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THE TRANSFORMATION OF PROPERTY REGIMES: TRENDS IN THE WORLD

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For more than two decades the mantra of privatisation has held sway in policy making circles in advanced market economies. In the post war period, the mixed economies which had been developed on the basis of the post-war Keynesian consensus became the target of a sustained attempt at systemic reform, designed to ensure the reduction in the size of the state in the economy, the removal of regulatory ‘burdens’ on the free functioning of private enterprise, and the sale of state assets to the private sector. Privatised firms were regarded as having greater flexibility than state enterprises, and as being more innovative with greater potential for growth. Privatised firms were thought to be more efficient than state-owned firms since their managers had greater incentives for efficiency due to comparatively high executive salaries and pensions, and performance-related pay and bonuses.

In the early stages of the privatisation reforms, a number of critical factors that also contribute to the performance of business enterprises, in addition to ownership transformation, were generally ignored. Amongst these, competition is a crucial factor. Most obviously in the absence of competition, a private monopoly has an opportunity to raise prices above the marginal cost of production and make a super-normal profit and absorb substantial inefficiencies. Evidence that state enterprises may operate relatively efficiently in a competitive market environment was ignored. The dysfunctions of the separation of ownership and control were also overlooked. Managers who control but do not own a company may run it in their own interest,

rather than in the interest of the shareholders. They may make too large investments in order to build their own empires, reducing shareholder profits in the process. They may also consume profits through lavish expenses and excessive expenditures on plush corporate premises, and perks and benefits unavailable to the ordinary workers. As shareholding became more and more fragmented it became more difficult to control the irresponsible behaviour of some senior executives. In some countries this effect was mitigated by a close identification of managers and shareholders within large family firms, as in Germany and some of the Nordic countries. But in the UK and the USA the private firms were plagued by a mismatch between ownership and control of the firm. This led to extravagant behaviour at the height of the recent economic boom, and the spectacular collapse of a number of well-known institutions, including some important commercial and investment banks.

Privatisation and globalisation

Privatisation began in UK under the Thatcher government in the early 1980s, following the free-market ideas promoted by the think-tank called the Institute of Economic Affairs. It soon spread through out the world, and with the collapse of the Soviet Union and the communist systems in Eastern Europe it became *de rigeur* to support privatisation. Many research studies seemed to show that privatised firms were more efficient than state firms. Yet within this there were subtle distinctions, as foreign owners appeared to be more efficient than domestic ones, and small de novo firms to be even more efficient still. It began to be realised that many of the benefits of privatisation were due more to the degree of competition in the markets in which they were based, to easy access to low-cost foreign finance, and to the selection bias due to the fact that the best firms were usually privatised first, leaving the least efficient firms in state hands.

Nevertheless, by the early 1990s, privatisation had spread to all corners of the advanced economies, including parts of the welfare state such as health, housing and education. Broad swathes of the welfare state in many countries were subjected to various forms of privatisation including hospitals, schools and even prisons and the armed forces, the latter in the form of mercenary security companies seen in the western presence in Iraq and elsewhere in the ‘war on terror’. At local government

level, refuse collection and other local government services have been ‘contracted out’ to the private sector. Contracting out has also been widely used in the health sector and other areas of the welfare state. The new private companies brought in to provide the services have often done so at lower cost, but often also with lower service quality.

The euphoria over privatisation was fuelled by developments in global capital markets. Throughout the 1990s and increasingly in the 2000s capital markets became more and more fluid with the growth of unregulated hedge funds and the development of innovative financial instruments known as credit derivatives. China was becoming the industrial powerhouse of the world, accumulating great financial surpluses, while America became the great consumer of Chinese products with a corresponding trade deficit. In order to keep the consumer boom afloat following the bursting of the technology bubble and the 9-11 terrorist attacks in September 2001, the US Federal Reserve lowered interest rates. Japanese interest rates were also rock-bottom following the prolonged deflationary slump of the 1990s. Under these circumstances, a great surplus of capital emerged in the global economy, searching for new opportunities for investment. This was channelled in part through the purchase of state assets from governments willing to sell off those assets through privatisation programmes.

Regulatory changes in pension industries also had a role to play. Pension funds were required to match the term structure of their assets to that of their liabilities, which led them to seek out longer term investments for their vast accumulations of capital, fuelling the growth of investment in infrastructure and utility companies. Often this was achieved through the mechanism of off-balance sheet ‘special investment vehicles’ (SIVs) set up by investment banks, which had the added benefit of avoiding national banking regulations. The opportunities for governments to earn revenues through privatising their utilities were enormous. Thus the privatisation surged on the wave of capital as well as on the tsunami of financial sector derivates and the leveraged credit boom which these enabled. It hardly mattered whether the private firms were more efficient than the state enterprises. The great wave of credit swept all before it.

