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Partial Privatisation: the Caveats and Experiences

Partial privatisation, in which a more or less large number of residul shareholdings remain in the hands of the state, is a widespread phenomenon in the countries of Central and Eastern Europe. The following paper compares experiences in Poland with those of the UK, where there has been extensive privatistion of public utilities in the last 20 years, and concludes with some policy recommendations for the transforming countries.

A state wishing to privatise a public enterprise may be unable to sell 100 per cent of the shares in one offering because of concerns over the market's ability to absorb such a large offering (price and liquidity issues) or because of pending/incomplete regulatory reform in the relevant privatised sector. Whatever the reason – and, as an English proverb says, everybody has many good reasons and the real one – partial privatisation may cause various problems. That is why it is necessary to look at different experiences and assess them critically in order to provide policy recommendations or warnings, especially for countries in Central and Eastern Europe (CEE), which still have quite a lot to privatise.

Schematically speaking, if the old politico-economic system in the CEE countries could be seen as being based on central planning and on public ownership of the means of production, whatever their specific forms in individual countries, then systemic transformation had to change both of these constitutive characteristics; it therefore consists of both marketisation and privatisation. Marketisation in turn embraces two types of action: liberalisation, i.e. increasing the realm of economic freedom; and re-institutionalisation, i.e. creating an efficient legal and organisational framework within which economic agents can exchange goods, services and assets. From this it follows that, firstly, privatisation in post-Soviet-type economies (post-STEs) brings about systemic transformation, and therefore can, or even should, be called *transformational privatisation.* Secondly, in this process whole economies are being privatised: transformational privatisation is privatisation *of* post-STEs, and not only *in* them. Perhaps slightly paradoxically, this centrality of privatisation in the process of systemic transformation follows from the ideological principles of the old system, as Włodzimierz Brus reminds us in one of his recent papers: "Not only did the ethical, justice and socio-political aspects (elimination of exploitation and of alienation) elevate public ownership to the sacrosanct level of a new order, but obviously, and perhaps primarily, its alleged function was to show socialism's economic superiority over the capitalist market economy."[1] In this context looking for third ways can be particularly seductive and precisely for this reason dangerous: the radical, either-or character of the past arrangements calls for equally radical remedies.

The main difficulties in achieving this goal follow not only from its size and multidimensionality but also from the existence of numerous trade-offs, dilemmas and paradoxes. Although the main objective of transformational privatisation should be the increased efficiency of the economic system in the countries, or rather in the region, concerned, this cannot be achieved without taking into account the various socio-political aspects involved in increasing the private sector's share of GDP. Similarly one must not forget, to quote Professor Brus again, that "... state assets (as well as those belonging to the formally cooperative institutions) were seldom (if ever) properly assigned to a well-defined public entity with clearly delineated property rights, but instead could be shifted between and by various layers of the organisational structure of economic management supervised by the corresponding ranks of the communist party hierarchy".[2] In consequence, transformational privatisation goes far beyond the

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[1] Włodzimierz Brus: General Problems of Privatisation in the Process of Transformation of the Post-Communist Economies, in: Y. Akyüz et al. (eds.): Privatisation in the Transition Process. Recent Experiences in Eastern Europe, UNCTAD, Geneva 1994, p. 47.

[2] Ibid.

mere transfer of property rights (privatisation from above) and/or establishment of new businesses (privatisation from below), because its necessary ingredients are also the redefinition and reallocation of property rights. The redistributive nature *par excellence* of the processes involved only adds to their enormous complexity and controversial character. The very logic of transformational privatisation will, however, almost certainly run against any residual shareholding. The sooner the critical mass of privately owned productive assets is achieved and the more private these assets are, the better.

Mixed Ownership Structure: a Caveat

The more general issue as to which economic – or politico-economic – system is more efficient seems to have finally found its definitive answer, despite many voices from both sides of the Iron Curtain having defended over decades the superiority of central planning. The debate on whether publicly owned enterprises are better than private ones – whatever "better" means in this context – is similar in character, but no similarly final solution of this issue seems to be in sight. The debate still has many ideological undertones, and the requirement of comparing like with like often cannot be adequately met, not least because of the so-called socio-political objectives of state-owned enterprises. Whatever our opinion about the dysfunctional or otherwise role of such objectives the difficulties with coming to unequivocal conclusions when one compares even only the economic efficiency of the two types of enterprises are rightly notorious. The increasing number of privatised firms does not really help, because many of them have changed beyond recognition in the process of their privatisation.

The problems with comparisons do not end here, however. The real world of enterprises does not fit easily into the private/public dichotomy. Co-operatives notwithstanding, there are also many so-called mixed enterprises, i.e. companies in which both the state (central or local government) and private investors have shares. These companies may be quoted or not, but it is precisely towards them that our interest in residual shareholdings directs our attention. In other words, partial privatisation by definition results in mixed enterprises, and no analysis of this phenomenon will be complete without having said at least a few words about the economic theory and empirical evidence regarding their performance, i.e. about the effect that this kind of arrangement can and does have on the performance of the enterprises (and economies) affected by it, on their objectives and on their ability to achieve them. Just as the (allegedly) higher economic efficiency of private enterprises is necessarily part of the case for the privatisation of state-owned enterprises in market economies,[3] so any (economic) case for or against partial privatisation will have to take into account comparisons of this ownership form with fully public or fully private enterprises.

