning of the First World War as they are today.<sup>4</sup> This is true, but some of the circumstances and ways in which the current globalisation has occurred seems to be new<sup>5</sup>.

It is above all the size of the foreign investment flows and the nature of capital movements that are much greater today. They consist mainly of short term, speculative investment on financial markets, while in the past these flows were much smaller. They were hindered by the difficulty in obtaining timely and reliable information, and

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<sup>3</sup> See the preface in Boyer R. e Drache D. (1996) for information on the relative importance of multinationals

<sup>4</sup> Bairoch P. (1966).

<sup>5</sup> See: Baldwin R. E. and Martin P. (1999); Bordo M. D., Eichengreen B. and Irwin D. A. (1999).

consisted above all of long term investments in the production of primary goods or loans for the construction of infrastructures.

Secondly there are the different characteristics of the processes by which economies have industrialised/de-industrialised in the first and the recent internationalisation of markets. A century ago the industrialisation of the more economically developed countries was the main cause of the stagnation of the more backward countries since the latter were unable to compete with the former. This triggered a slow catching up process among developed countries and led to a widening of the per capita income gaps<sup>6</sup>. In recent decades we have seen a very different process in operation and in fact the convergence of standards of living among developed countries is occurring very rapidly accompanied by an accentuated deindustrialisation; at the same time a certain number of countries, once defined as developing countries have sought and found ways to produce high industrial growth and have reached quite high per capita income levels. This tendency has been assisted by technological innovation. The greater efficiency and lower cost of transport has made it possible to set up enterprises in regions where environmental conditions are much more favourable. And then the huge progress made in the telecommunications sector has greatly reduced the times and costs of transmitting information so that production processes can be controlled at a distance. As a result, the way production is organised has changed considerably and individual production units forming part of a single production process have been scattered far and wide geographically.

The changed geography of production has given rise to a new international division of labour and to substantial changes in the size of international commerce. The traditional division, centred on trade in raw materials (supplied by developing countries) and manufactured goods (supplied by industrialised countries), has now been superseded by a series of commercial relations between much larger more complex markets where the majority of trade is in manufactured goods.

In order to appreciate the second of these factors (the changed relationship between states and markets) that characterises the institutional context in which public enterprises found themselves and which was mentioned at the beginning of this section, one must look to see what the consequences are of this new way in which globalisation is manifesting.

The first immediate result is the increase in the interdependency between systems. The connections are very much more extensive than they were a century ago and international economic and social relations are intensifying to an extraordinary extent with the result that local events are being influenced and modelled by events that occur very far away. We are all aware that the limits imposed by time and space which constrain the action of states and enterprises have reduced enormously.

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<sup>6</sup> Bairoch P. (1966).

According to some scholars, although this observation is significant it only highlights a consequence of globalisation that is not at all new and does not reflect a qualitative change but only a more evident quantitative change. What is more, since it focuses on an effect that is more evident on the surface, it does not point up a deeper and very great change which manifests in relations between politics and economics or, if you prefer, between states and markets<sup>7</sup>.

As has already been said, enterprises no longer consider the countries they belong to as necessary locations for their operations and they look around to discover new geographical areas in which to locate their business to earn higher profits. Investors too, no longer consider just their home market for investments but look at the entire world. Citizens themselves decide in a detached and rational manner to live in different countries to those they are from. All make their choice on the basis of the characteristics, the institutional characteristics in particular, of the geographical area in which they intend to live and operate: the cost of labour or the protection granted to it is defined for the most part by institutions; similarly, a country's growth prospects depend not only on the initial level of development or on the available natural, human and physical resources, but also on how its institutions are able to defend the right to free enterprise and property and contract rights, which lie at the foundations of trade and civil society. When individuals and enterprises choose determined locations to settle in and locate production plants or to invest in, in reality they choose determined institutional contexts rather than others. As a result, the different institutional and legislative contexts in the world, set in a global shop window, enter into competition with each other and are found to be more or less convenient by those who make location and investment investments. The game is won or lost in this comparison by the legislation that is planned, or by the existing rules and also, and sometimes above all, by the gaps in the legislation, and legal systems do not even have to be complete because single factors can make the difference.<sup>8</sup>

The results are clear: the ever increasing freedom of markets from nation states and the dispersion of political power which tends to find its way into new bodies (multinational companies above all<sup>9</sup>) and penalise states as the privileged location for it; the acquisition of greater planning capacities by markets (a characteristic typical of

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<sup>7</sup> Ferrarese M. R. (2000), page 13.

