A CONCEPTUAL ANALYSIS OF THE FINANCIAL AND OPERATING PERFORMANCE OF PRIVATIZED ENTERPRISES: A NIGERIAN CONTEXT

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Abstract
There is an evident government involvement running and managing the economy. The main government involvement in the economy is though the creation, nationalizing and regulating enterprises with the aim of fostering economic growth and economic development. The enterprises created or nationalized gradually becomes inefficient and a burden to the government and partially to the donor agencies. This led to the casting doubt on the ability of the state-owned enterprises to propel the desired economic growth and development, and the resurgence of market-led economic thinking. Theories justifying privatization as a public policy draw justification from the vision of a good society. Privatization, although viewed differently among different scholars, refers to the sale of government holdings in the public enterprises and it had wide circulation from 1970s to date. The theoretical foundation of privatization can be traced to the Neo-classical thinking, particularly the productive efficiency, property right, and the agency theories.

Key words: State-owned enterprises, privatization, inefficiency, operating efficiency.

1.1 Introduction.

Government involvement in the economy by using bureaucratic and regulated public enterprises as mechanism for national development is one of the marked features the world over Sader (1993). Government increasingly intervened directly in the economic process to support economic development. The primary arguments for this strategy were based on efficiency criteria. Particular sectors such as mining, petroleum, telecommunication, finance, transport, and heavy industries were viewed as central to development. Governments hope to accelerate economic growth by eliminating bottlenecks in these crucial areas and enhancing their profitability and performance. These intended efficiency gains were expected to improved export earnings and reduce foreign exchange constraint Sader (1993).

The trend of the first three-quarters of 20th century therefore witnessed state intervention in productive aspects of the economy. Enormous social and economic burdens imposed by repeated, protracted and worldwide wars; the near-breakdown of the capitalist system during the great depression; and the post-WW II, disintegration of European colonial empires and their replacement by regimes, few of which initially had ties to private economic actors. These summary factors led many governments, to adopt interventionist economic programs.

A prime operational principle of these programs was the public ownership and management of productive entities, especially in infrastructure. These “public enterprises” grew in number, size and significance, accounting, on worldwide average, for over 10 percent of GDP by the 1970s. Average percentages in developing countries surpassed 15 percent, with much higher figures in overtly socialist and communist economies. Nellis (2006). By 1980s, state-owned enterprises are estimated to account for an average 17 percent of GDP in sub-saharan Africa, Kikeri, Nellis, and Shirley (1992).

The augment continued, in Western Europe, governments debated on how deeply involved the national government should be in regulating the national economy and which industrial sectors should be reserved exclusively for state ownership. Except Thatcher’s government in 1979, the answer to this debate in the U.K and elsewhere was that the government should at least own the telecommunications and postal services, electric and gas utilities, and most forms of non-road transportation. Megginson and Netter,(2001). Many politicians also believed the state should control certain “strategic” manufacturing industries, such as steel and defense production. In many countries, state owned banks were also given either monopoly or protected positions, La Porta, Lopez-de-Silanes and Shleifer (2000).

Rondinelli and Iacono (1996) argue that government ownership grew in the developing world for slightly different reasons, primarily that government ownership was perceived as necessary to promote growth. In the postcolonial countries of Asia, Africa, and Latin America, governments sought rapid growth through heavy investment in physical facilities. Another reason for government ownership, often through nationalization, was a historical resentment of the foreigners who had owned many of the largest firms in those countries thus, there had been a tremendous growth in the use of state owned enterprises (SOEs) throughout the world Roger Noll(2000).

In the case of Nigeria, the shortage of capital and absence of a well-developed entrepreneurial class and huge oil revenue spurred government to be involved in almost all sectors of the economy. This resulted in the passage of some legislations in the 1970s and 1980s restricting the participation of foreigners in certain sectors of the economy. Government also creates parastatals which operated in the manufacture, financial, transport and communication as well as other sectors of the economy. It is therefore obvious that public investment in the public enterprises was enormous. The total investment in public enterprises, using the 1986 estimates, is about N36.465 billion, which is revalued, by Technical committee on privatization and commercialization (TCPC) amounting to about N500 billion (TCPC 1993).

