

Ownership, Competition, Management and Labour in Public Enterprises Transition: Literature Review

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Abstract

China's transition from a planned to a market economy achieved remarkable success through a gradual approach. Such transition was accompanied by the transformation of public enterprises. This paper conducts a literature review in relation to the three main arguments discussed above and sets up a theoretical perspective for the analysis in transition. The methods of this paper are embodied in a triangulation strategy, including a structured questionnaire, in-depth semi-structured interviews, literature research, and analysis of government documents and other relevant data sources. The rest of this paper is arranged as follows. It first reviews the reasons and objectives for the establishment of public enterprises, which is aimed to constitute a part of the basic framework of understanding why PEs were established and where the possible sources of PE problems lie. Secondly, the main theme is developed by examining the debates

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concerning the mechanisms for the improvement of public enterprise performance. These include three aspects: ownership, competition and management reform. Finally, it reviews labour issues associated with the transformation of public enterprises in transition.

Drawing on the literature review of public enterprises transition, this study found that a broad concept of competition, ownership, management and labour (COML) framework could be essential in guiding a smooth transformation of public enterprises as well as economic transition from plan to market. In this study, the transformation of public enterprises has been more likely to be successful when achieved through a gradual approach, as ownership change has constraints, and preconditions such as supporting institutions, which takes time to establish and function in an emerging new market environment. Moreover, labour interacts with the transformation of public enterprises, especially in the situation where there is a lack of a well-established social security, the consequences for labour from the transformation of public enterprises can be considerable.

Key Words: ownership, competition, management, labour, transition

I. Introduction

Public enterprises (PEs) were widely established in industrial countries between the 1930s and 1950s and rapidly expanded among developing countries in the 1960s and 1970s. They were built with state ownership for reasons of social and economic justice and the rational notion was that such PEs (namely state-owned enterprises, SOEs) could avoid problems resulting from market failure. However, from the late 1970s and especially throughout the 1980s and 1990s, the PEs had experienced wide-spread privatization and denationalization, which began significantly in the UK and other developed and developing countries around the world. This global phenomenon of privatization of PEs is defined, according to Cook and Kirkpatrick (1997: 2), as ‘the transfer of productive assets from public to private ownership.’ Faced with the challenges of government failure, public enterprise reform and privatization are seen as key policy instruments in the improvement of economic efficiency in the last two decades (World Bank, 1995, 1996; Yarrow and Jasinski, 1996; Cook and Kirkpatrick, 1988, 2000; Shirley and Walsh, 2000). In particular, privatization has been seen as a key means to promote market forces and shift the balance between public and private sectors in the economy.

There are various reasons for the rise and fall of the PEs. The global phenomenon of shift from state ownership to private ownership of public enterprises was accompanied by a burgeoning literature which carried an open debate over whether it is competition or ownership change from public to private that matters most in the improvement of economic efficiency. The combined force of the literature about the principal-agent, property rights and public choice theories concludes that enterprises operating under public ownership are less efficient compared to their private sector counterparts (Galal et al, 1994; World Bank, 1995; Shirley and Wals, 2000). By contrast, strong arguments against this

ownership-solution viewpoint come from the competition-solution viewpoint in addressing PE issues, especially the PE transition in developing countries. The competition-solution viewpoint argues that a competitive environment is more important than ownership per se and that a change in ownership is favoured only within a competitive market. That is, where there is a lack of competitive product and capital markets, ownership change (privatization) alone has only very limited success (Yarrow, 1999; Vickers and Yarrow, 1988; Cook and Kirkpatrick, 1988, 1997, 2000; Cook, 1997; Carlin et al, 2001).

Increasingly, a third voice regarding the PE transformation suggests that the real need is to reform the management concerned with public enterprises from both the state and enterprise levels. Those who argue for improved management, including institutions in public enterprises, rather than ownership change, are represented by Stiglitz (1993); Davey (1995), Korten (1995), Nolan (1995) and Farazmand (1999). This was supported earlier by the World Bank before the Bank shifted to advocate ownership change (i.e. privatization) in the last decade (Cook, 1997). The World Development Report for 1983 stated that ‘the key factor determining the efficiency of an enterprise is not whether it is publicly or privately owned, but how it is managed’ (World Bank, 1983: 50).

This paper conducts a literature review in relation to the three main arguments discussed above and sets up a theoretical perspective for the analysis of the study. The rest of this chapter is arranged as follows. It first reviews the reasons and objectives for the establishment of public enterprises, which is aimed to constitute a part of the basic framework of understanding why PEs were established and where the possible sources of PE problems lie. Secondly, the main theme is developed by examining the debates concerning the mechanisms for the improvement of public enterprise performance. These include three aspects: ownership, competition and management reform. Thirdly, it reviews the literature on labour issues associated with the transformation of public enterprises.

A. Reasons for the establishment of the PEs

A considerable body of literature has noted that the establishment of the PE was regarded as a remedy for market failures. Various forms of market failure, such as economies of scale, monopolies and externalities, prevented the economy from achieving an efficient resource allocation. Economic analysis rationalized government intervention in productive activities as a response to these specific market imperfections. The establishment of public enterprises could provide a way for direct government participation and intervention (Yarrow and Jasinski, 1996; Cook and Kirkpatrick, 2000). These justifications were coupled with arguments that public enterprises facilitated ‘economic independence’ and planned development. Where there is market failure, and the unregulated pursuit of profit does not lead to the maximization of economic efficiency, public enterprise can be made to correct the misalignment of public and private objectives.

Other reasons for the establishment of PEs were explored by Cook and Kirkpatrick (1988, 2000) and Van De Walle (1989). Firstly, it was thought that PEs in general would provide government access to much needed revenues. ‘Governments mistakenly believed that PEs would generate large profits with which they would be able to finance investment in priority sectors of the economy’ (Van De Walle, 1989:602). Secondly, there were ideological and political reasons. For example, public production could be made to seem more attractive in an ideological climate in which the private sector was held in low esteem and a large public role in the economy was seen as necessary for rapid and sustained development. It could secure for the government the provision of valuable industrial information and the control of strategic industries. On this point, the public enterprise may be justified for the sake of national security and employment creation. Thirdly, PEs could be used as a counterweight to the concentration of private economic power or as a remedy for short supply/risk aversion of the private entrepreneurs, or to strengthen the economic position of

particular ethnic groups or geographical regions or to overcome critical economic bottlenecks. Cook and Kirkpatrick (2000) state that public enterprises are often established by governments for reasons quite different from – and often incompatible with – profit maximization. Public enterprises often operate in noncompetitive markets, the absence of competition is one reason for creating them.

B. Objectives of public ownership

The mainstream of the public ownership literature has described the objectives of public ownership which varies from remedying market failure, redistribution of resources, ideological and political benefits to strategic industrial concerns (Yarrow and Jasinski, 1996; Cook and Kirkpatrick, 2000). Yarrow and Jasinski (1996) developed a summary of the various objectives of public ownership:

- (A) Remedying market failures / inefficiencies. Public ownership can provide one possible means for dealing with the perceived inefficiencies of certain types of market.
- (B) Redistributing economic resources. As with market failure, there may be a number of ways to achieve the desired redistribution of resources, for example by various combinations of taxes and subsidies. Such redistribution considerations often strongly influence the introduction of an enterprise or industry into the public sector. For instance, a public utility absorbs subsidies for one group of consumers from the profits made by another group of consumers.
- (C) Creating political benefits. The political benefits include the prestige projects that can be favoured by politicians in accordance with political needs and preference. A public enterprise can easily receive patronage from certain politicians.
- (D) Achieving strategic goals. More often than not, for reasons of military or national security or as a necessary counterweight to foreign ownership,

governments have designated certain sectors of the economy to be of 'strategic' importance for economic development. On this point, public ownership is one way of channelling resources to such strategic sectors.