Although neither the private sector nor the public one is homogeneous from a structural or organisational point of view, mixed enterprises (MEs) in particular have to be subdivided into different categories. Boardman and Vining[4] suggest a classification based on two criteria: the relative degree of public/private ownership and the extent of concentration/dispersion of private shareholdings. These criteria were chosen because the ownership conditions affect the enterprises' maximand (profits, sociopolitical goals and/or managerial utility) as well as the degree of conflict among the owners themselves and between owners and managers. The application of these two criteria, although each of them to some extent represents a continuum, results in six main types of mixed enterprises:

- ☐ low government share of ownership/concentrated private ownership
- ☐ low government share of ownership/dispersed private ownership
- ☐ medium government ownership/concentrated private ownership
- ☐ medium government ownership/dispersed private ownership
- ☐ high government ownership/concentrated private ownership
- ☐ high government ownership/dispersed private ownership.

To the extent that one of these forms was chosen consciously (more or less accidental developments, especially over longer periods of time, cannot be ruled out), the motivation behind the respective decisions can vary considerably: "The recent growth of MEs appears to be fuelled by several trends, including privatisation (mostly in developed countries), nationalistic desires to participate in the domestic

[3] Piotr Jasiński: The transfer and redefinition of property rights: theoretical analysis of transferring property rights and transformational privatisation in the post-STEs, in: Communist Economies and Economic Transformation, Vol. 4 (1992), p. 163-190.

[4] A. E. Boardman and A. R. Vining: The behaviour of mixed enterprises, in: Research in Law and Economics, Vol. 14 (1991), p. 223-250.

operations of foreign-owned multinational corporations (mostly in developing countries), the needs of governments to limit capital investment (borrowing requirements), and a general 'feeling' among politicians and bureaucrats that MEs combine the economic efficiency of private companies (PCs) with the sociopolitical objectives of state-owned enterprises (SOEs), resulting in the 'best of both worlds'."[5]

For a paper published in 1991 it was too early to refer to the problems created by the process of systemic transformation in the countries of Central and Eastern Europe. Five years later there is no doubt that the issue of mixed enterprises not only exists there, but also that in the process of corrupting the British model of privatisation,[6] the importance of this issue is rapidly increasing. However, the main question is whether MEs are really able to combine the "best of both worlds" and whether they actually achieve that. Or will it instead be the "worst of both worlds", i.e. high conflict and poor performance?

The issue of the (comparative) performance of MEs does not seem to have attracted too much attention from researchers. In 1987 Brooks was still right writing that, "the theoretical literature on mixed enterprises is slender and focuses mainly on decision-making within such firms".[7] Other research in the mid-1980s concentrated on the fact that, thanks to the observability of shares' performance and its ability to signal changes in expected efficiency and profitability, this form of ownership should reduce, as compared with SOEs, the need for government performance monitoring.[8] This however assumes that all owners, either separately or together, can translate such improved information flows into effective control, an assumption which is contentious itself and would require both theoretical analysis and empirical evidence to support it.

Effect of Government Shares

Boardman and Vining[9] start their analysis from the differences between public and private ownership, which can be expressed in terms of markets for property rights (corporate control) and for managers. It is also usually assumed that the objective functions of the two types of enterprise differ from each other with respect to their maximands. This state of affairs will, generally speaking, have two kinds of implication for mixed enterprises. Firstly, any government ownership usually insulates such enterprises from the market for corporate control, by reducing the threat of a potential takeover. In consequence one may expect that the level of managerial discretion will be higher, which in turn rarely leads to better performance, although the threat of privatisation may correct some of the deficiencies of this state of affairs.

Secondly, the fact that the government owns some shares may also affect the objectives which the managers are expected to achieve. More specifically, governmental socio-political goals, such as national and/or regional development, the balance of trade, the development of specific sectors, bailouts, nationalism and national prestige, and ideology,[10] may appear and be pursued at the expense of profitability.

One can expect that the relative importance of both of these phenomena will increase with the size of government shareholding and with the degree of dispersion of the privately owned shares. It will however be quite difficult to compare the two factors, not least because of their continuous nature. Namely, it does not seem possible to say *a priori* whether a majority government shareholding when there is just one private shareholder is going to have a stronger effect than a minority shareholding in a situation where the remaining shares are widely dispersed. The anecdotal evidence provided by Boardman and Vining does not seem to lend itself to generalisation in this way. It does, however, seem possible to compare the economic performance of the whole group of mixed enterprises, regardless of further subdivisions, with that of public and private enterprises, and this is precisely what Boardman and Vining did in 1989[11] and 1992.[12]

The data used by Boardman and Vining in their

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[5] Ibid., p. 224.

[6] Piotr Jasiński: Privatisation in the United Kingdom and Poland: The model and its transformation, paper presented at the Egon Sohmen Symposium on "Privatisation at the turn of the century", Budapest, 5-7 September 1996.

[7] Stephen Brooks: The mixed ownership corporation as an instrument of public policy, in: Comparative Politics, Vol. 19 (1987), p. 174.

[8] C. Eckel and A. R. Vining: Elements of a theory of mixed enterprise, in: Scottish Journal of Political Economy, Vol. 32 (1985), p. 82-94.

[9] A. E. Boardman and A. R. Vining, op. cit.