The efficiency consideration, initially used as an explanation for expanding economic activities of the public sector were gradually replaced by short-term political goals, rendering state-owned enterprises to large employers and suppliers of highly subsidisized goods and services to the public. In many cases state-owned enterprises did not contribute significantly to the development process directed at quelling economic dissatisfaction Sader (1993). Instead of generating economy-wide multiplier effects, fostering the development of private industry though the provision of essential services and raw materials, state-owned enterprises turned out to be grossly inefficient, bottlenecks and generally inadequate with deteriorated infrastructural condition World Bank (1991).

The social benefits resulting from the provision of goods and services to the public in the form of staple foods, energy, transport, etc became an increasingly financial burden to the government, many of the state-owned enterprises incurred substantial financial losses and drained the resources from the budget, Sader (1993) Therefore, government involvement in the economic activities has increasingly come under attack on the ground that the intervention led to distortions in running the economy, breed inefficiencies and resulted in misallocation of resources. The involvement is criticized for failing to accomplish the economic, social and political objectives for which they were created. It is therefore, opined deregulation of public enterprises can yield substantial benefits relating to efficiency, budgetary savings, preservation of scarce resources, and restoration of physical balance and reducing government involvement in the economic activities.

2 .0 Theory

The theories justifying privatization as public policy draw their inspiration from several different visions of good society. The most influential is the vision grounded in laissez-faire and free market economy that promises greater efficiency, a smaller government, more individual choice, property rights and market forces. The second vision is rooted in a more socially minded tradition that promises return of power to communities through a greater reliance on families, religious institutions, and other nonprofit institutes. In this view, privatization assumed to mean devolution of power from the state to nonpolitical and noncommercial forms of human association. Yet a third perspective sees privatization as a political strategy for diverting demands away from the state and thereby reducing government "overload." Starr (1988) This last view, does not conflict with the other two--indeed, some advocates of privatization draw on all three--but each vision suggests a different framework for analysis and policy. Even within the economic theory of privatization, there are some subtle but important differences between the radical view of privatization as a reassignment of property rights and the more moderate, conventional view of privatization as an instrument for fine-tuning the economy Starr (1988).

2.1 The Meaning of Privatization

Privatization is an unclear concept that covers range of ideas and Policies, however varied, and a time unclear in its meaning, privatization has unambiguous political origins and objectives. It emerges from the countermovement against the growth of government in the West and represents the most serious effort of our time to formulate a positive alternative. Privatization do not aim merely to return services to the private sector but seek to create new kinds of market relations and promise results superior to conventional public programs.
The current wave of privatization initiatives opens a new chapter in the conflict over the public-private balance**.** ***Starr,(1988*)** privatization gain wide circulation in 1970s and early 1980s.With the conservative governments in Britain, the United States, and France. The term privatization mean any shift of economic activity performed by state-owned enterprise to the private sector; it also means a shift of the production of goods and services from public to private. The broader definition of privatization includes reductions in the regulatory and spending activity of the state. Public sector here includes Agencies administered as part of the state and organizations owned by it, such as state enterprises and Independent public authorities, the private sector include not only commercial firms but also informal and domestic activities, voluntary associations, cooperatives, and private nonprofit corporations .Musolf and Seilman (1980).In the definition, privatization refers to shifts from the public to the private sector, not shifts within sectors. Therefore, the conversion of a state agency into an autonomous public authority or state-owned enterprise is not privatization, though it may well put the enterprise on a commercial footing. These intra changes might be described as commercialization. In the case of public agencies, commercialization is sometimes a preliminary stage to privatization. It should be noted that shifts from publicly to privately produced goods and services may result not only from a deliberate government action, but also from the choices of individuals or firms that a government is unable to satisfy. In many countries, private demand for social services such as education, health care, or retirement income has outstripped public provision. As a result, private schools, medical care, and pensions have grown to relatively

larger proportions. This is known as demand driven privatization. When privatization is a demand-driven process, it does not require an absolute reduction in publicly produced services.

If you shift attention from the sphere of production to the sphere of consumption, we may alternatively define privatization as the substitution of private goods for public goods. A public good, in the economist's sense, has two distinguishing properties: One person's consumption does not preclude another's; and excluding anyone from consumption is costly, if not impossible. Starr (1988).