C. Problems of PEs under public ownership

As a result of government participation and central planning, the majority of public enterprises failed to meet the planned objectives and standards of efficiency, partly because too many social burdens and expanding government interventions affect the PE's efficiency. The divestiture of the government/state ownership of public enterprises has been the pervasive paradigm in the last two decades. Privatization has been implemented across the globe, which involves the extension of market principles to goods and services financed and/or produced by governments. The phenomenon of public enterprise transition (mainly through privatization) has been reflected in the main theme of a considerable body of literature. It is claimed by a number of studies that public enterprises as a whole are less efficient than private firms and cause resource misallocation (Alchian, 1965; Killick, 1983; World Bank, 1995; Shirley and Walsh, 2000). Shirley and Walsh (2000) have summarized the common problems of public enterprises as follows: unclear, multiple or sometimes conflicting objectives (both social and economic); bureaucratic meddling; over-centralization of decision making; inadequate capitalization; lack of managerial skills; and excessive personnel costs (over-manning and over-extended public sector and therefore high labour turnover).

The World Bank (1995) points out that public enterprises have the following inherent problems of information and incentives: (A) information asymmetry due to managers' information advantage. Under this circumstance, managers were able to use their knowledge of the enterprise to negotiate with government - the owner of the enterprise - for targets which may be just in favour of themselves; (B) inefficient incentives and impaired profit-orientation due to controlled prices and

political intervention. Compared with private firms, penalties and rewards in/for SOEs were not employed properly, which resulted in the waste of resources and poor performance; (C) deficits (loss-making) brought in a significant burden to the government by absorbing too many government subsidies, and therefore usually undermined macroeconomic stability.

II. Debates on solutions to the problems associated with public ownership

In the face of the problems associated with public ownership in PEs, a perception that development planning had ‘failed’ (i.e. government failure) emerged. The growing concern with the apparent inefficiency of PE performance led to a wide variety of policy attempts to improve the PEs’ performance and therefore economic efficiency. Among them privatization has been a pervasive instrument widely implemented in developed and then developing and transition countries. In the 1980s and 1990s, reform measures of PEs incorporated a policy priority in a dramatic shift of PEs from public ownership to private ownership, although enterprise reform measures still continue in such countries as China and Vietnam (World Bank, 1997a; Cook et al, 1998; Cook and Kirkpatrick, 2000; OECF, 1998; Shirley and Walsh, 2000). In particular, policy attempts to change PE ownership went beyond the 1980s to roll back the government’s role in economies. Divestiture or privatization as a means to shrink the public sector has featured prominently in these attempts. Other solutions embraced in the main theme of the literature include the introduction of competition and management reform. These are accompanied by a body of literature which has investigated the solutions from various perspectives, most from the economic perspective and some from the managerial perspective. But there remains an open debate in the literature over the solutions to PE problems.

The arguments reflected in the debate can be broadly grouped into three

categories. Group one emphasizes ownership change as a means to address the PEs problems, and their policy priority is given to privatization (here it is named ‘ownership-solution group’). Group two stresses the importance of the competitive market in tackling PE problems and their policy priority is given to promoting competition to foster a competitive market (here it is named ‘competition-solution group’). Group three advocates the reform of management within the system, and their policy priority is given to the improvement of management of PE at both macro-state level and micro-enterprise level in terms of the perfection of institutions and the improvement of internal firm management (here it is named ‘management-solution group’). The arguments between groups one and two are very strong. The following section examines the debates in relation to the three groups of literature in turn.

A. Ownership-solution group of literature

(A) Theoretical grounds

The ownership-solution literature advocates privatization - a shift from public to private ownership (Nellis (1999) defines privatization as a majority of ownership shift from state to private hands) as a measure to improve economic efficiency. It argues that ownership (property rights) matters with the assumption that the state uses public enterprises for political purposes rather than profit maximization which is the purpose of private firms; this will have an adverse affect on enterprise performance in any market structure (Shirley and Walsh, 2000). After Alchian’s (1965) study on PEs, whose conclusion is that they will be inherently less efficient than private firms, the considerable body of ownership-solution literature argues that private ownership is superior to public ownership. The key reason is that public ownership has inherent problems of information and incentives which can be solved by private ownership. Shirley

(1999: 117) supports this viewpoint by stating that ‘some recent literature, through comparing the performance of enterprises before and after privatization or a privatized firm with a counterfactual, has generally favoured private ownership in both competitive and, although more ambiguously, regulated monopoly markets’ (Galal et al, 1994; Megginson et al, 1994; Martin and Parker, 1997). Shirley and Walsh (2000) maintain, by summarizing 52 empirical studies between 1971 and the present on the comparison of public and private enterprises, that the empirical results of privatization across sectors and countries show clear support in favour of private ownership, although the theoretical arguments on private versus public ownership show ambiguity.

The theoretical grounds of ownership change (i.e. privatization) are rooted in theories of government behaviour and corporate governance, principally including the public choice, property rights and principal-agent theories (Cook, 1997; Shirley, 1999). The following section examines these theories in turn.

1. The public choice theory

Public choice theory advocates that logical and deductive models of how government agencies behave are developed with clear directions for policy analysis and normative recommendations (Dunleavy, 1986). The body of this theory suggests that public managers, bureaucrats and politicians will use their control of SOEs to serve their own interests, rather than the state firm’s efficiency (Shirley, 1999). It further describes three manifestations of bargaining behaviour - the petitioning of politicians by SOE managers, equal bargaining between the two and the ‘capture’ of the political element by managers. The interests of income, power and prestige of politicians or bureaucrats can be enhanced in the public sector by increases in managers’ budgets (costs), whereas in the private sector, increased profits are the source of such rewards. It is assumed that under the public ownership system, managers are modelled as constantly petitioning for

ever-growing budgets and transfers. If SOEs are always asking for higher budgets as the SOE interest groups are often budget-maximizers, while politicians can allocate funds to a variety of purposes besides transfers to SOEs, the managers must have something to offer the politicians in return. Thus bribing politicians and other forms of corruption are more likely to take place within the public ownership at the expense of efficiency. 'This body of theory attributes poor performance of publicly-owned agencies to a divergence of 'interests' between bureaucrats and politicians that run government and the public interest in general'(Cook, 1997: 890). Furthermore, Shleifer and Vishny (1997) indicate that SOE efficiencies can be reduced by political meddling resulting from public ownership.

2. Property-rights theories

The property rights theory notes that individuals respond to incentives, as do managers, and that the pattern of incentives is influenced by the property rights structure. The property rights literature suggests that when a company has no right to be a residual claimant - that is, no individual or group with a clearly specified right to claim any residual benefits or surplus left after other claims are met - it will be operated with low efficiency. It is assumed that individual business people in private firms are profit maximizers. When owners are not managers, they incur costs in contracting, policing, negotiating and monitoring the management actions and enforcing the owner's property rights. Private property rights are exclusive and voluntarily transferable. However, in SOEs it is virtually impossible to transfer state ownership rights from one individual or group to another. Such an inability to transfer ownership rights is viewed by privatization advocates of state ownership as being inherently less efficient than private property. It is claimed that the owners of a private firm have better incentives to monitor management behavior to ensure efficiency than owners of state-owned enterprises. The greater the personal financial investment, the greater the interest in the operation of the

firm. According to this theory, in an SOE the manager has no wealth invested in the firm and no rights to share profits, therefore he or she is less motivated to pursue efficiency.

Shirley (1999:116) echoes that ‘since no one can clearly benefit from an SOE’s efficient operation, no one will be strongly motivated to hold management accountable for performance, hence agency problems will not be reduced.’ According to this theory, private ownership with clarified property rights can be a solution to SOE problems.