<sup>8</sup> Ibidem, page 46.

<sup>9</sup> According to some authors such as S. Strange (1998) multinationals have played a significant role in recent decades in determining "who-gets-what" in the world system. This statement is supported by four observations:

1. there has been a decline in public ownership and state control of companies and even in the direction of research and technological innovation
2. multinationals are more active than governments and humanitarian organisations in redistributing wealth between states. The investments of enterprises have created employment and raised the standard of living more than official aid programmes have;
3. enterprises have progressively replaced government and taken the dominant role in the settlement of labour-management disputes
4. enterprises have avoided taxation on profits and generated tax competition (a bottom race) which has reduced the potential of governments to raise taxes.



governments) while politicians are starting to move with greater ease in the fields of bargaining and commerce (traditional prerogatives of business); the greater rationality of governments who use the language of vested interests more openly and even reinvent the internal rules of public administrations basing them on the business model<sup>10</sup>. It is in this strengthening of the market and the symmetrical weakening of politics that the most intense effects of current globalisation are to be found. A century ago, the opening up of markets did not have this result. The state conserved its entire political power and with its use of legislation, of economic policies and the control of public enterprises, it continued to control the market. That is no longer the situation today. We are not faced with a gradual eclipse of the state, as some wishing to force the argument, would prophesy, but there is certainly a new shift of power and a change is perceptible in the functional relationship between states and markets which has favoured the latter (at least according to what people say). There has been no declaration of war between the two, but the market, functioning according to the assumptions on which its evolution is based, has managed silently and behind the scenes to change the institutional set up<sup>11</sup>.

The international liberalisation of economies and the connected change in the balance of power between state and market has important side effects on the condition of the public sector and on how it takes action in society.

The most striking examples are encountered in the fields of social politics and the regulation of the labour market. The costs of the welfare state and of regulation hit the budgets of companies and affect the competitiveness of the economy. If this should result in excessively high costs per unit of production, then industries subject to international competition may call for cuts in public welfare spending, for a reduction in the tax burden and insurance contributions and less strict labour regulations. The threat to cease production makes the state weaker in relation to the market and inclined to satisfy its demands. As a consequence it is very probable that traditional welfare policies will be reduced in scope and the rules that protect labour rewritten with new industrial agreements and so on.

There are also far from negligible consequences for traditional instruments for controlling the economy. Competition between different geographical regions for new industries and investments translates increasingly into fiscal competition which transforms fiscal instruments and adapts them to the requirements of enterprises and economic operators. Even in the case of personal income tax, a comparison between different sets of legislation starts to become important. Citizens want more freedom to make their own resource allocation decisions and the traditional compromise between equal rights and efficiency is changing as the state shows more interest in the latter at the expense of the former. Monetary and budget policies are having to take account of

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<sup>10</sup> Ferrarese M. R. (2000), pages. 55-56.

<sup>11</sup> Ibidem, page. 14.

the liberalisation of markets and the interdependence of economies that limit the freedom of decision over domestic policies and even make them ineffective. Industrial policies, which in the past were used to encourage and defend national production, must now take account of the multilocalism of enterprises. They are now conditioned by the interests of private enterprise which increasingly limits their room for manoeuvre<sup>12</sup>.

The direct production of goods and services by the state must be considered as part of the set of economic policy instruments available to governments. In the past, public enterprises were given numerous objectives. Some of these (such as controlling prices to keep inflation down, keeping unemployment down and saving companies in trouble) are no longer considered appropriate to the characteristics and possibilities of the instrument while others (the supply of intermediate goods and services and the supply of services that are essential and socially useful to households) have maintained their importance and public enterprise is still considered capable of helping to support the competitiveness of the economy and increasing well-being in society. In this case too, however, the liberalisation of markets must be taken into account. Achieving optimum conditions for production becomes essential and it is here that the paradox arises, because the more public enterprises take account of the need for efficiency imposed by markets, the more similar they become to their competitors. They become “privatised” and lose their “public” qualities with which and for which they were created.

## **5. PUBLIC ENTERPRISES IN AN INTERNATIONAL CONTEXT**

The accent on the need to minimise costs obviously means that other objectives, which we may call distributive, such as the protection of the more disadvantaged in society are neglected or at least given a lower priority. A public enterprise which is and above all must “only” be efficient loses, however, part of its reason for existing and especially so if it provides a so-called public service. There are public sector companies that aim, in their behaviour, at maximum efficiency, at maximising profits and consequently there is no way at all in which differ from any private sector monopoly (e.g. the current behaviour of ENEL and of ENI). One asks oneself how public enterprises can justify their existence in these circumstances.