These forms of privatization vary in the extent to which they move ownership, finance, and accountability out of the public sector. The spectrum of alternatives runs from total privatization to partial privatization. The implications of privatization vary with its degree. In cases of partial privatization, the government may continue to finance but not to operate services, or it may continue to own but not to manage the assets. Privatization may, therefore, dilute government control and accountability without eliminating them. Where governments pay for privately produced services, they must continue to collect taxes. Privatization in this sense diminishes the operational but not the fiscal or functional sphere of government action. By putting the delivery of services into the hands of a third party, governments may divert claims and complaints to private organizations, but they also risk seeing those third parties become powerful claimants themselves. Starr (1988).

Privatization has also been defined in differently, Ibrahim et al (1992) conceptualized privatization to include:

i. Curtailment of overextended public enterprise and overhaul of loss marking parastatals since they add to budget deficits.
ii. Increasing the efficiency and profitability of state-owned enterprises by restructuring incentive for managers.
iii. Allowing competition from private (including foreign) firms.
iv. Encouraging and allowing the private sector to perform the activities, it does best, allowing the state to focus on managing the macro-economy, providing basic educational, scientific and health services and providing infrastructure.
v. Providing more appropriate price of the product and services produced by state enterprises e.g. electricity, which reflect soil marginal costs.

In general, therefore, privatization involves the reduction of public sector intervention in economic activity. The nature of privatization therefore, is going to vary according to the public sector intervention. Also Usman (1987) opined that privatization could involve:

1. Reduction in state provision of goods and services e.g. by sale of government shares, expansion of privately provided education, health care, etc.
2. Reduction in State subsidy-e.g. the introduction of user charges where they did not exists; reduction in subsidies provided by government in the production of goods and services.
3. Combination of (1)-(2) above.

In this perspective, there is an obvious need to consider privatization along the functions of public enterprise reforms. In other words, privatization is not always a substitution of public provision with private provision by profit maximizing, unregulated market operators. Sometimes it is simply provision by the same or another public enterprise, which, this time, is operating under less regulated, and more competitive environment. Usman (1999) conceptualized privatization to involve redefining the role of government by having it disengaged from those activities, which are best, handled by the private sector, with overall objective of disinvestments by the Federal Government of all its ordinary shareholding in the designated enterprise" and partial privatization means disinvestments by the Federal government of parts of its ordinary shareholding in the designated enterprises.

Others with similar view of privatization for instance, Cook and Kirk Patrick (1988), Jerome (1999) observed that privatization reflects new policy initiative geared to alter the balance between the private sector and public sector. Nankani, (1990), in his view, privatization is the transfer of public sector activities to private sector. It takes various forms including management contract, management buyout, load shedding, deregulation, liberalization as well as outright liquidation of state-owned enterprise. Others quickly add divestiture to the conception of privatization. According to Nellis, (1991) divestiture involves the full range of mechanism including full; or partial sale, transfer of ownership, the sale of assets, leasing arrangement, or contracting out.

The wholesale privatization can be viewed from two perspectives, the macro and micro institutional perspectives. The macro institutional approach is theoretically a sector-wide approach, which is predicated, on the stringent assumption that all public enterprises share common problems, many of which constitute the base of public enterprises failure to get the maximum possible output from the inputs it uses, and so requiring a common frame work to solve. The perspective provides a concrete base for the liquidation of nonviable enterprises, and the sale of those with commercial orientation.

The micro institutional perspective concentrates on one enterprise at a time before moving to several others, I. e. one after another. Changes are expected to emerge from the process of structure, size, functions and operations of affected enterprise. The experiences gathered from one could ease the problems in subsequent enterprises, Ayodele(1999)

Finally Mugerwa (2002) sum up privatization to imply the transfer of ownership from the public to the private sector, as well as changes in income flows between groups. In this way it has important socioeconomic implications for the various interest groups, not least the bureaucratic elite. Politically and in terms of administrative resources, privatization have been more demanding than the ‘stroke of the pen’ measures such as exchange rate and price reforms, which brought about macroeconomic stability. Furthermore, in recent years, donors and multilateral financial agencies have made privatization a key conditionality. Indeed most African countries undertook privatization in an effort to fuldfied and to assuage donor fears over domestic reform commitment than out of ideological or economic conviction. Privatization therefore touches on a complex set of issues, including property rights, nationality, ethnicity, bureaucratic practices, donor conditionality, nature of markets and politics. Mugerwa (2002) concluded.