However cracks began to emerge in the edifice with the collapse of a number of large private firms with weak corporate governance structures which enabled their managers to act in their own interest to amass large fortunes, sidestepping the interests of the shareholders and other stakeholders. Large companies such as Enron were brought down by the corruption of their chief executives. Yet, even more serious misalignments of incentives were building up within the financial sector. There, the derivatives boom and the sup-prime mortgage crisis were fuelled by excessive risk-taking by managers whose incentives were aligned to the short term bonuses rather than to long term interests of shareholders and other stakeholders. Many banks borrowed cheap short-term money from the global money markets, and lent long term at higher interest rates in the sub-prime mortgage market. A further part of this risky lending was directed towards financial support for privatisation deals, acquisitions and mergers, which rose to an enormous scale on the basis of easy credit and the accumulations of capital which were assembled by the unregulated hedge funds.

However, in 2006 the US Federal Reserve began to raise interest rates, increasing the cost of refinancing home loans. Holders of sub-prime mortgages began to default on their loans. The value of mortgage backed securities and other complex financial derivatives began to decrease, and banks began to lose trust in one another since they could not gauge each others' exposure to these opaque 'toxic' debt instruments. This led directly to the dramatic near-collapse of the entire global financial system in 2007 and 2008. At this point governments stepped in the bail out the failing banks. The model of private sector capitalism received a heavy blow, and faith in the ability of private enterprises to operate more efficiently than state enterprises was shattered. Along with this has come a re-evaluation of the ability of the private market economy to deliver sustainable growth, and a realisation that, as in the past, business cycles are an endemic feature of the capitalist system.

Current privatisation trends

By the end of the 2000s, the onward march of the privatisation phenomenon began to slow down. The disadvantages of private ownership in the provision of public services, especially where quality is critical and difficult to monitor, has become

apparent. In the UK, railway privatisation has been rolled back following catastrophic failures of safety management in the track maintenance operation, while the privatisation of the track maintenance in the London Tube has failed due to delays to essential maintenance programmes. The privatisation of the UK Post Office is in doubt over concerns that private postal services would fail to deliver to high cost customers in peripheral locations. Continuing concerns about the partial privatisation of the National Health Service have led even the Tory party to declare their commitment to a nationalised service free at the point of delivery. In the US the Obama regime seeks to reform the health system with a stronger state involvement.

Partly as a response to similar concerns, but mainly due to the impact of the global economic crisis, the privatisation process began to slow its pace around the world. In 2008, instead of selling state assets, governments began to invest in failing private banks and manufacturing companies in order to rescue them from impending bankruptcy. Governments around the world acquired more assets from the private sector than they sold to investors through privatisation. Astonishingly, the $1.5 trillion invested by governments in banking sector assets in 2008 was equivalent to the entire amount earned by governments from privatisation sales in the whole period since modern privatisation began in 1997. At the end of the year, the collapsing stock market valuations led to the cancellation of privatisation programmes in Sweden, Turkey, and South Korea. In France, the €26 billion offer that France Telecomm made for TeliaSonera was withdrawn. In November 2008 Germany cancelled the planned sale of a €6 billion stake in Deutsche Bahn. Sales of a turnpike in the USA, and a power plant in Australia also fell through.

Despite the crisis, some privatisation deals continued to be made, but on a much reduced scale. In 2008, only $111 billion of assets were privatised, significantly less than the $138 billion of privatisation deals achieved in the previous year. Within the EU, France was in the lead with a total of almost €21 billion in privatisation, and the largest single privatisation was the merger of Gaz de France with Suez for €15 billion. In the USA, the Chicago Midway Airport was sold for €1.8 billion. Sweden privatised its stock exchange and a drinks company for almost €14 billion, before halting its privatisation programme in the second half of 2008. Thus, privatisation is not about to come to a complete standstill. However, even though privatisation has not been ended

by the crisis, it has been put into question to an extent that has not happened in the last twenty years.

Nationalising the banks

Due to the crisis, the privatisation trend has been reversed with large swathes of the banking and financial sector coming into public ownership to prevent their collapse. Bank managers had allowed their staff to carry out incredibly risky lending to 'sub-prime' borrowers, many of whom were without even a regular income. By early 2009 more than two out of every five sub-prime loans in the USA were in payment arrears or had been closed down. As the credit crunch developed, banks and hedge funds found it increasingly difficult to recapitalise their positions in exotic financial derivatives such as mortgage backed securities. Credit markets seized up as banks became increasingly reluctant to lend to one another. Governments were forced to step in to fill the gap and prevent the complete collapse of the global financial system.