Public enterprises must have a social welfare function which takes into account the general interests of society, including those that can be achieved through income redistribution. This is all made easier if there are no external constraints. If there are, an enterprise can be persuaded to concentrate on efficiency only and to give up those other objectives that justify its existence.

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<sup>12</sup> Ninni A. and Silva F. (1997).

The nature of the process of economic integration between different countries and economic regions has another important consequence. In the new technological context, enterprises are now often the co-ordinating centres of production units, which may be scattered all over the world and which may or may not belong to a single company. The geographical location of an enterprise is less clear, just as the features of enterprises, subject to the phenomenon of outsourcing, are modified *tout court*.

What are the consequences for public enterprises? In order to exploit their potential as efficient organisations they must be ready to operate across national borders. In fact it can be observed that public enterprises do this increasingly more often and there are numerous examples such as EDF, which purchased English and German power companies and more recently has made moves to acquire control of Italian and Spanish companies and there is the presence of American companies in the British electricity industry, etc. And then of course there are the telecommunications companies which are now true and genuine transnational enterprises which enter into agreements, make alliances, start joint ventures, etc.

When public enterprises operate on the international market, however, they lose, or at least partially lose their “public” characteristic because they operate in territory which is subject to another jurisdiction to which they do not belong. Their general objective, which is that of social well-being, contains variables that concern the general interest of society rooted in a geographical area. When a public enterprise operates abroad, it does so almost exclusively for business objectives that only concern the individual business itself. It may perhaps be used as a instrument of foreign policy for the state it belongs to. A public enterprise with a presence in a foreign country acts either according to the internal logic of the enterprise itself or to the benefit of its country of origin. It would hardly concern itself with the social welfare of the host country which would create understandable suspicion and mistrust. Since it would be able to count on the help, open or hidden, of its state of origin, it would have more than just economic powers and may pursue objectives that could even be contrary to the normal interests of the host country.

Recent important innovations in technology constitute a third explanation for the weakening of public enterprises. The huge changes that led to the introduction of new production processes and new products had a radical effect on the conditions in which enterprises operate. The underlying causes of natural monopolies in the public services sectors that were affected by this wave of technological innovation, sometimes disappeared and situations were created where it was possible to introduce competition. Furthermore, the greater degree of internationalisation led many states to try to create integrated economic regions such as the EU, NAFTA, MESUR, etc. The increase in the size of markets often had the effect of destroying the natural monopolies which had favoured the creation of public enterprises with legal monopolies and the reason for the existence of many public enterprises was cut at the

roots. Furthermore the status of public enterprises in these integrated economic regions - such as the European Union - presented contradictions. When they are subsidised by the state they may distort competition, especially if public services form a general part of production costs. Alternatively, as we have mentioned, public enterprises may be used as a sort of foreign policy tool.

In the presence of great innovation, such as in the telecommunications industry, a fully liberalised market also has the advantage of allowing the maximum possible number of ventures to seek to exploit new inventions. In these circumstances it is in the very nature of private enterprises to have more rapid reaction times and more flexible organisational structures than public enterprises and this gives the former operational advantages of some importance over the latter which are bound by numerous political and bureaucratic constraints.

One must also consider that in those sectors in which the greatest technological change is concentrated (telecommunications, the electricity industry, etc.) there are new opportunities for making large profits. This has made them appetising for private enterprise which did all it could to have them privatised.

## **6. PRIVATISATIONS AND MACRO-ECONOMIC EQUILIBRIUMS**

In addition to the forces described above, which are basically the consequences of micro-economic factors, there are also macro-economic factors that have resulted in the adoption of privatisation policies. Difficulties with public finances, monetary policies and the balance of payments all constitute motives for undertaking vast privatisation campaigns.

In recent history - as recalled above - the public sector expanded considerably in both developed and developing economies. In industrialised countries, the difficulty in balancing national budgets became particularly acute when at the beginning of the 1970's GDP growth rates halved, while demands for rises in spending conserved all their force and increases in revenues on income naturally tended to slow. In underdeveloped and developing countries increases in revenues are in some ways limited by the backward tax systems, which are unable to collect new potential revenues rapidly. Fiscal policies have often therefore been restrictive in their attempt to contain budget deficits.