3.0 Theoretical overview

Theoretical overview focused on two main perspectives of privatization. The normative view which conceptualized privatization as necessary to curb waste, raise economic efficiency and develop the activities of the private sector via increased domestic and foreign investment. The main driving force being the eradication of the ‘soft budget’ constraints that make public firms a major cause of fiscal imbalance, as state-owned enterprises encourage waste and obstruct the flow of services Harsch (2000), Kornai (2000). The normative theory also presupposes benevolent governments and politicians. The normative theory assumed politicians to be generous, their main concern being to maximize aggregate welfare. The politicians are willing to abandon a discretionary system where market forces determine performance.

The point of departure for the positive view is that in sub-Saharan Africa, privatization is a politically charged subject. This relates to the agency and credibility problems that are unleashed by the exercise as well as its income distribution implications. In managing state-owned enterprises, politicians and bureaucrats enjoy rents and are also able to exercise political patronage, by creating jobs for their supporters as well as targeting credit and other benefits to them. In turn politicians are assured re-election and other means of retaining power. Why then would politicians that are pursuing group-interests and, under them, bureaucrats with discretionary powers, be willing to commit to a privatization policy that does not favour particular groups or agree to the establishment of an impartial regulatory mechanism post-privatization? Mugerwa (2002). The answer from the positive theory is that privatization only goes ahead when politicians see in it clear-cut economic and political benefits. In their application of the model on sub-Saharan Africa, Laffont and Meleu (1999) conclude that the speed of privatization is directly related to the shares that politicians or their relatives can fetch in the privatized firms to compensate themselves for the loss of the rents previously enjoyed under state ownership. Similarly, interest groups and constituencies, depending on the amount of political influence they wield, can also affect the speed and sequence of privatization In this way governments could end up maximizing group than aggregate welfare. For example, since the divestiture of loss making state-owned enterprises implicitly lowers the tax burden, privatization rewards taxpayers, often the middle classes, while reducing the rents and employment opportunities enjoyed by senior bureaucrats and other public sector employees.

There is thus a trade-off between the goals of economic efficiency postulated by the normative approach and the issues of income distribution and voter maximization of the positive approach Gupta (1998), Talley (1998). However, bureaucratic collusion and political patronage need not be the only spur to privatization. As already noted, privatization was undertaken in many African countries as a direct response to demands from the donor community and the multilateral agencies to get governments out of business. There is one important reason why donors would have influence in the context. The inflow of aid keeps government bureaucracies operative and sometimes even increases their activities and wages. Mugerwa (2002) It can also be argued that for many regimes, for example those that had forcefully nationalized or expropriated properties belonging to multinationals and non-indigenous groups, privatization became a means of signaling the end of the old ways and the beginning of legality.

4.0 Theoretical Underpinning

Privatization form the core of the market-based alternative to the management of State Owned Enterprises (SOEs).It play crucial role in the structural adjustment programmed generally implemented both in the developed and developing countries. Proponents of privatization contend that the reforms will bring efficiency gains in services delivery due to discipline imposed by the profit motive and will reduce the scope of political inference (Kate, 2001).

Supported by neo-classical *productive efficient theory, property right theory, agency theory,* as well as *the theory of allocation efficiency,* the advocates of privatization believe that this element of economic reform offer the best opportunities for improving efficiency in public enterprise management and service delivery.

Production efficiency theory focuses on a decrease in production costs, which can be achieved by proper management and right incentives. In this respect, neo classical economists argue that private ownership stimulates the implementation of efficiency-enhancing policies. Property rights, on the other hand, are instrumental in achieving both a locative and productive efficiency with respect to the use of firm resources Ali, (2000). Ali further argues that abolishing the public sector property right has a positive impact on the productive performance and innovation of the firm.

Agency theory states that agents act merely out of self-interest and therefore incentives have to be offered that motivate them to adjust their aims to those of the enterprise. Agency theorists, therefore, believe that privatization stimulates the design of new management control system, including accounting systems Macias, (2002). Furthermore, privately owned firms are presumed to be governed by business goals and capital market acts as a deterrent to managerial non-profit behaviors, Ott and Hartly, (1991).

According to Adam et al (1992), competition generated by private ownership is essential in achieving a locative efficiency, as during this process crucial information is revealed, which is required for an efficient use of the firm's input. If the level of competition is low, it will be more difficult to detect signals on the basis of which a proper input-output balance can be determined. In addition, due to managerial inefficiency or low level of demand, profits may decrease.