[10] A. E. Boardman, C. Eckel and A. R. Vining: The advantages and disadvantages of mixed enterprises, in: Anant R. Neghandi, Howard Thomas and K. L. K. Rao (eds.): Multinational Corporations and State-Owned Enterprises: A New Challenge in International Business (Research in International Business and International Relations, Vol. 1), JAI Press, Greenwich CT 1986, p. 221-244.

[11] Anthony Boardman and Aidan Vining: Ownership and performance in competitive environments: a comparison of the performance of private, mixed and state-owned enterprises, in: Journal of Law and Economics, Vol. 32 (1989), p. 1-33.

[12] A. R. Vining and A. E. Boardman: Ownership versus competition: efficiency in public enterprises, in: Public Choice, Vol. 73 (1992), p. 205-240.

1989 paper come from *Fortune's* list of the 500 largest manufacturing and mining corporations outside the USA, published on 22 August 1983. Among companies for which data were complete, there were 409 private corporations, 23 mixed enterprises and 57 state-owned enterprises, representing various countries and industries.

The final version of the model was estimated using ordinary least squares: first for four dependent variables measuring profitability (return on equity, on assets, and on sales, and net income) and then on three other dependent variables measuring efficiency (sales/employee, sales/assets and assets/employee). Explanatory variables included two dummies representing ownership (state-owned or mixed companies respectively), sales, assets, employees (each of them once in each regression), market share, concentration, non-concentration (a dummy equal to one when no concentration measure is available and zero otherwise), industry (14 variables), country (6 variables) and a constant.

The results show that large industrial MEs and SOEs perform substantially worse than similar PCs. The results also suggest that partial privatisation where a government retains some percentage of equity, which is occurring in many countries (for example, British Telecom in the United Kingdom), may not be the best strategy for governments wishing to move away from reliance on SOEs.[13] The latter phenomenon can be explained by what the authors call *cognitive dissonance*,[14] caused by the conflict between public and private shareholders, i.e. their divergent or even contradictory objectives.

Boardman and Vining conclude their 1991 paper by saying that, in summary, "the potential major advantage of the ME form stems from the presence of private shareholders who are sensitive to socio-political goals and who will discipline politicians for marginal deviations from profitability. Our analysis, however, suggests that this will rarely work".[15] From the point of view of our interests here and now, Boardman and Vining's conclusion means that the decision not to sell all shares, regardless of the reason for which it is taken, will almost necessarily require a very careful cost-benefit analysis. Partial privatisation *may* improve the results, but why stop there? The risk of overstretching the absorption capacities of a stock exchange has to be compared with likely efficiency losses in the medium to long term. There are also discontinuities as far as the risk of a flop is concerned. All of this, in turn, will not be made easier by the fact that, as is plausible, it will be the respective economy as a whole that will have to pay for the hidden gains of the few.

The 1992 paper by Vining and Boardman goes beyond a straightforward comparison of different types of enterprises. It attempts to test the hypothesis that competition is a more important determinant of economic efficiency than ownership.[16] Their article tries to show (1) that ownership is both theoretically and empirically important; (2) that most of the evidence that purports to show the "primacy of competition versus ownership" or "no difference in efficiency" does not, and indeed cannot, convincingly do so; and (3) that new empirical evidence, using Canadian data, confirms the importance of ownership. In short, ownership does matter for both technical and allocative efficiency.[17]

The paper contains an updated review of the literature, first presented in the 1991 paper, and the newer studies seem to reinforce the balance of evidence in favour of private enterprises.[18] As far as the new empirical data is concerned their model estimated performance as a function of the type of enterprise (state-owned, mixed but also Caisse, as a special case, and cooperatives). The data came from the 500 largest non-financial corporations in Canada, according to the list compiled for 1986 by *The Financial Post.*

In the profitability equations (return on assets, return on sales, and net income as dependent variables) the coefficients for both mixed and state-owned enterprises are negative, and all are statistically significant. On average SOEs and MEs have lower profitability than PCs, with SOEs consistently lower than MEs. In turn, the results of the efficiency equations (sales/assets, sales/employees and assets/employees as dependent variables) are generally

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[13] A. E. Boardman and A. R. Vining: Ownership and performance..., op. cit., p. 26.

[14] Ibid.

[15] A. E. Boardman and A. R. Vining: The behaviour of mixed enterprises, op. cit., p. 243.

[16] See, inter alia, T. E. Borcherding, W. W. Pommerehne and F. Schneider: Comparing the efficiency of private and public production: A survey of the evidence from five federal states, in: Zeitschrift für Nationalökonomie / Journal of Economic Theory: Public Production, Supplement 2 (1982), p. 127-156; R. Millward: The comparative performance of public and private ownership, in: E. Roll (ed.): The Mixed Economy, Macmillan, London 1982; George Yarrow: Privatisation in theory and practice, in: Economic Policy, Vol. 2 (1986), p. 323-379; and, for a slightly different view, P. J. J. Welfens and P. Jasiński: Privatisation and Foreign Direct Investment in Transforming Economies, Dartmouth, Aldershot 1994.

[17] A. R. Vining and A. E. Boardman, op. cit., p. 206.

[18] Ibid., Table 2, pp. 214 - 215.

consistent with those of the profitability equations but not statistically significant for sales/employees. Overall, the importance of the results is strengthened by the fact that so many measures of economic performance were included, overcoming in this way the inherent weaknesses of each of them.