3. Principal-agent theory

A third theoretical argument for ownership change comes from the principal-agent theory, which rests upon the assumption that the aim of decision makers (owners) of privately-owned firms is the maximization of profit. In this theory, there exists a principal (i.e. the owner) and an agent (i.e. the manager) of a firm, and there is an agency problem as the agent (the manager) would not share the same objectives with the principal (the owner). The principal wants to induce the agent to act in the principal’s interests, but the principal’s control over the agent is always somewhat imperfect due to the lack of full information about the circumstances and behavior of the agent, as well as the difference of interests between the principal and agent. Therefore the principal faces a monitoring problem and monitoring costs (Vickers and Yarrow, 1988). According to this theory, the central question for the principal is to lay down the optimal incentive scheme for the agent, and the solution to the principal-agent dilemma is crucial to the efficient operation of a firm. Hughes (1994, cited in Cook, 1997: 890) notes that ‘the (principal-agent) theory was originally developed for the private sector to explain the divergence often found between the goals of managers (agents) in private firms and shareholders/owners (principals). In this theory, when the functions of ownership and control/operation in a firm are separated, very often there are conflicts between the interests of the owner and the manager in relation

to information asymmetry and ill-matched incentives and control'. Managers have every incentive to use their control to serve their own purposes at the expense of profitability and the owner's interests. Thus there are agency problems which may lead to impaired owner's interests. Principal-agent theory is concerned precisely with the problem of information and incentives (Vickers and Yarrow, 1988). This is backed up by Cook (1997:890) 'Principal agency theory generally attempts to find incentive schemes to encourage agents to act in the interests of principals.'

The relationships between owners and managers of business firms are examples of principal-agent relationships. The manager (agent) is contracted to act on behalf of (private or public) shareholders (principals) so that the latter is assumed to act to maximize the former's interests. Therefore a 'perfect' contract is needed to structure the manager's incentives to correspond exactly to the interests of the shareholders. However, in real life situations it is impossible to draw a perfectly complete contract to meet this standard (Aharoni Yair in Cook and Kirkpatrick, 2000). Under public ownership the problems of information asymmetry in agency relationships make it even harder for the principal to hold the agent accountable for achieving the agreed targets (Laffont and Tirole, 1986; Sappington, 1991). Under state ownership, the populace as a whole is the principal, with a variety of agents acting on its behalf, including various government ministers, members of parliament, managers of the firms and so on¹. All these agents are in fact a coalition - a group who work together and share some, but not all, goals. The populace does not have an effective voice in their discretion and control. In this circumstance, the ownership-solution literature claims that private enterprises have fewer agency problems than public enterprises and that it is less costly to monitor the agents in private enterprises than public enterprises. In other words, private ownership is superior to public ownership.

In the light of the insights of the above theories, their major policy attempts

¹ Aharoni (Cook and Kirkpatrick, 2000) warns the notion that the government or minister is the principal and that the state-owned enterprise is the agent is misleading.

are to strengthen monitoring by owners, and ownership change through privatization is viewed as the best solution to PE inefficiencies, as it is anticipated as making government intervention more difficult and enterprises are assumed to be freer to focus on profit maximization which may lead to higher economic efficiency (Shleifer and Vishny, 1997; World Bank, 1995; Boycko, Shleifer, and Vishny, 1996; Shirley, 1999; Shirley and Walsh, 2000). Shleifer and Vishny (1997) argue that, even in fully competitive markets, PEs will be inefficient because politicians may force them to pursue political goals such as over-employment. Such distortionary political interventions adversely affect the efficiency of PEs. Under private ownership, such interventions are more costly and transparent, and therefore it is more difficult to influence the private firms. Thus the ownership-solution group regard ownership as the key source of efficiency difference and argue that ownership matters more than competition for monitoring and for productive efficiency.

(B) Empirical evidence from previous studies

Empirical evidence is used to demonstrate that private firms are more efficient than public firms and that ownership matters most (Megginson et al., 1994; World Bank, 1995, 1996; Shirley and Walsh, 2000). Specifically, Boardman and Vining (1989) presented data showing that private firms are more efficient than PEs, even in competitive industries. Based on the comparison of the 500 largest non-US industrial firms, Boardman and Vining claim that state-owned and mixed ownership firms are significantly less profitable and productive than privately-owned companies, and that full privatization is needed because mixed ownership firms are no more profitable than those owned wholly by the state. Boardman and Vining challenge the competition-solution idea 'that ownership does not affect efficiency in the case where markets are fully competitive', for they demonstrate with empirical work that private performance is superior in competitive markets. They believe that ownership has a greater impact, and that

competitive markets are rooted in private property and it is impossible to simulate competitive conditions under conditions of government financing or government production. Kikeri (1999) provide empirical evidence that PEs hamper market performance as they are more likely than private firms to set prices below marginal cost and to seek regulatory barriers to entry by political influence. Galal et al (1994) find that after privatization, 11 out of 12 cases in developing and industrialized countries experienced increased consumer and labour welfare, despite layoffs and price increases. Megginson et al (1994) look at firm performance before and after privatization, and find that private ownership increases efficiency in all situations, although this effect is clearer in competitive markets. Nellis (1999) notes that politicians distort PE functions to meet political goals, private firms produce advantages for management monitoring, and that privatization is a key part of transition. World Bank (1995) supports these claims by documenting the political use and abuse of PEs in sample countries. The World Bank stresses that in a highly competitive market, a private firm is superior to a public firm and therefore emphasizes that ownership itself does matter. Furthermore, it is impossible to obtain the advantages of competitive markets in government provision and production of goods and services.

World Bank (1995) and Shirley (1997) provide a systematic approach to reform by identifying three political preconditions — desirability, feasibility and credibility. They analyze 12 countries' reforms including Chile, Poland, Turkey and China and recommend five components of PE reform. These components include divestiture (ownership transfer), competition creation involving liberalized trade, eased restrictions on entry, unbundled large enterprises, hard budgeting by eliminating subsidies and more commercially-based credit, financial sector reform and changes in the relationship between PEs and government. He World Bank argues that 'the greater the participation of private agents in ownership and management, the better enterprise performance' (World Bank, 1995: 6). Similarly, although both ownership and market structure significantly

affect efficiency, the ownership effect is slightly more robust across different measures of performance.

Nellis (1999) notes that ‘it is time to rethink privatization in transition economies, but it is not time to discard it. Privatization remains the generally preferred course of action where competitive markets are in place and the market-supporting institutions are functioning’. Concerned with the problems presented in privatization, Shirley and Walsh (2000) blame the flaws in the implementation process of privatization rather than the actual idea of privatization. They maintain that both ownership and how to change the ownership evenly matters.

The ownership-solution group criticizes the competition-solution advocates, stating that the concept of markets without property is a ‘grand illusion’, that under public ownership, government interference in PEs overwhelms the effects of competition and that inherent difficulties in management of PEs negate the impact of competition. In the face of studies showing the performance of PEs to be improved in the presence of competition (Yarrow, 1999; Shirley and Walsh, 2000) criticize them for failing to question whether this improved performance matches that of private (or privatized) firms. Shirley and Walsh further argue that ‘while market structure has a positive impact on performance, this impact fails to dominate the ownership effect’, and that there are many ways in which the effects of ownership can negate the influence of markets. Among the privatization approaches, Galal et al (1994); Pendleton (1999) and Kikeri (1999) stress employee share ownership and other different forms such as public sales.

B. Competition-solution literature

(A) Theoretical grounds

The competition-solution literature is based on theories arguing that market competition, not property rights, is the primary determinant of enterprise

performance. It can be seen as rooted in public interest theories.

It is noted by some competition-solution literature that the meaning of competition needs to be understood correctly beforehand in order to fully understand its role in the improvement of efficiency. Cook (2001) points out that the classical and neo-classical interpretations of competition differ, neo-classical economics views competition as a state of affairs, a competitive equilibrium characterized by market structure, while classical economics relates competition to a process of business behaviour. Drawing on competition as a process, Schumpeter states that it is not price competition which counts, but the competition from the new products, new technology, new source of supply, and new types of organization (cited in Cook, 2001). In the behavioral and evolutionary approaches to competition, competition is a process of change characterized by competitive order rather than a competitive equilibrium, and it can lead to a variety of market structures that can give efficient outcomes.

The competition-solution group argues that competition is the major determinant in influencing the performance of enterprises. This group emphasizes that competition influences allocative, operational and internal efficiencies. Theoretical evidence indicates that these effects can be extended to public firms (Beato and Mas-Colell, 1984; Cremer et al, 1987; Vickers and Yarrow, 1988). As described in Vickers and Yarrow (1988: 27), 'public interest theories are based upon the assumption that, in their dealings with industry, government departments seek to maximize economic welfare'.