Neo-classical economics school of thought claim that the a locative efficiency of the public enterprises is poor because the politicians, the managers and workers are motivated by goals that do not correspond with the interest of the company. They also argue that adequate allocation of resources will be stimulated by measures such as market pricing, the removal of import restrictions and quotas, the promotion of private sector, and the curtailment of government activities by closing state enterprises and contracting out government functions to the private sector. Ade et al (2009)

The view is that private rather than public ownership will produce more efficient enterprises, beneficial to customers, the industry and the nation as a whole Adam et al, (1992). It is in the light of these theoretical underpinnings, that empirical evidences are currently being sought as to the ability of the neo-liberal economic reform in transforming the state-owned enterprises to a more profit-like and more efficient manner.

4 .1 Privatization and Microeconomic Efficiency

To date, there is a vast literature in microeconomics that addresses the question of why ownership matters. This question can be re-stated by asking whether and in which way the decision process of the firm is distorted when the government intervenes. This can be analyzed by looking at the components of the optimization problem: the objective and the constraints, and how these are affected under different types of ownership structures, Shenshinski and Calva (2000). Within the microeconomic literature, it has been theoretically established that, under condition of perfect competition, absence of information problems, and complete contracts, ownership does not matter, i.e., you would observe the same performance of firm regardless of their ownership structure Shenshinski and Calva (2000).

The original arguments in favor of public ownership were justified as a solution to the failure of those conditions: the *market failure* argument. Under non-competitive conditions --characterized by decreasing average costs in the relevant range of demand within the specific market-- the existence of more than one firm is not justified on efficiency grounds. The possibility of exploitation of monopoly power by a private owner created the need for public ownership in those "natural monopoly" sectors. This argument in favor of public ownership was used by important scholars for a long time, as shown by the opinions expressed by Lewis, Meade, and Allais early in their careers --during the 1940s-- in favor of the nationalization of industries with such characteristics Shleifer (1998). The market failure argument, and the perspective that the government takes into consideration social marginal costs, has been called the *social view*.

The formal analysis of information problems, contract incompleteness, and the role of incentives in promoting efficiency within the firm, has shown that efficiency losses involved in public ownership are non-negligible. In many cases, they are higher than the gains that can be obtained by solving a market failure problem. This is especially so as the scope of competition becomes larger when the size of the market increases, the economy is open to international trade, and technology develops. Thus, the weakening of the market failure argument and the evidence in favor of the relevance of the other two conditions --asymmetries in information and market incompleteness-- gave rise to a re-thinking of the original views in favor of public ownership. Shenshinski and Calva (2000).

In relatively competitive markets, the advantages of public ownership were put in doubt. In non-competitive sectors, however, the natural monopoly argument cannot be abandoned as a justification of public ownership without solving one important policy question: how to deal with the possibility of exploitation of market power by private owners. In this regard, the evolution in the theoretical work on regulatory mechanisms and their properties to function as a second-best solution to the above problem showed that there was an alternative to public ownership. It was also shown that, under certain conditions, this solution was more efficient. Therefore, the question was translated into how to efficiently impose a regulatory constraint on the decision making process of the private firms without deterring innovation and cost-reducing effort, Shenshinski and Calva (2000) concluded

4.2 Incentive and Contracting Problems

One of the views in favor of privatization is be characterized by moving away from the natural monopoly argument and considering contracting and incentive problems within the firm as the relevant issues to foster efficiency at the microeconomic level. This perspective is termed the *agency view*, Shenshinski and Calva (2000) Within the *agency view*, there are two perspectives on the causes of the existence of poor incentives for efficiency. The first one, termed the *managerial* perspective. Managerial perspective believed that monitoring is poorer in publicly owned firms and therefore the incentives for efficiency are low powered (Vickers and Yarrow (1989). The second is the *political* perspective. The political perspective claims that political interference is what distorts the objectives and the constraints faced by public managers (Shapiro and Willig (1990), Shleifer and Vishny (1994)).