The United Kingdom

In order to be able to look a little more closely at the issue of residual shareholding it seems to be useful to present and to discuss some real life examples. The choice of the UK, the pioneer of privatisation, and of Poland, where the process of systemic transformation started in 1989, seems to be justified, regardless of what one could consider to be the author's comparative advantage.

The privatisation process, so closely associated with the name of Mrs. Thatcher, started, as is well known, even before the Conservative Party won the 1979 general election. What is even more interesting, it started with a sale of shares that resulted in a residual government shareholding, namely with the 1977 sale of British Petroleum's shares. In the almost 20 years that have passed since then, assets worth billions of pounds were transferred from the public sector to the private one, where their value increased further, and that not only because the shares at the moment of their sale were undervalued.

However, despite the highly recommendable either/or approach to privatisation, which for example in the case of public utilities consisted in replacing control mechanisms based on property rights with

Table 1

Shareholdings in Privatised and Former Government-Controlled Companies

Company	Date of Privatisation	Size of Share Register: Initial	Size of Share Register: Highest since Privatisation	Size of Share Register: Latest	Proportion of Shares retained by HMG	Proportion and Dates of Disposals	
British Petroleum	Dec 1977	n/a		445,945 (31 Dec 1994)	51.00%	5.17% 7.12% 31.5% 0.09%	Nov '79; Sep '83; Sep '87; Oct '90
British Aerospace	Feb 1981	27,179	120,200 (Dec 1986)	92,631 (12 Nov 1993)	48.43%	48.43%	10 March '85
Cable and Wireless	Oct 1981	27,320	210,994 (31 Mar 1986)	163,450 (31 Mar 1994)	50.64%	27.54% 23.1%	Nov '83; Dec '85
Amersham International	Feb 1982	10,051		5,435 (20 May 1994)	nil		
NFC	Feb 1982	10,334		55,000 (May 1994)	nil		
Britoil	Nov 1982	37,257	245, 556 (31 Dec 1985)	owned by BP	49.00%	49%	8 Aug '85
Associated British Ports	Feb 1983	37,205		13,802 (Dec 1994)	48.50%	48.5%	17 Apr '84
Enterprise Oil	June 1984	13,695	14, 166 (June 1985)	9,445 (31 Dec 1994)	nil		
Jaguar	July 1984	125,000		owned by Ford	nil		
BT	Nov 1984	2,139,520	3, 760, 709 (19 July 1993)	2,696,174 (31 Mar 1994)	49.80%	0.8% 25.9% 20.7% 0.6%	Dec '87; Nov '91; Jul '93; Jan '95
British Gas	Dec 1986	4,407,079		1,921,668 (31 Dec 1993)	3.30%	1.6% 1.6%	Jan '90; Jul '90
British Airways	Feb 1987	1,200,000		242,805 (31 May 1994)	2.50%	1% 1%	Jun '87; Mar '90
Rolls Royce	May 1987	1,988,966		453,215 (31 Dec 1994)	0.40%	0.4%	sold during 1987
BAA	July 1987	2,187,966		525,822 (27 May 1994)	4.36%	1.42%	Aug '90
British Steel	Dec 1988	650,533		239,511 (2 Apr 1994)	0.05%	0.04%	disposed of during 1989
Water and Sewage Companies	Dec 1989	2,650,000		1,000,000 (2 April 1994)	1.62%	0.8%	Jan '93
Regional Electricity Companies	Dec 1990	8,860,000		2,975,119 (7 August 1992)	1.50%	0.8%	Jan '94
Generating Companies	March 1991	1,670,000		2,800,000 (March 1995)	40.00%		
Scottish Electricity Companies	June 1991	1,810,000		1,400,000 (15 March 1993)	3.50%	36.7%	Mar '95
Northern Ireland Electricity	June 1993	437,414		298,734 (1 Dec 1993)	3.30%		

Source: The HM Treasury Guide to the UK Privatisation Programme, HMSO, London 1995.

statutory regulation by independent bodies, the British government still holds shares in many companies. Recent reports, such as *The HM Treasury Guide to the UK Privatisation Programme*, published in August 1995, listed a surprisingly large number of holdings.

The causes of this state of affairs are in most cases very similar. In most public offers, the buyers of shares were offered incentives not to sell their shares immediately. These incentives took two forms: either the next instalments were discounted, or free shares were distributed to those who still held their shares, bought in the public offer, at a pre-specified date. These bonuses were not transferable. Therefore, when somebody chose to receive free shares in the future, and in the meantime sold his or her shares, the free shares which he or she would have received at a later date had initially to be put aside and so eventually remained in the government's hands. As can be seen in Table 2, in most cases the amounts involved are negligible, and there does not seem to have been any controversy regarding either their sale at a later date, or the exercise of voting rights by representatives of the Treasury.

Two more features of the British privatisation programme deserve our attention. Firstly, some of the largest privatisations took place in tranches. This was the case for example when British Telecom was leaving the public sector: the first 50.2 per cent of shares were sold in November 1984, the next 25.9 per cent in December 1991, and the remaining 20.7 per cent in July 1993. Similarly, not all shares in the electricity generating companies, National Power and PowerGen, were sold initially. In March 1991 the government sold only 60 per cent of the shares of the gencos, and 38.3 per cent of National Power and 39.9 per cent of PowerGen in March 1995. Leaving aside the problem of the effect that a public offer which was expected but not fixed in time had on the transparency of trading in capital markets and their efficiency, neither sale was free from difficulties of its own. Since the current share price was to be used as a reference point for the new issue, traders could be interested in suppressing the price before the next tranche was to be put on the market. In particular when the third tranche of BT's shares was to be sold, the UK government went a long way to pre-empt this kind of manipulation, the costs of which operation can certainly be classified as transaction costs.