'Given a welfare-maximizing government, and assuming for the moment that monitoring of management is equally effective under both types (public and private) of ownership, it is immediately obvious that public ownership has some potential advantages over the private alternative. In particular, it provides government with additional policy instruments to correct any deviations between social and private returns that arise from failures in goods and factor markets' (Vickers and Yarrow, 1988: 28).

Shirley and Walsh (2000: 5) note that ‘competition’s influence on operational efficiency falls into two categories — incentive effects and information effects. Competition in product markets creates incentive effects by threatening the managers of inefficient firms with diminished market share’. World Bank (2002: 133) documents that ‘product market competition increases efficiency (and productivity, and the growth of productivity in the economy) by providing incentives for managers to reduce costs, innovate, reduce slack, and improve the institutional arrangements in production’.

With respect to information effects, competition can provide information about costs and manager effort to owners, who would be otherwise in the dark. With this information, owners can design better incentive systems and evaluate manager efforts more accurately (Holmstrom, 1982). Vickers and Yarrow (1988) strongly cite the information effect of competition as an important influence on public-sector performance. In the presence of competition, prices will tend towards marginal cost, as such resources can be allocated to their highest value. On the contrary, in the absence of competition, prices are raised and production is lowered relative to the competitive equilibrium.

In relation to policy for the improvement of enterprise performance and economic efficiency, the competition-solution group gives priority to the creation of competition rather than ownership change (privatization). Yarrow (1999: 332) claims that ‘it cannot be expected that one form of ownership will be superior to the other in all industries and in all countries.’ The competitive and regulatory environment is more important than the question of ownership per se. Similarly, Kay and Thompson (1986) believe that although private ownership has an edge in fully competitive markets, focussing on ownership at the expense of competition yields sub-optimal results. Ayub and Hegstad (1987) extend the point that there are needs for the creation of a competitive environment, financial autonomy and accountability, and the extent and manner in which managerial autonomy and accountability are ensured. Vickers and Yarrow (1988: 44) confirm that, in

competitive markets, public enterprise is not always and everywhere the less efficient type of ownership, that 'managerial incentive structures are determined via a complex set of interactions among factors that include the type of ownership, the degree of product market competition, and the effectiveness of regulation'. Vickers and Yarrow (1988) further argue that in the absence of vigorous product market competition, the balance of advantage of incentive or monitoring efficiency under private or public ownership is less clear cut and that much will depend upon the effectiveness of regulation. This is backed up by Williamson (1975), who has argued that hierarchical arrangements can, in appropriate circumstances, produce more efficient monitoring than capital markets. Based on a comprehensive evaluation of British privatization between 1979 and 1987 – a period of approximately the first two Thatcher governments, Vickers and Yarrow (1988: 3) conclude that 'the allocation of property rights does matter because it determines the objectives of the 'owners' of the firm (public and private) and the systems of monitoring managerial performance'. Yet they argue that 'the degree of product market competition and the effectiveness of regulatory policy typically have rather larger effects on performance than ownership per se' (Vicker and Yarrow, 1988: 3). They also claim that 'public ownership and competition are perfectly compatible with each other' (Vicker and Yarrow, 1988: 51).

Galal et al (1994) have developed a theoretical model embracing a number of the determinants of the level and distribution of gains from public enterprise reform. They argue that increased competition in the economy, wide social insurance, fiscal stringency and financial market development can all increase the reform gains.

Cook and Kirkpatrick's (1988) research on privatization in less developed countries echoes that gains in efficiency performance are more likely to result from an increase in market competition than from a change in ownership. Cook and Kirkpatrick (1997) further note that privatization is a policy instrument that can be used in developing countries to bring about improved economic efficiency,

but it needs to be used in a selective and pragmatic manner alongside political capability and commitment of the government, not as a ideological crusade. The market environment and policy framework must also be liberalized if enterprise performance is to be significantly improved. Commander et al (1999) echo that changes in ownership without adequate attention to market structure can result in longer-term negative effects, restructuring to occur requires imposition of hard budget constraints and increases in competition, while restructuring consistent with improved competition prior to privatization is challenging at best. World Bank (2002) admits that ‘competition is an important force in promoting institutional change as well as economic development and growth.’

(B) Empirical evidence of previous studies

Willig (1985) shows that competition can reveal information about managerial effort by increasing the sensitivity of profits to costs. It is assumed that armed with better information, owners can devise incentive structures that align managers’ interests more closely with their own. As to whether the effects of competition are stronger or weaker than the effects of ownership, Vickers and Yarrow (1988) cite the information effect of competition as an important influence on public sector performance. This is supported by the findings in Cook and Kirkpatrick (1988) and Cook and Minogue (1990) which note that competition-led instruments such as market liberalization and deregulation, rather than privatization, are likely to yield more substantial gains in the context of developing countries. Shirley and Walsh (2000) cited two studies demonstrating empirical evidence that in the absence of competition, SOEs will produce allocatively inefficient results. Caves and Christensen (1980: 278) found in a comparison of public and private Canadian railroads that in the presence of competition, there is no significant difference between public and private efficiency. But they conclude that ‘public ownership is not inherently less efficient than private ownership - that the inefficiency of government enterprises stems

from their isolation from effective competition rather than their public ownership *per se*'.

In particular, Yarrow (1999) acknowledges that competitive and regulatory environments shape the incentives of managers. His survey of pre-and-post privatization firm performance in Britain suggested that performance depended more on market structure than on ownership. Cook and Kirkpatrick's (1988) study on developing countries points out that improvements in economic performance are more likely to result from an increase in market competition than from a change from public to private ownership in less developed countries where institutions and regulation are often weak. Yarrow (1999) came to a conclusion that reforms emphasizing ownership over market structure are misguided. Furthermore, ownership change, particularly through privatization which is often undertaken for reasons of raising revenue by heavily debt-burdened governments, is not necessarily linked to the notion of promoting efficiency or competition. Thus market competition (especially product market competition) is necessary for privatization to be fully realized. Cook and Kirkpatrick (1995) demonstrate that privatization of enterprises in non-competitive market environments, often in the circumstances of developing countries, will do little to improve economic performance. Parker and Martin (1997) produce further empirical evidence of a total of 159 comparisons before and after privatization with results that in 82 instances performance improved and in 77 instances performance deteriorated. In other words, it shows that privatization did not have much impact on performance.

Pendleton's (1999: 788) British bus industry case study also shows that 'competition may be necessary to achieve the objectives of privatization'. Carlin et al (2001) similarly document evidence from a survey of 3,300 firms in 25 transition countries and conclude that competition appears much more important than the effect of ownership *per se* in influencing performance. Cook (2001) further stresses that 'given the lack of information and institutional weaknesses found in low-income countries, private monopolies are more likely to exploit their

position by influencing the regulatory environment or by evading regulation.’ This is likely to undermine the potential gains to be made from privatization and deregulation.

Besides, competition is claimed to be beneficial in addressing regulatory failure, although as Cook (2001) indicates, competition policies require a strong government to implement them. Demsetz (1968) develops a solution to regulatory failure, that is to foster competition through bidding for the right to operate as a monopoly. This solution received support from Kay and Thompson (1986) and Bishop, Kay and Mayer (1994) who saw it as a way to introduce a form of competition into non-competitive markets. However, Williamson (1975) and Goldberg (1976) indicate several problems with this approach. In the cases of natural monopoly where competition is neither possible nor desirable, regulation has an important role to play since there are difficulties in privatizing natural monopolies.