Within the managerial view, the impossibility of complete contracts plays a fundamental role in explaining why ownership indeed matters Williamson (1985), Sappington and Stiglitz (1987). According to Williamson (1985), the impossibility of writing complete contracts with the private owners would make state-owned enterprises(SOE) to function at least as well as privately owned firms (under the same conditions), whereas "selective intervention" by the government when unforeseen contingencies arise could actually result in a socially preferred outcome. The selective intervention argument relies heavily on the "benevolence" of the government, in the sense that it always has the right social welfare function as an objective to be maximized. Shenshinski and Calva (2000)

4.3 The Political Perspective

The *political perspective* argues that distortions in the objective function that managers seek to maximize and the constraints that the managers face, through the soft budget problem result in lower efficiency under public ownership. Shapiro and Willig (1990), Kornai (1980), Public managers, who to report to politicians and pursue political careers, incorporate to the objective function aspects related to maximization of employment --at the cost of efficiency-- and political prestige (the empire building hypothesis). The reason why managers are able to do that without facing the threat of bankruptcy relates to the distortion of the soft budget constraint.

In any situation in which the firms have engaged in unwise investments, it will be in the interest of the central government to bail the firm out using the public budget. The rationale for this relies on the fact that the bankruptcy of the firm would have a high political cost, whose burden would be distributed within a well-defined political group, like unions. On the other hand, the cost of the bailout can be spread over the taxpayers, a less organized, larger group in society, with diversified interests and preferences Shenshinski and Calva (2000).

. The threat of bankruptcy is non-credible under public ownership. Under a very simple assumption we can obtain the soft budget constraint result as the equilibrium in the game between the public manager and the central government (or "ministry of finance"). The assumption is that the political loss involved in closing a publicly owned company is larger than the political cost of using taxpayer money to bail it out (or public debt, i.e., future tax collection).

4.4 The Managerial Perspective.

Imperfect monitoring is the first cause of low-powered incentives according to the *Manageria* perspective. The reason why the managers of state-owned enterprises are poorly monitored has to do with the fact the firms are not traded in the market, as is the case of any private firm. This fact eliminates the threat of take-over when the firm performs poorly.

Additionally, shareholders cannot observe and influence the performance of the enterprises Yarrow (1986),Vickers and Yarrow (1989). Debt markets cannot play the role of disciplining the managers, because SOE's debt is actually public debt that is perceived and traded under different conditions. Some have argued that partial privatization can solve this problem without having to pursue full divestiture. Shleifer and Vishny (1996) and others have argued against partial privatization using the *political perspective* as an explanation. Even partial ownership allows the politicians to have an influence on the performance of the firm and give covered subsidies to achieve political goals.

The cost of intervention increases as the share of public ownership decreases, full divestiture being an important commitment device to signal no political intervention. According to the model, partial privatization could solve the monitoring problem by making public information that was previously not available. That policy, however, would not be enough to solve the problem of political intervention through "side-payments" Shenshinski and Calva (2000). The relevance of the existence of "side-payments" through which the government can achieve political objectives at the cost of efficiency is related to another argument in favor of the irrelevance of ownership. Sappington and Stiglitz (1987) provide a result termed the "Fundamental Privatization Theorem" which states that, through mechanism design, an optimal contract can be implemented so that whatever is feasible through private ownership can be achieved through public ownership and vice versa.

Two assumptions are driving the result: the existence of unlimited side-payments, as in the case of subsidies to "bribe" the private owners, and the existence of complete contingent contracts. Both assumptions are strong. The cost of "bribing" private owners increases as the share of public ownership decreases. It is not clear that the government can give subsidies to the firms that are privately owned in the same way it would do it to SOE's. The second assumption, the existence of complete contracts is actually even stronger. Though Williamson's original claim is that "selective intervention" makes incomplete contracting a favorable argument for public ownership, when the distortions in the objective function of public managers are introduced, the argument severely becomes weaken. More sophisticated incomplete-contracting models have shown that there are costs and benefits attached to privatization under unforeseen contingencies that cannot be specified *ex-ante*. Laffont and Tirole (1991) based their analysis on the existence of *ex-post* re-negotiation possibilities that led to profitable investments being foregone by public managers. The costs were associated to the need of regulation