The second public offer of shares in National Power and PowerGen also illustrates well the potential dangers connected with residual shareholding even in the most mature capital markets. The sale coincided with Professor Littlechild's announcement that he would be repeating the so-called distribution review despite the fact that his earlier proposals were accepted by the regional electricity companies. What the Director General of Electricity Supply did then was not technically illegal, but it did run against the very logic of economic regulation UK-style, undermining markets' confidence in the predictability of the operation of the whole system. Although not directly connected with the sale of shares in National Power and PowerGen, the announcement sent the share prices down to below the level at which they were bought initially. In consequence the government was

Table 2
The UK Government's Holdings of Special Shares

Company	Date of Sale of Company	Expiry Date of Special Share
Amersham	Feb 1982	Redeemed July 1988
Belfast International Airport	July 1994	Non time limited
British Aerospace	1981 and 1985	Non time limited
British Aviation Authority	July 1987	Non time limited
British Gas	Dec 1984, July 1987	Non time limited
British Steel	Dec 1988	Dec 1993
British Telecom	1981, 1985, 1993	Non time limited
British Technology Group	July 1995	31 March 1997
British Technology Group International	July 1995	31 March 1997
Britoil	Nov 1982, Aug 1995	redeemed 1990
Cable & Wireless	Oct 1981, Dec 1983, Dec 1985	Non time limited
Enterprise Oil	June 1984	December 1988
Jaguar	July 1984	Due to expire 31 Dec 1994, waived in Oct 1989 during the Ford takeover
National Grid Company	Dec 1990	Non time limited
National Grid Holding	Dec 1990	Non time limited
National Power	March 1991	Non time limited
Northern Ireland Electricity	June 1993	Non time limited
Power Gen	March 1991	Non time limited
Regional Electricity Companies	Dec 1990	Redeemed March 1995
Sealink Stena Line	July 1984	Non time limited
Scottish Hydro-Electric	June 1991	Non time limited
Scottish Power	June 1991	Non time limited
Water Companies	Dec 1989	Non time limited
VSEL Consortium	March 1986	Non time limited

Source: The HM Treasury Guide to the UK Privatisation Programme, HMSO, London 1995.

accused of acting in a cynical way: first selling the shares, and then making announcements having – or least alleged to have – impact on their value, although the content of these announcements was known at the moment of the sale.

The second feature of the British privatisation programme, important from the point of view of the subject matter of this paper, is the so-called golden share. When selling a public enterprise, in some cases the government thought it appropriate – "there was a clear need" – to protect the company from unwelcome takeover, on national security grounds, or as a temporary measure, "to provide an opportunity to adjust to the private sector".[19] In order to achieve these objectives, the government first created and then retained a special share that requires that certain provisions in the Articles of Association of the Company may not be changed without the specific consent of the special shareholder. The details of the provisions vary according to the circumstances of each company, but they typically include, for example, a prohibition of any one person, or group of persons acting in concert, controlling more than 15 per cent of the equity of the company. Some of the golden shares, as these special shares became to be known, were non time limited, although the government retained the right to redeem them at any time. Also the provisions attached to them might be amended or waived where the Government deemed the circumstances to warrant it. The details regarding both past and current golden shares are provided in Table 2.

Table 3

Shareholding of the Polish Government in the Companies Listed at the Warsaw Stock Exchange

Company	Treasury Holding as a Percentage of Total Shares	Treasury Votes as a Percentage of Total
Agros Holding S.A.	8.23	3.61
Animex S.A.	22.48	14.85
BPH S.A.	46.61	46.61
Bank l ski w Katowiach	33.17	33.17
Bytom S.A.	5.03	-
Góra dze S.A.	26.11	26.11
Indykopol S.A.	12.16	15.80
Jelfe S.A.	60.14	60.14
Kable Bydgoskie S.A.	8.48	8.48
Krosno S.A.	11.87	11.87
Okocim S.A.	18.67	18.67
PBR S.A.	62.48	62.48
Polfa Kutno S.A.	9.90	9.90
Polifarb Wroc aw S.A.	15.95	15.95
Remak S.A.	5.88	5.88
Rolimpex S.A.	24.48	49.50
Stalexport S.A.	35.66	35.66
Stomil Olsztyn S.A.	16.49	16.49
Tomil S.A.	37.22	37.22
Warta S.A.	34.67	34.67
WBK S.A.	25.10	25.10
Wedel S.A.	11.02	6.22

Source: Komisja Papierów Warto ciowych and Gazeta Bankowa, 4/1996, 28.01.1996

As has already been mentioned, the validity of these golden shares was in many cases limited in time, and regardless of how one assesses their usefulness in general, their expiring at the predetermined date proved to trigger hectic activities on the Stock Exchange, not always justified in themselves. In consequence many companies in which the UK government used to have golden shares were taken over immediately after these shares expired. Takeovers, or rather their possibility and/or risk, are certainly an important mechanism for disciplining the management, but for example the fact that in the first year of life without their golden shares six out of twelve regional electricity companies lost their independence, and two more mergers were investigated by the Monopolies and Mergers Commission, after having been referred by the President of the Board of Trade, has all the appearances of a bandwagon effect. One may trust that the new structure of the British ESI, being a result of the functioning of the capital markets and not of administrative decisions taken by politicians and bureaucrats, is going to be efficient and not dysfunctional, but the whole process would have been more credible if it had been spread over a longer period of time and developed without artificial stimuli.