The competition-solution literature casts criticisms over the ownership-solution advocates in relation to their flaws in weak theory and empirical analysis (Vickers and Yarrow, 1988; Cook, 1997). Vickers and Yarrow (1988: 39) warn that ‘many studies focus almost exclusively upon ownership variable and fail to take proper account of the effects on performance of differences in market structure, regulation, and other relevant economic factors’ and the interacting effects of ownership, competition and regulation on incentive structure and performance of firms. In finding theoretical and empirical evidence, the methodology of some studies leads to a bias in favour of private ownership. Cook (1997) questions the World Bank’s advocacy of privatization. Cook notes that the property rights and principal-agent arguments used by the World Bank as the basis for ownership change policies have a number of weaknesses, even when applied to the private sector. First, the assumptions of the two theories on the existence and operation of an efficient capital market do not apply to developing countries, particularly lower-income economies. Williamson (1975: 238) notes

that the profit-maximization hypothesis in the theory of the firm (which is reflected in the theoretical basis of the ownership-solution literature) has been subjected to repeated criticism. Williamson indicated that more fundamental criticisms hit ‘treating profit maximization as being the entire objective of the firm without regard for the conditions of competition in which the firm operates’. Yarrow (1999) supported this view that the application of principal-agent theory to explain the problems of modern firms or guide privatization is not fully satisfactory. It is claimed that a broader framework than profit maximization is necessary to understand the performance of firms sheltered from the rigours of competition. Cook and Minogue (1990) indicate that the ownership-solution advocates have not paid enough attention to the fact that political economy dimensions also apply to the private sector. The competition-solution advocates also show dissatisfaction with the empirical analysis of the ownership-solution advocates. Cook (1997) implies that it is inappropriate for ownership-solution advocates to transfer their findings in developed countries to developing and transition countries, and to derive general conclusions (e.g. ‘one size policy (privatization) fits all’) from a small number of empirical results. Some empirical evidence also does not favour ownership change for improved performance, for example, Nolan’s (1995) study on Russia and Bevan’s et al (2001) study on 437 Russian enterprises arrived at the conclusion that ‘private ownership and better performance are not correlated, though restructuring is positively associated with the competitiveness of the market environment’.

After the discussion of the respective main advocates of ownership-solution and competition-solution groups of literature, it is worth noting at this stage that there is some common ground between the two groups. Both groups admit that ownership and competition matters (disputes are about which matters most) for the improvement of enterprise performance. Vickers and Yarrow (1988: 426) note the view that ‘private ownership is most efficient – and hence privatization is most suitable - in markets where effective (actual and potential) competition prevails’.

While the debates between these two groups extended to the late 1990s, the practical experiences of transition showed mixed results, with both groups facing the pressure to consider a broader concept of transition. Evidence in their subtle adjustment of advocates can be found in Shirley (1997: 854) ‘divestiture is less effective without competition, incentives fail if budgets are soft’. Shirley and Walsh (2000) document that a number of empirical studies favour private ownership in a competitive market. This claim implies, at the same time, that a competitive market is a condition for successful privatization. In their conclusion, Shirley and Walsh (2000) note that ‘further research is needed to model the institutional circumstances under which privatization will dominate state ownership and vice versa’. This is echoed in Sachs et al (2000b) which clearly conclude that ‘while ownership matters, institutions matter just as much’. Sachs et al point out that the idea ‘one size policy (ownership change) fits all’ is problematic in transition economies. Privatization alone is not enough. Privatization must be tailored by complementary reform in relation to institutions to support ownership functioning. Success factors include market competitiveness (removal of entry barriers), institutions to address agency issues, hard budget constraints and depolitization of firm objectives. They draw a conclusion for a new privatization paradigm - ‘While ownership matters, institutions matter just as much’. Cook and Kirkpatrick (1997) document that privatization is a part of a broad programme of public enterprise reform. Cook (2001: 31) implies that privatization is one of the instruments influencing competition policy and warns that ‘weak regulation of competition is likely to undermine the potential gains to be made from privatization and deregulation’.

C. Management-solution literature

It is increasingly highlighted that there are limitations of economic discipline in incorporating the theoretical framework for ownership-solution and

competition-solution (Stiglitz, 1988; Barr, 1992). In addition, the successes and failures of a number of developing and transition economies become clear in sharp contrast. For example, as documented in Nolan (1995) by comparing Russia and China, Russia and other former Soviet Union states are viewed to have experienced privatization failure (Sachs et al, 2000a, 2000b); whereas China's reform without radical privatization is viewed as a genuine success (Qian, 1999). In this context, a sizable body of literature incorporating the framework of institutions and management is emerging. This body of literature assumes that there is more to organizational incentives than just privatization, and that the assumption of profit-maximizing and profit as the single argument between the owners and managers is naive and simplistic (Wildsmith, 1973). It is argued that state enterprises which offer proper incentives to individual managers can be efficient, and that rapid ownership change is not considered to be the best measure for the improvement of performance and efficiency. Rather, the reform of management, including the government's role in 'rule of law', regulation (World Bank, 1997b), and market-supporting institutions are a means to improve performance and economic efficiency. The reform of management embraces a broad concept at the macro and micro levels. It includes state macro management in relation to institutions and government functional structure and operational management at the micro enterprise level. Since this body of literature places its focus on management reform at the state and enterprise levels, it is therefore labelled here 'management-solution group'.

(A) Theoretical Grounds

Management-solution literature rests on a broad concept of public enterprise reform by bringing into focus of institutions and management dimensions (Shirk, 1993; Stiglitz, 1993, 1999; Davey, 1995; Naughton, 1995; Nolan, 1995; Smyth, 1998; Farazmand, 1999; Kolodko, 1999; Nolan and Wang, 1999; Xu, 2000). They advocate management reform without the need for mass privatization, while

calling for a shift away from focussing on ownership, and paying more attention to institution and management for the improvement of efficiency and performance. Stressing the importance of management can be seen in some ways as grounded on institutional economics, managerial, behavioural and growth theories as described in Cyert and March (1963); Marris (1964); Williamson (1975, 1990); Crew (1975); Cyert (1988); and Samuels (1995). The theories on institutions agree that markets are organized by, and have effects on, the institutions which form them, and institutions matter in economic transformation. Those theories on enterprise management place managers and managerial motivation in a central position, with profit-maximizing not seen as the unique goal of the firm. Williamson (1975) points out that since the managers of the firm are empowered and have substantial discretion, they often pursue goals other than profits. As such, the management may choose a position between minimum and maximum profit bounds. Similarly, Cyert and March (1963) note that profit-maximizing held by the neoclassical theories has been replaced by profit-satisfying by the behavioural theory. It is assumed that modern firms are highly complex systems with considerable problems of control and organization and have to be managed rather than uniquely subjected to the market. Furthermore, based on the assumption of managerial discretion, Marris's growth theory stresses growth-maximization instead of neoclassical profit-maximization. Diversification (e.g. through acquisition) will be induced because it will often be difficult for the firm to grow at a faster rate than the rate of growth of the industry. The firm will become interested in diversification when the growth rate in the original market becomes insufficient to sustain the firm's growth potential. In this way, the internal growth of the firm supplements the competitive control mechanism. Especially in industries where barriers to entry are high, entry from the diversified firm may be the only possible entry (Cyert, 1988). Wildsmith (1973) comments that managerial theories are more realistic and general and that as a consequence they predict responses which in most cases are different from those of profit

maximisers and closer to those found in reality, as in modern corporations, especially large ones, there could no longer be traditional owner-managers, other forms of control having already emerged, and government involvement should be considered. An example is given in Crew (1975) about the implications of management-focussed theories for public policy, namely that the concern for preserving the natural environment and the failure of market mechanisms to conserve natural resources and to control pollution lead to government involvement. Thus it brings in another theoretical perspective - new institutional theory - described as follows.

New Institutional Theory

There is an emerging literature on post-socialist transformation and transition economies drawing on new institutional economics for their analysis from the 1990s onwards, albeit it is still in its infancy (Smyth, 1998; Kolodko, 1999). Importance is increasingly attached to institutions in transforming economies in the recognition of 'not only ownership matters, institutions evenly matter'. The literature agrees that markets are organized by, and in turn have effects on, the institutions which form them (Williansom, 1990; Samuels, 1995; Levy and Spiller, 1996). Smyth (1998) offers a review of a few key institutional perspectives and evaluates their relevance to the debate on post-socialist transformation. Smyth states that the essence of the new institutional economics is that 'institutions matter'. Kolodko (1999) claims that 'new institutional arrangements are of key importance for successful transformation. A market economy requires not only liberal regulation and private ownership, but also adequate institutions'. According to Kolodko, market economies do not expand without well-designed institutions. In other words, without taking adequate care of institutional arrangements, liberalization and privatization alone are unable to establish a sound market economy.