Where governments have wished to reduce deficits, privatisation has often been used as an instrument to complement and/or replace fiscal policy. If one considers the intertemporal budget constraint then privatisations do not have any effect since the sale price will be equal to future flow of profit discounted at present value. Different conclusions are reached if we consider one period budget constraint in which finance

must be found to cover the whole of a state's expenditure. Sales of public enterprises constitute an instrument for covering expenditure just like any other. They can be used, at least temporarily, to maintain existing levels of expenditure or to lower taxes and, if they can be introduced above the line, also to reduce the general level of deficit. Obviously all this is only important if the size of the sales of public sector enterprises is significant and this seems to be the case for many countries where the cumulative value of sales account for not insubstantial percentages of GDP<sup>13</sup>. These circumstances have turned out to be important in recent years not just for developing countries but also for EU countries which were bound by very stringent budget constraints, firstly by the Maastricht treaty and then by the stability and development pact<sup>14</sup>. Obviously resort to privatisation only solves deficit problems temporarily. Permanent resolution of the problem requires a permanent increase in taxation or other type of revenue.

There is nevertheless one case in which privatisation results in a permanent reduction in a public deficit. This occurs when public enterprises make losses and are subsidised by the state. When sold governments no longer need to make up the deficits. Clearly, if the losses are not the result of inefficiency, no longer paying the subsidy means giving up general interest. The sale of public enterprises may be a politically acceptable solution when the funds that the state uses to make up deficits are in competition with those destined to welfare spending (mainly pensions and health services) which are probably felt to be more important. Naturally, before a public enterprise can be sold, it must first be restructured so that the new private owners are not hindered by losses and other constraints such as a redundant work force, which would limit its ability to make profits. The state frees itself of the responsibility for running public enterprises and once it has reorganised a sector, this encourages the flow of new investment to it.

Privatisation can also be used as a tool monetary policies. Where there is inflation or hyperinflation caused by budget deficits that are financed by the printing of new money, revenues from privatisations - when they are deposited to central bank deposits - reduce the monetary base. The effect of privatisation is similar to that of open market operations. Empirical studies (e.g. on Argentina<sup>15</sup>) show that the sale of public enterprises has helped to lower inflation rates significantly.

Lastly, privatisations have also been used to tackle balance of payments problems. They have been used to reduce national debt held abroad, a large and fixed cost for some developing countries, by means of asset swap operations whereby bonds held by foreign borrowers is converted into equity in privatised companies. This certainly means at least partial loss of the ownership of the companies, but releases the state from the payment of the fixed interest on the government debt.

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<sup>13</sup> Schipke A. (2001)

<sup>14</sup> In the case of Europe, the sale of public enterprises mainly concerned the constraint given by the National Debt

<sup>15</sup> Schipke A. (2001)

Some authors have even stated that the principal explanation of the world privatisation movement lies in the financial aspects. It has undoubtedly been an important stimulus, but it would not have been decisive if it had not been accompanied by the argument that public sector enterprise did not constitute an appropriate instrument for economic policies that give priority to growth and efficiency.

The privatisation process was also assisted by policy changes at the International Monetary Fund and the World Bank. While in the period before the 1980's assistance from these two bodies was only given to programmes where public sector and public enterprise were present, in more recent years they have made their intervention dependent on privatisation policies and on the reduction of the public-sector. This change of attitude by international organisations definitely reflects the general greater degree of trust in market mechanisms, but it is also due to experience acquired in previous years, when developing countries were often very poor at managing complex programmes and public enterprises. The managers of multinationals were felt, rightly or wrongly, to have greater management experience and ability.

## **7. PRIVATISATIONS AND THE POLITICAL CONTEXT**

There are finally two more explanations of a general nature that concern the behaviour of society and the evolution of institutions. The first goes back to the well known thesis of Hirschman that there are cyclical fluctuations in the relationship between public and private sectors, i.e. periods in which "public commitment" prevails are followed by periods in which individuals look to themselves and dedicate more attention to the pursuit of private goals and vice versa. These cycles are due to the general dissatisfaction that always accompanies human action. There is more support for state intervention in periods when "public spirit" prevails, while the opposite occurs when "private" spirit prevails. The change occurs because the expectations aroused either by public intervention or market mechanisms are always greater than the actual results and therefore, a phase of euphoria is followed by disappointment. Mistrust of the "public" sphere was widespread in the years when privatisation exploded as is demonstrated by the huge cleft that existed between politicians and electorates almost everywhere. It is also obvious that to the extent that privatisation was due to cyclical causes, the phenomenon is destined to attenuate, at least partially.