Poland

Since in the process of privatising the Polish economy many techniques are used, there are also many different cases of residual stake- and/or shareholdings. Of course, in the strict sense of the word, the concept under consideration refers to publicly quoted companies, and Table 3 shows to what extent the Polish government is the single largest shareholder on the Warsaw Stock Exchange. The table lists the companies in which the Treasury has more than 5 per cent of shares.

[19] The HM Treasury Guide to the UK Privatisation Programme, HMSO, London 1995, p. 7.

Since initial public offerings (IPOs) are only one form of what is called in Poland capital privatisation, a similar list could be produced regarding public limited companies that are not listed on the Warsaw Stock Exchange. Finally, as far as public limited companies are concerned, there are relatively large state shareholdings in the companies taking part in the mass privatisation programme. The list is far too long to be quoted here, but in each of the 514 companies 33 per cent of shares went to the so-called leading National Investment Fund *(Narodowe Fundusze Inwestycyjne, NFI)* and 27 per cent of shares were equally distributed among other NIFs. The employees are entitled to receive up to 15 per cent of shares, and the rest, i.e. 25 per cent, remains as a "reserve" of the State Treasury. It has not yet been determined what will be done with them, but allocating them to pension funds, as part of the reform of the social security system, is one of the options being discussed.

Bankowe post powanie ugodowe, bank-led rescheduling and conversion of public enterprises' debts, based on the 1993 Law on Financial Restructuring of Enterprises and Banks, may also result in the Treasury's increasing the number of its residual shareholdings. This is the case when the bank leading the procedure decides to go for a debt-for-equity swap. Since it is rather unlikely that all shares will be transferred to creditors, the Treasury may end the whole process with a lower, but still considerable shareholding, and the enterprise with a mixed ownership structure.

The state preserves some ownership rights – but not residual shareholding – in two more cases. Firstly, in liquidation privatisation, based on the 1990 Privatisation Act, all or some assets of the state-owned enterprises being liquidated are leased to a new company created by the employees, with or without the participation of external investors. Although this new company will eventually acquire ownership of these assets, as long as this does not happen, the state is still the owner. Nevertheless, the state's ability to make use of the assets is limited. The same arrangement applies to agricultural land, once belonging to state-owned farms and now being rented out by the *Agencja Wlasności Rolnej Skarbu Państwa* (agency for agricultural land owned by the Treasury).

Two things have to be pointed out. Firstly, one of the main justifications of not selling all a company's shares in one go, or even not intending to sell them at all, has a sectoral character. For example, for a long time it was government policy not to sell about 30 per cent of shares in the privatised banks, and there are plans to introduce similar provisions in other strategic industries. And one does not have to look very far for dysfunctional consequences of this state of affairs. On the one hand, it stopped, at least temporarily, some banks, for example the *Wielkopolski Bank Kredytowy (WBK)* S.A., from raising their capital, because the Ministry of Finance claimed to have no money to buy new shares, and at the same time was reluctant to see its share of the company diminish. On the other hand, in cases where the first day gains were enormous (and even later on the trading price was far higher than the issue price), the government was tempted to take advantage of this fact and to sell some of the remaining shares in order to earn additional revenue. In the case of Bank Śląski the first day gains were thirteenfold, and the temptation to flood the market correspondingly strong. Flooding the market with Bank Śląski's shares is widely credited with bursting the bubble at the Warsaw Stock Exchange, and the eventual fall of its index by more than 50 per cent.

Secondly, reading Polish newspapers one gets the impression that considerable state shareholdings in public limited companies may be used to create and sustain political fiefdoms, in particular when, as it is the case at present, the coalition government consists of two political parties with a nomenklatura past. And needless to say that even a minority shareholding may bring with it considerable power when the remaining shares are widely dispersed and the second most powerful group of shareholders are managers, again politically well connected. Tracing the influence of political parties on various companies (and their profits) in which the government still has considerable shareholding seems therefore to be a popular pastime of both tabloids and serious newspapers, but it certainly is not helping to develop sound capital markets and free and competitive goods and services markets.