Nevertheless, unlike the ownership- and competition-solution groups, due to

limited studies and the lack of sufficient empirical tests to date, the management-solution literature on transforming economies is still in its infancy and seeking a stronger theoretical framework and empirical evidence. Smyth (1998) notes that the application of new institutional economics is very limited as the insights it offers are still too general for policy guidance. Farazmand (1999: 565) suggests that a new theory of public enterprise needs to be proposed to create an economically efficient and fair and socially and politically just government. 'This theory of public enterprise management must serve as a bridge between the excesses of market / corporate inequality and injustice on the one hand and the authoritative / coercive functions of the modern state on the other'. Furthermore, Farazmand (1999:566) notes that 'such a theory of public enterprise management must be based on professional competence, effective accountability and responsiveness measures, competitive productivity scales, and measurable organizational performance'. In comparison with the transition of China and Russia, Nolan (1995:56) supports that 'there existed no theory of the transition from the command system', and that in analyzing large issues of system change, 'proper policy requires political economy, not merely the separate sciences of 'economics', politics or sociology'. The theory used to guide the improvement of a market economy will not be the same one used to guide the transformation of a command (planned) economy. Nolan (1995: 84-107) casts comprehensive criticisms over the transition orthodoxy which strongly advocates rapid privatization by over-stressing the role of the market - the 'invisible hand'. Nolan argues that the theoretical and empirical basis of the transition orthodoxy's policy of economic reform is out of date. He cautions against exaggerated claims of market-driven mass privatization and relevant high-speed transition, insisting that 'the conclusions of the accumulated developments in Western economic theory are far from being so strongly supportive of the power of the 'invisible hand' as the transition orthodoxy imagined' (Nolan, 1995:84). Nolan (1995) cautions that it is practically impossible to exercise rapid privatization of state assets, as

successful privatization is hugely time-consuming and requires an established market economy; He further notes that in transition, state-owned enterprises can improve their performance without outright privatization (Nolan, 1995).

Furthermore, Nolan (1995:316) states that ‘the essence of capitalism is much more the existence of contracts that encourage effective use of resources by the manager of those resources, than it is the direct interest of the manager of resources being stimulated by the fact that they own those resources. The vast bulk of managers within large companies are stimulated to effective performance by appropriate contracts and by non-pecuniary motivation, rather than by ownership’.

Distinguishing ownership from control rights, it also can be suggested that the control rights of management matter and that performance improves with output-based (pay sensitivity) and input-based (monitoring) and both output and input-based incentives (managerial wage discretion).

With respect to the limitations of competition, Stiglitz (1993) states that because of politicians’ desire to use SOEs for political purposes, they cannot credibly commit to encouraging competition. And it is acknowledged that market competition is often imperfect and incomplete, even in the most economically advanced countries (Stiglitz, 1988; Barr, 1992). Stiglitz (1999) favours China’s gains of improved economic efficiency through reform while the majority of state ownership remains, albeit Stiglitz (1999) unfolds his mixed views on the controversies between privatization and government corporatization (public enterprise reform). On the one hand, he admits that in many areas, there is little reason for there to be a significant governmental role, except as a part of a transition process; and that corporations under state ownership but paying attention to individual incentives can be efficient. What matters more is a pragmatic position, not an ideological position on public enterprise transition. ‘If the corporatization route is chosen as part of the transitional strategy, it is essential that hard budget constraints (essentially privatization) be imposed, and that due

attention be paid to individual incentives' (Stiglitz, 1999). The behavioural theory of the firm proposes that managers operate the firm in the only fashion consistent with the assumption of self-interest rather than only attending to the shareholders' best interest by maximizing profit (Williamson, 1990). Noting that privatization is to be used in a selective and pragmatic manner, and that privatization alone is unlikely to be sufficient in significantly improve public enterprise performance, Cook and Kirkpatrick (1997: 27) have also shown 'other forms of public enterprise reform, where ownership remains with the state but the contractual relationship between the enterprise and government is redefined, are needed'.

Davey (1995), Korten (1995), Thayer (1995) and Farazmand (1999) call for the reform of public enterprise management rather than privatization, and have shown their sharpest criticisms to the ownership-solution advocates, especially sweeping privatization. Thayer warns that privatization promotes more corruption and contributes to rises in unemployment. Davey (1995) notes that one of the consequences of privatization is to turn a 'welfare state' into a 'police state', as privatization brings in social problems and requires a 'police state' to maintain social order. These writers against privatization point out that 'western values of efficiency and the British and American approach to large-scale privatization are generally not applicable to countries where the private sector is underdeveloped and corrupt, and itself in need of government support' (Farazmand, 1999: 555).

Farazmand (1999) cautions that the warnings about the long term negative consequences of sweeping privatization as a proclaimed marketplace panacea for the illnesses of public enterprises have been ignored by policy-makers and academic proponents of privatization around the world. Proponents of privatization are, in general, ideologically oriented toward a conservative political economy favouring a strong marketplace and 'free' enterprise, small government with a limited role in the economy, and a supply-side economic system.

Davey (1995), Korten (1995), Thayer (1995), Farazmand (1999), and Cheng (2006) warn that the long-term negative consequences of sweeping privatization,

which they see not as a simple economic policy but rather as a global ideological strategy of capitalism designed to reverse the older strategy of state intervention in the economy for reasons of social and economic justice. Their criticisms of privatization point to a variety of concerns such as market failure, exploitative nature of the private sector, massive corruption (especially among contractors doing business with government), social problems and degraded citizenship values, and deterioration of public infrastructures and environmental destruction. As Farazmand (1996, 1999) forcibly states, privatization only benefits the globally dominant states (UK, USA), international donors (IMF, WTO, World Bank) and transnational and global corporations which use it as a global strategic instrument of capital expansion, surplus value promotion and global corporate capitalism. As such, privatization will domestically put the poor at greater risk of violence and globally result in turning the underdeveloped countries into subsidiaries of transnational corporations and global donors. According to Farazmand, an alternative to sweeping privatization is serious reform of public enterprise management. 'What is needed is to ensure that public enterprise managers are adequately equipped with new skills of accountability, transparency, flexibility, responsiveness and responsibility, efficiency and effectiveness. It is also necessary to promote a culture of respectful and dutiful treatment of citizens, consideration of citizens as human beings and partners in public management (not as clients or consumers), and to resist commodification of people and their values' (Farazmand, 1999: 563). Farazmand (1999: 566) states that 'public enterprise management must also be based on professional competence, effective accountability, responsiveness measures, competitive, productivity scales, and measurable organizational performance'. In terms of flattening the organizational structure of public enterprise to promote information transparency and accuracy and to balance incentives and control, reforms need to be taken to reorganize the managerial structure of public enterprises.

(B) Empirical evidence from previous studies

There is very limited empirical evidence to support the management-solution advocates, as only limited studies have been conducted so far. The arguments supporting management-solution are mainly grounded on the experience of a small number of countries (China and Vietnam are examples in (OECF 1998)) which have improved their economic performance mainly through reform rather than through mass privatization.

Orru et al (1997) offer some evidence on the emergence of new economic institutions in East Asia. Shirk's (1993) study produces an empirical study showing some evidence on management and institution changes by examining the Chinese state-owned industrial enterprises reform. Shirk (1993) focused on the reforms in industrial management and finance. She stated that 'Chinese political institutions shaped industrial reform policies by establishing the incentives of political actors and the rules by which they made decisions', and that 'the overall path of Chinese economic reform over the past decade can be best understood by focusing on the political institutions in which reform policies were made' (Shirk, 1993:20-21). Shirk argues that Chinese economic reform policies were shaped by the institutional setting in which the policies were made and two features of the political institutions are suggested necessary for economic reform, namely flexibility and authority. The former refers to the presence of choice-making institutions with internal rules and an enfranchisement formula that encourages (or can be modified to encourage) innovation. The latter refers to China's approach to the retention of authority by retaining the Party's power to appoint government officials and SOE managers (Shirk, 1993: 336-338). Levy and Spiller (1996) develop an institutional model of privatization in telecommunications (using evidence from Argentina, Chile, Mexico, Philippines and the United Kingdom). Their model highlights the importance of an independent judiciary, a capable bureaucracy in making credible and efficient regulation for privatized firms, and

checks and balances in the government. Based on the evidence from a number of transition countries, Sachs et al (2000b) conclude that privatization alone is not enough as institutions matter just as much as ownership. Sachs et al also articulate that 'policy prescriptions, therefore, should be less ideological and more tailored to the country's institutional conditions and stage of transition'. The transfer of ownership without the institutional structures in place for owners to exercise their authority may even worsen the overall economic performance, as this means a simple replacement of poor government control of management with weak private sector control or none at all.