One of the earliest interventions was by the German government which bailed out the Rhineland subsidiary of the IKB bank in August 2007. Three subsidiaries of BNP Paribas went bust at the same time. Several large US banks collapsed in 2008 starting with the dramatic failure of Lehman Brothers in September, followed by the rescue of Merrill Lynch by Bank of America, and the nationalisation of Freddie Mac and Fannie Mae, the two government sponsored mortgage companies. The crisis quickly spread to the insurance sector as the government rescued the largest US insurer, AIG, with a $123 billion bailout including a $40 billion ownership stake. In October, a $250 billion bailout plan for the top banks and many others brought about the partial nationalisation of the US banking sector.

Similar events took place in the UK, where the government nationalised the failing Northern Rock bank outright in February 2008. This followed the first 'bank run' in over a century, with depositors queuing in panic to withdraw their savings from the bank. In early 2009, several large banks were effectively nationalised as the government took a majority holding, including a 68% stake in the Royal Bank of Scotland, and a 65 % stake in the Lloyds Banking Group (which had been formed following the state-sponsored takeover of the failing mortgage bank HBOS by Lloyds

TSB, previously one of the safer British banks). It will certainly be an interesting test of the privatisation hypothesis to see whether efficiency deteriorates under such public ownership.

The changing balance of the state and the private sector

The state has been forced to intervene in the private sector to an extent that few could have imagined only a couple of years ago. In its scale and drama it represents a historical turning point, suggesting a systemic transformation similar to that which took place in Eastern Europe after 1989 under the name ‘transition’. The difference is that this transition from neoliberal turbo-capitalism is, if not towards socialism, into a more regulated form of capitalism in which the state is likely to have a greater say. At least that is how it began to seem in late 2008 and early 2009.

However, all is not turning out quite as expected. With the first signs of economic recovery beginning to appear, the power of the financial institutions is re-emerging, and the determination of the state regulators appears to be faltering. The top managers of the failed banks have managed to walk away with outrageous bonuses in the face of managerial inefficiency and failure on a grand scale. Instead of retiring in penury, these managers have received pensions and redundancy payments amounting to millions of euros. In one case the chief executive of the devastated Royal bank of Scotland (RBS), Sir Fred Goodwin, received a pension of £550,000 per year plus a £2.7 million lump sum, the annual payment being later reduced to a ‘mere’ £350,000 following public uproar. Without a realignment of the perverse managerial incentives which tie bonuses to short-term risk taking, the underlying causes of the crisis will not go away. Instead the governments will have bailed out the banks, and gained little in the form of long-term stabilisation.

The regulation of casino capitalism of the sort we have witnessed over the past two years will require a far greater political will than appears to be on the table at the moment. The recognition that the state has an essential stabilising role, that privatisation cannot extend to all corners of the economy, and that the mechanisms of corporate governance need to be reformed to take on board the interest of a far wider

group of stakeholders, will be major challenges for economic policy in the next decade.

This may involve novel forms of corporate governance and new ways of thinking about contracting out. A wider range of stakeholders will need to be involved in the major decisions taken by private companies, enabling greater accountability to those groups with a real interest in the long-run performance of the largest corporations, including both workers and consumers. This will involve a re-examination of the lessons of employee participation which has been tried out in many forms including US style employee share ownership plans, British mutual organisations, French associations and Italian cooperatives, not to mention the much derided example of employee self-management in the former Yugoslavia. The involvement of consumers through membership schemes, and welfare beneficiaries through similar schemes such as the Italian social cooperatives and the English “Foundation Trust” hospitals recently established throughout the National Health Service. In these largely autonomous hospitals, governing boards are elected by constituencies of staff, patients, and local residents. These will all provide interesting examples of alternative methods of corporate governance to follow in the future.

Contracting out of public services will also call for a re-examination. The role of the private sector in providing public services will still play a role, but there will be far more attention to the implications of these mechanisms for the balance between quality and efficiency. While for-profit private enterprises may be good at reducing costs, if this if done at the expense of quality then voters will be unlikely to support the extension of such schemes. Not-for-profit businesses, sometimes called ‘social enterprises’, may provide a partial answer to the extent that they have a greater intrinsic concern for the quality of the services which they provide.

Thus, the failure of the extreme version of neoliberal capitalism in the greatest speculative collapse since the great depression will undoubtedly usher in a new systemic transition towards a more moderate and participatory form of market economy. How this new transition will turn out will determine the extent and stability of the economic recovery and the shape of the global economy in the decades ahead.