Good Reasons and the Real One

If one looks at the privatisation policies of the UK government, the mother of all privatisation policies, in terms of residual shareholdings it becomes immediately evident that apart from two privatisations in which shares were sold in two or three tranches, with the sale planned in this way from the very beginning, the either-or approach dominated, and this general conclusion can be qualified only by pointing to the so-called golden share. This share was in a sense an attempt both to eat the cake (to have all the revenue) and to have it (to preserve control over some companies, the importance of which for the economy was claimed to be self-evident). To what extent this arrangement had an effect on the value of the companies in which the government held such golden shares seems difficult to estimate, but it certainly lowered this value rather than increasing it. That could have been so because those buyers to whom the given company is worth most, not to mention those who would prefer to take over the control of the company and not only be one of many shareholders, would be excluded. All in all, however, one has to admit that with the exception of shares to-be sold in the second or even third tranche no substantial residual shareholding was ever planned, and the existing residual shareholdings can be described as accidental. According to press reports from November 1995, the UK government planned to dispose of these leftovers as soon as possible without, however, disturbing the stock market. Or at least this was the intention of the government and Rothschild, their advisors on these issues. These plans were realised over the following year, and the way in which this was done earned praise from the National Audit Office.[20]

The track record of other governments, either in OECD countries or in developing countries, seems to be less laudable, partly because they lacked Mrs. Thatcher's ideological commitment, and partly because at the same time privatisations there were to a larger extent driven by the miserable state of their public finances. Selling less than 100 per cent of shares seems to be the rule rather than an exception, and one does not have to look very far for examples: if selling 90 per cent of shares can still be called a residual shareholding, one will be able to apply the conclusions of this paper to Deutsche Telekom for a long time.

None the less, despite the fact that the UK government was rather successful in its efforts to part decisively with publicly owned assets, the 1984 - 1993 BT privatisation is a kind of paradigm as far as residual shareholding is concerned. Firstly, since the selling of 50 per cent of BT's shares was at the time going to be by far the largest public offer ever on the London Stock Exchange, this seemed to be a good reason for not selling more shares. On the one hand, this assumed self-restraint on the part of the government not to interfere with BT's day-to-day management, as a considerable proportion of the shares was very dispersed. On the other hand, although this assumed a rather minimalist definition of a private sector company, strictly speaking any sale of shares by government can be called privatisation. The problem is, however, that the fewer shares sold, the more the fiscal opportunism of selling the family silver becomes evident. The constructive use of privatisation proceeds is always a problem, and myopically most of them disappear into the black hole of the budget. Selling a non-controlling stake leaves the company in a no-man's land: the efficiency gains from being in the private sector are impossible to realise, the chances for full-blooded liberalisation and competition, especially in the case of public utilities, remain slim and the money is gone. In this context the talk about strategic industries appears to be nothing but a smoke screen.

Secondly, although everybody knew that the first public offer of BT's shares was deliberately underpriced, the extent of the first day gains exceeded the most optimistic forecasts. (Taking into account the whole period 1984 - 1996, these shares barely, if at all, outperformed the FT-SE 100 index!) Underpricing only one tranche allowed the government to increase substantially its revenue from the remaining shares. It is most likely this experience that led the government to selling the gencos also in two tranches (see above), which sale was recently praised by the National Audit Office for its fiscal efficiency. Railtrack was another possible candidate for maximising the government's revenue by using stock market information to price more precisely the rest of the shares, but in this case political expediency - not to say opportunism - dictated the reverse. Selling only slightly above 50 per cent of shares would, namely, make it far too easy for a Labour government to fulfil that party's threats to reverse the process by leaving only less than 50 per cent of shares in the public sector. In other words, from the point of view of political cycles, partial privatisation is a very dangerous exercise.

Transformational Privatisation

The above conclusions, and the empirical evidence on which they are based, seem pretty general and widely applicable. Although the size of the public offer, in particular in comparison to the capitalisation of the given stock market, could be considered an argument in favour of partial privatisation, the risks involved have to be considerable in order to outweigh the losses implied by mixed ownership. However, does the situation of systemic transformation affect these conclusions materially? In other words, should

[20] National Audit Office: Sales of Government's Residual Shareholdings in Privatised Companies, Stationary Office, London 1997.

residual shareholding in market economies and in post-STEs be treated in the same way?

At the beginning of this paper the concept of transformational privatisation was introduced. It meant that privatisation in CEE countries was privatisation *of* their economies and not only *in* them. In this context privatisation from below is important, but it is even more important that privatisation of state-owned enterprises lives up to its name and does not serve to build half-way houses or facilitate attempts to both have the cake and eat it. From the point of view of the concept of transformational privatisation it is important to achieve the so-called critical mass of privately owned assets that can assure the autonomous, efficient functioning of market mechanisms. But equally important is the transparency, both economic and political, of the environment in which privatised or partly privatised enterprises operate. Neither will be achieved if only 51 per cent of shares in 51 per cent of enterprises are in private hands.

The issue of the economic efficiency of enterprises with mixed ownership as discussed by Boardman and Vining seems to be less of an issue in CEE countries, where even public enterprises have been able to adjust their behaviour to the new market environment, and there are quite a few examples of success stories. But the key question is to what extent are they exceptions proving the rule? In any case, there is no doubt that it can be relatively easy to improve the performance of enterprises previously subject to central planning, i.e. there is plenty to improve, and therefore the differences in the performance of, for example, fully and partially privatised companies will not be immediately self-evident. Nevertheless, if the conclusions reached by Boardman and Vining are anything to go by, then the decision to keep some shares in the state's hands will simply limit the improvements that one can expect from privatisation.

As far as the size of the public offer is concerned, it can certainly be more of a problem, although whether the ratio of largest privatised company to total stock market capitalisation will be different from that in mature market economies is an open question. On the other hand, the capitalisation caveat can be turned round: very large issues of shares allocated both to individuals and institutional investors could also help to develop capital markets and keep the stock exchange liquid.