Overall, the management-solution group suggests instruments for management improvement, including the perfection of institutions at the macro-level, reorganization of the managerial structure of public enterprises, performance contracting, the use of takeover and bankruptcy. It is assumed that these instruments exert pressure on enterprise managers to pursue efficient performance. Nevertheless, partly due to limited existing studies, the theory and empirical evidence for this group seems to be weak in comparison with that of the ownership- and competition-solution groups mentioned earlier.

III. The interaction between the PE transformation and labour

As the transition of public enterprise in the world enters its third decade, a growing body of literature has begun to examine the impacts of such a transition (Parker and Martin, 1995; Parker and Pan, 1996; Cook and Kirkpatrick, 1998; Kikeri, 1998). Despite its importance, labour is one of the least addressed issues in public enterprise transition/privatization. Subsequently, the lack of information on the employment impact of privatization has increased the fears and concerns of government and workers alike (Kikeri, 1998). There is very little literature looking at the impacts on labour and relevant employment and social welfare resulting from public enterprise transition (Kikeri, 1998, 1999; Pendleton, 1999). Commander (1998) describes enterprise restructuring and its interaction with the

labour market in Central European firms. Van der Hoeven and Sziraczki (1998) examine lessons from privatization on labour issues by drawing on the experience of the Republic of Korea, India, Mexico, Bulgaria, the Czech Republic, Eastern Germany and Hungary. According to the existing literature, there is certainly widespread evidence showing that attempts to improve efficiency and profitability during public enterprise transition led to the continuing reform of working practices, such as improving labour flexibility and the adoption of innovative pay systems. However, as regards employment trends, the literature generates an open argument on employment increase and reduction (Pendleton, 1997). Parker and Hartley (1991) show that most firms reduced employment, but Bishop, Kay and Mayer (1994) indicate employment increased after privatization. Johnson (2001) claims that privatization does not necessarily require massive public sector layoffs. Joshi (2000) looks at the social consequences of restructuring taking place in South Asia (i.e. Bangladesh, India, Nepal, Pakistan and Sri Lanka) and calls for adequate measures for workers' protection and participation in order to raise public awareness and reduce workers' resistance to privatization.

It is stressed that there is a need to raise public awareness on issues relevant to the impacts of privatization on the workforce. Furthermore, an effective mechanism of doing so is to mandate employee-ownership of a certain percentage share in the privatized enterprise, alongside establishing compensation funds and retraining opportunities. This is backed up by Johnson's (2001) evidence from the US that privatization does not necessarily require massive public-sector layoffs and indicates that public employees benefit in the long term from private sector management. Kikeri (1998, 1999) examines the effects of privatization on labour and the mechanisms for governments to use to minimize the political and social costs of labour restructuring in privatization. Kikeri points out that workers often recognize that reforms of inefficient public enterprises are inevitable, but lack of information on what happens to them and lack of involvement exacerbates fears and resistance. According to Kikeri, efforts should be made to raise public

awareness of the costs, benefits, timing and methods of privatization, to build a social safety net, and to develop regulatory arrangements for consumer welfare. Share ownership schemes are also advisable. Chu and Gupta (1998) look at the issues and experience of social safety nets and Gupta et al (1999) examine social impacts in relation to social safety nets of privatization. Li (1996) notes that unemployment is the most difficult 'hard core' to dissolve when a planned economy is transformed into a market one such as Central and Eastern European countries. Li further indicates that the weight of unemployment seriously affects political stability and therefore affects the selection of reform approaches and methods.

Cook and Kirkpatrick (1998) note that the transition of public enterprises (privatization) generates consequences in relation to employment and the labour market. These consequences involve social protection benefits (particularly pensions), job security, wages and work conditions. Cook and Kirkpatrick also draw on examples of 10 developing countries in Sub-Saharan Africa, Asia and Latin America, and indicate that few generalizations can be made as to the impacts of privatization on employment and social protection. Yet 'it is often assumed that employment will fall when privatization occurs, since the new owners will be unwilling to maintain the overmanning and surplus labour associated with the public ownership of the enterprise. The loss of employment will obviously have an immediate adverse impact of labour's social protection status' (Cook and Kirkpatrick, 1998: 262-263).

IV. Reflections and Conclusion

In the last two decades and before, public enterprises (PEs) confronted widespread development problems such as inefficiency, multiple and often conflicting objectives, over-extended government intervention and resulting poor economic efficiency of the PEs. The situation has drawn enormous attention from

academic studies and policy-making. For the improvement of efficiency, the main themes of the literature, theoretically and empirically, centre around the advocates of ownership change (privatization), the creation of competition and management reform from the economic, institutional and managerial perspectives. A variety of policy solutions have been suggested, among which privatization has been a paradigm widely implemented in different economies. It has been an international phenomenon in the last two decades or so, which mainly involves a change of ownership from public to private. Shirley, Walsh and World Bank (2000) argue that ownership matters more than competition and management reform, and further claim that how ownership is changed from public to private also matters. It is noted that the ownership-solution (mainly privatization) has a range of constraints and prerequisites of success such as a competitive market and capitalist institutions. Sachs et al (2000b) warn that ownership matters but that privatization alone is not enough, since institutions matter just as much and privatization alone is not applicable to developing and transition economies. Competition solution advocates believe that the introduction of competition matters more than ownership per se in the improvement of public enterprise performance. Cook and Kirkpatrick (2000) claim that competition is via the removal of entry and exit limits, deregulation and new regulation. Debates remain on-going between competition, ownership change and management reform. The arguments between the advocates of ownership change and competition remains strong and inconclusive. Those advocates of the use of management improvement as a mechanism for transition have drawn relatively less attention. Overall, each group gives priority to ownership, competition or management respectively, while relatively neglecting the other two aspects which are focussed upon by the corresponding group. That is, the ownership-solution group focuses on ownership change, whereas the importance of competition and management does not receive the sufficient attention as it deserves. The same goes for the competition- and management-solution groups; while one aspect - competition or management - is

focussed upon, the other aspects are relatively and undeservedly neglected.

To date, the literature acknowledges that ownership matters (World Bank, 1995) and that how to change ownership equally matters. Yet a considerable literature has also warned that ownership is not the only important factor in influencing economic performance and efficiency (Sachs et al, 2000a, 2000b). Competition and market environment, and institutional and administrative systems are also important. Whether it is competition or ownership change that matters most for the improvement of enterprise economic efficiency remains an open debate (Shirley and Walsh, 2000; Carlin et al, 2001; Cook, 2001). The argument from the management - solution group urges that performance improvement can be achieved under dominant public ownership, and that ownership change through mass privatization does not apply to all countries, and is especially not applicable to transition economies where privatization prerequisites do not hold. The management -solution group view that public enterprise reform should avoid sweeping privatization, as evidence shows that in a very competitive market private companies fail due to poor management. Therefore the building of institution is a key part for a successful transformation, apart from the development of sound internal firm management. It is argued that long-term consequence of privatization leads to market-chaos and requires a 'police state' to control social problems.

The overall literature implies that a broader concept of public enterprise reform should be considered, including the use of mechanisms of ownership change and competition, and management improvement whenever and where necessary during the reform process. In all, the reviews of literature call for comprehensive analytical studies from an integrated perspective of economy, institutions and management. This study also shows that Chinese PE transformation has employed a range of mechanisms and measures which include the introduction of competition, ownership change and management reform, and that these mechanisms are implemented in a gradual and evolutionary

manner (Zhou, 2003). The current transition stage has come to the point where much more difficult and politically sensitive issues are to be tackled as the transformation goes deeper. Such issues include the improvement of competitive markets, restructuring of PEs' ownership, management (government functional transformation, institutions and enterprise internal organisation) and surplus labour ('COML' in short).