under informational asymmetries. Shapiro and Willig (1990) used the distortions in the objectives of the public managers to show the benefits of private ownership under incomplete contracting.
Finally, Schmidt (1990) eliminates the assumption of a "malevolent" government and shows the costs and benefits involved in privatization. The fact that bankruptcy is a non-credible threat under public ownership makes the managers increase the scale of production, whereas a private manager would face a real threat of failure that induces productive efficiency. These arguments show that privatization has costs that are generally associated to the need of regulation under asymmetric information. The implication is that, under competitive conditions, privatization must result in a net gain Shenshinski and Calva (2000).
Taking the argument above to the limit, it has been argued that competition is what matters, putting ownership at a lower level in the hierarchy of policy prescriptions Stiglitz (1993), Vernon-Wortzel and Wortzel (1989). Though it is true that important efficiency gains can be achieved through the introduction of competition and the maximization of market contestability via deregulation policies, there are two limitations to this argument. First, the existence of a publicly-owned firm as the incumbent, in most cases subsidized, may deter other firms from entering that market, even when it becomes legal to do so. Real competition would be difficult to introduce under those conditions. Competition implies not only free entry in the market, but also freedom to fail, i.e., the existence of free exit. Maintaining public firms in the market, given the arguments discussed above, would make free exit a non-credible commitment for such firms. The second argument against the idea that the elimination of legal barriers to entry is sufficient to achieve the desired goals is that in many markets is not possible to have competition because of natural monopoly conditions. In those cases, the introduction of competition by eliminating barriers to entry and exit are not a sufficient condition for the reform to be successful. Many times, changes in ownership are needed complements for the creation of a market environment through the necessary legal reforms and opening to international trade.
According to Hart, et al. (1997), an incomplete-contracting model that shows conditions under which public ownership is superior to private ownership is When the scope of competition is limited in terms of consumer choice and the incentives for cost reduction may lead to a reduction of non-contractible quality, there is a case for public ownership. This is termed "the proper scope of government".

4.5 Macroeconomic Effects of Privatization

The interaction between privatization and macroeconomics comes from the fact that macro instability, especially budget deficits, tend to accelerate privatization. The effect of poor public sector financial health,on the willingness to reform and on the political acceptability of such reform results in a clear relation between higher public deficits and faster public sector restructuring. The evidence has been shown in Serven, et al. (1994) and López-De-Silanes, et al. (1997), among others. It is expected that privatization of state-owned enterprises would lead to lower budget deficits, *ceteris paribus*. Privatization allows the government to raise funds in the short term and eliminates the need of permanent subsidies to previously publicly owned enterprises. If firms go from deficit to surplus in their operation, the government will not only eliminate subsidies, but actually start collecting taxes from them. The actual change in the financial position of the government is determined by the difference between foregone dividends and taxes collected from the company. Future higher dividends of the firms under private ownership should also be reflected in the proceeds the government obtains during the sale. The use of the proceeds from privatization determines to a large extent the impact of privatization on public sector's cash flows. If the revenue from the sales is used to reduce public debt, as has been the case in most countries, lower interest payments and consequently a stronger cash-flow position of the public sector would observed. The effect of privatization on public sector borrowing requirements should be reflected in lower interest rates, which foster investment, growth, and lower inflation. Another important macroeconomic effect of privatization, especially when it is done through public offerings and mixed sales, is the increase in the level of stock market capitalization and, in general, the development of the financial sector. As shown, in World Bank (1995), state-owned enterprises tend to crowd out private investors in the credit market --given that they represent a less risky investment for the banks. Privatization mobilizes resources in the financial sector, reallocating credit to more productive uses.

Finally, from a theoretical perspective, the sale of public sector enterprises would reduce the aggregate level of employment in the short-run, because of the elimination of redundant labor. Unemployment, however, may decrease in the medium and long-run as the rate of growth of the economy increases as a result of the efficiency gains at the micro level and the increasing stability at the macro level. Privatization has been one policy among a set of structural reform policy measures. These measures include trade liberalization, deregulation, financial sector restructuring, and opening to foreign direct investment Shenshinski and Calva (2000) concluded.

5. O Conclusion

Government involvement in economic activity has a long standing history and objectives. The objectives range from provision of goods and services, economic and growth, but sometimes ideological inclination. Government involved into the economy by stashing, nationalizing and controlling state-owned enterprises. The enterprises established were infected by various forms of inefficiencies and to become a pipe through which government budget is drained. State-owned enterprises therefore become a burden to government. These developments led to re-thinking along the line of market-led economics. Privatization is sale of government holding in the state-owned enterprises. The prominent theory justifying privatization draws much from the vision of good society. But the underpin theory of privatization has its origin from neo-classical economic thinking. In particular the theory of productive efficiency, property right, agency theory and a locative efficiency

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