It seems however that the most important arguments against partial privatisation lie in the realm of politics. This is partly due to the inherent paradoxes of all privatisations, and partly to the fact that systemic transformation concerns not only the economic systems of STEs, but also their political ones.

The most important paradox present in the case of the privatisation of a firm in a market economy can be formulated as follows: the negative effects resulting from "government failure" can only be remedied by political means. Firstly, the very decision to transfer ownership rights has to be taken by politicians. Secondly, the decision to go ahead with the transfer is usually accompanied by deliberately introduced changes in the degree of competition and/or in the regulatory framework faced by the newly privatised companies. In most cases such changes are in fact unavoidable.[21] Furthermore – and this is whence all the problems stem – these changes are discretionary in the sense that even if we assume that they are aimed at improving economic efficiency, which is by no means certain (not least because of the many goals that each privatisation was supposed to achieve), such an aim does not predetermine unequivocally the option to be chosen. That is why privatisation decisions are usually exposed to the same dangers (stemming from the political character of the process of taking them) which they are supposed to eliminate. This is true also for the choice of the techniques of privatisation, as well as for other strategic choices. In other words, it is only politicians who can (re-)establish the priority of economics over politics, but why should they be interested in doing this at all, not to mention doing it properly, if they are, as is plausibly assumed, utility maximizers? Is their desire to be seen to be doing the right things strong enough to be relied on? Gains from eliminating political interference and from exposing agents to economic pressures (conditional upon transfer of property rights) may be potentially large, but may remain unachievable by political processes, and not selling all the shares in a privatised enterprise, not to mention keeping more than 50 per cent of them in the state's hands, is definitely one of the best ways of undermining the possible efficiency gains from privatisation.

What about the state in post-STEs? In "the good old days" there were many problems with central planning and public ownership of the means of production, but equally important was the political

[21] This is precisely what makes any comparison between the periods before and after privatisation almost impossible.

system within which these economies operated: This authoritarian system, called by those in charge of it "socialist democracy", was characterised by the unquestionable dominance of communist parties, the arbitrariness of its rule, and, in the case of countries other than the Soviet Union, dependence on the motherland of socialism. Politics was the main reason for which STEs were established, but their poor performance eventually forced political changes which in turn allowed the countries of Central and Eastern Europe to begin their return to capitalism.

To change the political system it was apparently enough to call a free general election and to let the newly elected MPs gather together and form a government. To re-establish the rule of law it would then apparently suffice to ask the legislative, executive and judiciary branches of government to follow certain procedures as well as to consider properly the scope of their activities.

There were, however, no political parties which usually mediate between voters and candidates and structure political processes, and the social groups whose actions made the breakthrough possible perceived the world around them as a black and white cliché of "us and them" and it was naïve to expect that forty or so years of propaganda would leave the minds of the public intact. Things often moved so quickly that programmes were written only after the new team was already in power. The implementation of these programmes had to be entrusted to the old nomenklatura, who were too large a group to be sacked and replaced by new people. In addition, the ideas that some members of the "new nomenklatura" had about what market economies are all about also left much to be desired. In this context a fully fledged, western-style liberal democracy could easily be confused with its external appearances, and the recent electoral victories of post-Communist parties further complicated this web of already complex relationships.

One consequence of this state of affairs is that privatisation should be perceived as an either/or issue, i.e. everything should be done to avoid a situation in which the state – and therefore the politicians – preserves control over apparently privatised enterprises. Accepting this recommendation should have beneficial effects both for the polity and the economy. While improving the functioning of the latter, it will at the same time help politicians to concentrate their minds on issues that from the point of view of public interest are more important, or simply needed, than politicians' clinging to power and its exercise. Instead of putting their cronies on boards of directors, they could work on the reform of the social security system.

Conclusions

Having said all of this, partial privatisations and residual shareholdings are simply a fact of life in CEE privatisation. That is why it is so important to make the fullest possible use of any advantages that such arrangements may have, at the same time trying to minimise their negative consequences. This is not exactly a surprising conclusion, but it can be translated into the following policy recommendations:

☐ Although the relationship between the capitalisation of the given stock exchange and the size of the given issue is a problem, large issues can be used to increase the capitalisation, and further, the government should increase its efforts to help its stock markets grow.

☐ The problems of preserving state control over some, very clearly defined, strategic industries, should be solved by methods other than just partial privatisation; despite all the negative features of the so-called golden shares used in the UK, they seem to be more acceptable than keeping 51 per cent of shares in the hand of the state.

☐ One should also be very careful about the fiscal side of residual shareholdings; it is true that having 51 per cent of the shares of a telecom operator may prove in the future to be an important source of budgetary revenue, and that selling the shares in tranches may help maximise the revenue, but will the governments make good use of this money? Having additional income may, for example, relieve pressure for reform of the social security system, myopic as it may be in practice, and giving in to the temptation to require that a substantial dividend be paid may endanger the future of the given company.

☐ Finally, and perhaps most importantly, there is the issue of transparency in general, and political transparency in particular. One does not have to subscribe to public choice theory or to agree with certain theories of state capitalism, but it is a matter of fact that democracies in CEE countries are still very young, the break with the past is sometimes less radical than it appears, and the old nomenklatura has managed to some extent to transform its political power into an economic one. And precisely because "normality", whatever this term means in practice in any of the countries under consideration, is still far away, one must not create opportunities for mixing party politics with state finances.