In general, Privatization as a type of ownership change is more often seen in the transition of small- and medium-sized PEs. In the 1990s large public enterprises have begun to be transformed under the framework of the modern enterprise system (MES) which highlights the clarification of property rights, the separation of government and enterprise and effective management. Under the MES, ownership restructuring is prioritized among the transforming measures and policies. With regard to management, although internal management has been emphasized through the transformation process and particularly highlighted since the 1990s, institutional issues have only drawn attention to a significant extent in recent years. Since in-depth reform of management will inevitably have to touch some forbidden areas of Chinese government and the CPC (the Communist Party of China), many thorny problems remain to be addressed.

A. Ownership matters in some way

In the Chinese case, state ownership was changed only when the goal of establishing a socialist market economy was legalized in the early 1990s. In the face of competition from the fast growing non-state sector, the SOEs as a whole started to make net losses around the mid-1990s. It was more clearly realized that the SOEs seemed to be uncompetitive and would not be favoured any longer in a new economic structure where the private economy grows dynamically. Thus the MES was taken as a major counter measure, as a framework for state-owned enterprise transformation. According to the MES, property rights are prioritized in

transforming the SOEs, especially the large ones. The clarification of property rights has since remained at the top of the agenda of further enterprise transformation. The predominant reason for ownership change was the increasing losses made by the SOEs and associated government fiscal pressure and government intervention, as substantial government subsidies flooded into the SOEs for their losses (see the Chinese case of government subsidies). This provides further support to Yarrow's (1999) argument on ownership change.

B. The process of ownership change matters

By and large, two types of new ownership structure are most widely employed in China, as reflected by the case companies. The first type, is that where the state (central or local government) holds controlling shares, often in the case of large- and medium-sized enterprises. The second type, is where the employees and management own the restructured enterprise through employee ownership, most often in the case of small- and medium-sized enterprises. However, these kinds of ownership structure are not problem-free. In the case of the state as the controlling shareholder, namely the state holds over 51 per cent or a major portion of the enterprise shares, the state as an owner often assigns a special inspector to the company to take charge of financial and accounting monitoring, evaluation of operation and performance appraisal of main managers. It may also control decision-making in the personnel, production and investment. In such a post-restructured situation, firstly, the state constitutes the single large shareholder and its shares are not tradable; secondly, shares held by the state, institutional legal persons and individuals are treated differently. In essence, such ownership change does not constitute much difference from the previous state ownership, and therefore the post-restructured SOE still cannot overcome problems as could the pre-transformed SOE. This is especially the case with management incentives and control, state asset stripping, continual government intervention in enterprise operating activities, lack of competition between

enterprises and the drive for the competitiveness of the enterprise itself (as described by Shirley, 1999; Shirley and Walsh, 2000).

C. The introduction of competition is important

Despite the improvement of the competitive environment, the case companies also show that market competition in China is still very limited, especially with less intensive involvement in international competition, financial or human capital markets. As the literature reviews show, all the case companies face some competitors, but few face international competition. Apart from the small size of the sample, the negligible involvement of SOEs in international competition implies at least two points: (A) the Chinese market is not that open to international competitors, (B) the SOEs are locally protected and less internationally competitive.

As regards competition for human capital, the Chinese government authorities still play a decisive role in the appointment of company managers. There lacks a managerial market, let alone competition among SOEs for quality managers. This represents a strong obstacle to the creation of competitive markets in human capital.

Limitations to fair competition also heavily exist in the main industries of public services / goods such as the railway, telecommunications and other monopoly industries. Besides, disorderly competition exists in current Chinese markets. In the competition in telecommunications industry, new entrants are often disadvantaged. The infrastructural facilities of telecommunications are repeatedly constructed; if consumers change from one supplier to the other, they have to change to infrastructure facilities such as communication wires and cables which are provided by the new supplier.

D. Government intervention still exists

Nonetheless, government intervention still exists in some way, but the strength of the intervention varies in different industries. The companies in the industries of public interest and national monopolies such as the railway and defence industries complain more about government intervention than do the more profit-driven manufacturing industries. In the Chinese case, the current government intervention is mainly concentrated in large investment, state asset reorganisation, regulations on taxation, finance, the appointment of management personnel, wages and labour welfare and so on.

With respect to institutional regulations, China has cleared and stipulated more than 10,000 laws and rules in the pursuit of rule-by-law and a socialist market-economy. In addition, the Corporation Law is currently employed as the main framework for enterprise transformation; but market-supporting institutions remain insufficient and in high demand. In this sense, the government is expected to play an important role in regulating the market, at least as a part of the transition process, even though it is associated with some transition costs (Stiglitz, 1999). Government subsidy is an example in point. To some loss-making and troubled SOEs, Chinese government (central or local) subsidies continued to flow in for some time. Although it is strongly advised that government subsidies should not be encouraged for poorly-performing enterprises, in the Chinese case they have often been used to relieve pressures of unemployment and social instability.

E. The interaction between labour and transformation

The analysis sheds light on issues around wages, labour productivity, employment and social welfare by referring to empirical findings and theoretical evidence. This problem is especially highlighted because it is one of the most important aspects of the overall economic transformation and the SOE transformation in particular. This is so not only in the Chinese case, but also in the

context where the similar economic and welfare systems are practiced.

Obviously the *status quo* of the SOE's role in social welfare needs to be improved and the current social burdens need to be lightened in order to sharpen the enterprise's competitive edge. Otherwise, the state enterprise transformation is difficult to break out of the vicious cycle: inefficient and over-staffed SOEs need restructuring / transformation; the transformation inevitably causes layoffs; better welfare benefits than the non-state sector and lack of social security make it harder to lay off surplus workers. Fear of social instability due to workers' resistance delays the transformation of the SOEs.

Nevertheless, it is not advisable for the enterprise to completely withdraw welfare benefits for the employees, as the provision of some employment-related welfare would enhance competitiveness in attracting quality employees for a company. This may be a reason for the new trend whereby an increasing number of SOEs are running trials to change the previous enterprise-based welfare system to a new system where the enterprise, the government/society and individual employees share contributions. It is perceived that in doing so, a sound social security net can be built and social unrest and resistance from the transition can be reduced. In return, a smoother enterprise transformation, or even economic transition can be achieved.

In addition, the transformation process of public enterprises generates extensive and far-reaching effects on labour, the employment relationship and the social security in particular. This issue is less well addressed by the existing literature. In order to minimize the adverse affects of the transition of public enterprises, some literature has claimed that it is crucial to raise public awareness of the costs, benefits, timing and methods of such transition through wide worker participation. Furthermore, the paper also suggests that decent social security has an important role to play in the process of the transition of public enterprises.

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公營事業轉型之所有權、競爭、管理 與勞工的探討：文獻分析

周美香*、鄭國泰**

摘要

中國大陸的市場改革已由過去的計劃經濟，逐步地邁向市場經濟，也相對地帶動了公營事業之改革。本文旨在運用深度訪談和相關的文獻探求，藉著分析十八間中國大陸的公營事業個案，來探索轉型國家中所有權、競爭、管理和勞工的相關議題及其可能的問題。首先，是針對公營事業設立之目的和原由，以做為公營事業在轉型中國家的角色及其架構；再者，則是著重在本文所欲深入探求的主題，以做為改善事業績效的機制：所有權、競爭和管制；最後，則是針對轉型中國家的公營事業在朝向市場化時所無法避免的議題：勞工的問題，並提出一些省思。

根據本文文獻分析的結果，本文認為競爭、所有權和勞工所形成的架構，正引領著中國大陸公營事業的革新，如同過去大環境的市場改革，從過去的計劃經濟，逐步地邁向市場經濟。從本文的分析發現，公營事業之成功改革，主要係在所有權之更變受到了限制，再加上一些配套措施和制度，使得新的市場環境能漸進地浮現和波動。再者，根據本文分析，吾人發現勞工議題和利益，在公營事業改革中，由於缺乏健全的社會安全機制，所以有必要針對勞工的議題，再進行更為深入地探究和思量。

關鍵詞：所有權、競爭、管理、勞工、轉型

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