Another explanation of a general nature concerns the way in which social systems develop and is to be found in an adaptation of Mancur Olson's theories. These state that development processes are accompanied by the creation of vested interests. These acquire increasingly more power and make the processes of change in the system more rigid thereby preventing the spontaneous and healthy development of society. Big crises, wars, depressions and so on cause these power centres to break up giving new life to society. One might say that in the course of time a network of corporate

interests (politicians, managers, employees, etc.) was formed which conditioned the behaviour of public enterprises and reduced their efficiency. The present reaction would simply be an attempt to become free of these vested interests in order to give a new boost to growth in industries occupied by the public sector.

## **8. THE FUTURE OF PRIVATISATION: THE PROBLEM OF PUBLIC SERVICES**

We may ask, at this point, if the recent process of privatisation is destined to continue or to reverse, leaving room for at least a partial return of public enterprise. Naturally one must proceed with great caution, but nevertheless some considerations can be made. The first concerns the privatisation of public services, the last, in chronological terms, for very precise reasons. There is strong justification for the existence of public enterprises in these sectors, because they guarantee services that are important if not essential to the whole of society. Public services operate, as is known, under conditions of natural monopoly which almost always subsist with this type of service and privatisation does not therefore guarantee the introduction of competition. The pure and simple transfer of a service to a private enterprise would allow the latter to exercise unbridled monopoly powers. Regulation must be introduced to prevent this. It was therefore decided to go beyond mere price control of monopolies (whether private or public sector) and to subject the structure of the market to new and more complex systems of regulation designed to at least partially liberalise the sector. The belief was that the vertically integrated monopoly regimes, typical of nationalised industries, could be broken up because for some segments of the supply chain, the conditions for increasing return to scale did not exist and it was therefore possible to introduce competition to them. Regulation of this type is, however, very complex and very difficult to implement. Simulation of a competitive market presents problems which are at times impossible to overcome because it assumes that the regulator is in possession of detailed information on cost structures, on future technological developments, on demand characteristics, etc. It is particularly difficult to regulate grid or network infrastructures where the manner and price of access is fundamental if there is to be healthy competition and an adequate flow of investment. In some cases regulation has not given good results. In California, for example, there was a crisis in the electricity industry for reasons partly attributable to mistakes made by the regulator who allowed producer prices to rise, while retail prices were controlled<sup>16</sup>. This naturally resulted in the bankruptcy of the enterprises that operated in the retail sector. A second example is found in the U.K., where the company that ran the railway network had to be saved from bankruptcy and, in reality, if not officially, it was renationalised. Where it is not possible to eliminate the need for a regulator or where the regulator's functions are not reduced to a minimum, the result may not always be satisfactory. A recent work by Kahn, who, as is well known, was one of the advocates

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<sup>16</sup> Borenstein S (2002)

of deregulation and of the new regulation, points out a series of difficulties encountered by the regulation process.<sup>17</sup> Therefore, either it is possible to liberalise an industry with a minimum of regulation, at least in time, or there is a risk of creating inefficient positions. On the whole it is true that the first studies on privatisation “offered at least limited support to the claim that privatisation is associated with improved operating results of the companies sold off”.<sup>18</sup> This, however, does not necessarily mean that where there is a strong monopoly component in public services, the results obtained have always been satisfactory.

Given these privatisation failures, might not the Hirschman mechanism come into operation whereby these results which fail to come up to expectations make people once again consider greater “public” intervention more favourably.

## **9. THE FUTURE OF PRIVATISATIONS: RESISTANCE TO INTERNATIONALISATION OF THE ECONOMY**

The other aspect which should be considered concerns possible resistance to the globalisation of the world economy. As has often been recalled, the previous period marked by extraordinary internationalisation and by extraordinary movements of capital, enterprises and populations came to an end with the First World War. It was followed by a difficult period marked by recessions and restrictions of various types that made individual economies more isolated. The situation is certainly different today and one reason, already mentioned, is that international commerce itself has different characteristics; nevertheless it must be acknowledged that the process in progress produces imbalances which could lead to a change of direction. The change in the patterns of international trade flows, for example, may damage determined industries even in developed countries and cause serious unemployment, at least temporarily. It is therefore possible that entire manufacturing industries must be reduced in size without the redundant work force being able to find immediate employment in service industries. Also policies designed to hold on strongly to existing levels of social protection could find support within each individual country.

The future of privatisation depends therefore on the successes of the new private sector enterprises in the public services sector and on the development of the general political situation and in particular on the continued internationalisation of the economy. Should this come to a halt, then it is probable that the public sector will increase with more public enterprise.

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<sup>17</sup> Kahn A E. (2001)

<sup>18</sup> Megginson W.L. Netter J.M. (2001) page 356



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