Privatisation in East Asia: Comparison of Causes, Processes and Results

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Abstract

Causes of privatisation examined in this paper include the level of economic development, business cycles, fiscal constraints, national debt and external influences. Privatisation can be centralised, decentralised, rapid or gradual or it can be conducted through a privatisation programme or in an improvised, ad hoc manner. The most common privatisation methods include share issue privatisation, direct sale, leasing and privatisation from below. The outcomes of privatisation are viewed in the light of privatisation proceeds and profitability.

Keywords: privatisation, state-owned enterprise, China, Japan, South Korea
Introduction

Since the end of the 1970s, privatisation has become a significant political economic phenomenon on a global scale. Although transfer of assets between the state and private businesses has probably existed in some form or another for as long as there have been ownership rights, the current trend of privatisation is closely connected to globalisation and the rise of neoliberalism in the 1970s. The total proceeds gained from privatisation between 1977 and 1998 amounted to nearly US$ two trillion throughout the world (Palcic and Reeves 2010). Although the majority of the proceeds have accumulated in the West, privatisation has also been a prominent feature in reforming and restructuring the state-owned enterprise sector in East Asia. Three countries, China, Japan and South Korea (hereafter Korea), have each been very active privatisers and their share of the privatisation proceeds amount to approximately US$450 billion or between 20 and 25 percent of worldwide proceeds from government divestments (see section below on Proceeds and results from privatisation).

While Japan was the pioneer in reformulating the relationship between the state and the economy in East Asia, Korea soon followed the trend. China, as a former centrally planned economy, also launched its own experiments with privatisation. The monetary value of China’s privatisation has been second to Japan’s in East Asia. Regarding future development in the field, the relationship between the state and the economy in Japan has achieved maturity, whereas in China the relationship is continuing to evolve as the Chinese state still has vast holdings in state-owned enterprises. Reflecting this fact, as well as East Asia’s significant share of privatisation, future development will continue to take place in East Asia.

Privatisation and state-owned enterprises

Privatisation means any act leading to a reduction in public or state ownership (OECD 2010: 7). The antonym for privatisation is nationalisation, which denotes the takeover of non-state or non-public property by the state. Denationalisation, on the other hand, is used as a synonym for privatisation.

The roots of late 20th-century privatisation can be traced back to the economic problems and subsequent rise of neoliberalism in the 1970s and early 1980s in the Western world. According to David Harvey (2006), neoliberalism emerged in the West as an antithesis to the postwar consensus of state intervention, the welfare state and policies of full employment. The oil crises of the 1970s and persistent stagflation were viewed as failures of Keynesian economic policies. The difficult economic situation forced private firms to streamline their activities and cut costs at the same
time as governments were maintaining the Keynesian line of government spending and piling up deficits. It was against this background that public financial policies were condemned as inefficient (Harvey 2006; Shumpei 1984).

At the same time, governments increasingly found themselves confronted by pressures to cut down on spending and debt. Attempts to curb government budget deficits led to demands to downsize state-owned enterprises (SOEs), reduce their subsidies and harden their budget constraints. Some SOEs had been notorious for their bad management and inefficiency, which provided further impetus to privatisation. It was hoped privatisation would create better incentives for managers and crowd out companies’ secondary functions, which were not necessary for their vitality. There was also a desire to extend competition to sectors where SOEs had earlier been dominant. In addition, privatisation was also thought to help governments to raise revenue without indebting themselves or raising more taxes (Chang 2007).

Besides economic factors, technological development and financial deregulation also affected the pace of privatisation. For example, new technological innovations rendered some of the government monopolies obsolete, as was the case in telecommunications. On the financial front, internationalisation of financial markets increased the supply of capital. In order to gain access to this credit, companies had to become more profitable and their soft budget constraints harder (Chang 2007).

These policies became embodied within the Reagan and Thatcher administrations, which initiated deregulation, privatisation and reform of public services to create growth and economic dynamism (Harvey 2006). Neoliberal policies expanded their reach and impact towards the end of the 1980s in the developed world. Finally, as the Cold War ended, neoliberal policies gained global momentum when a large number of Eastern European countries and former states of the Soviet Union abandoned the planned economy and engaged in deregulation and mass privatisations (Chang 2007; Shirley 1998).

Despite the international nature of privatisation and its impetuses, the process did not proceed identically in every country. Moreover, very few important companies and sectors were fully privatised. Instead of this, governments usually retained a certain amount of ownership (Chang 2007). To sum up, neoliberal policies in general advocated a minimisation of state intervention, deregulation and privatisation.

The objects of privatisation can be anything state-owned: land, real estate, precious metals or, as in the case of this paper, companies. State-owned companies will be referred to as either state-owned enterprises—SOEs—or public enterprises (PEs). Simply put, an SOE is an entity that is either entirely or partly owned by the state. Although this definition applies to all state-owned enterprises, not all companies with government shareholders can be accurately called SOEs. Most of them are state-owned because they are deemed important to national interests in areas such as the military, the economy or even health. States also own SOEs in order to prevent
capital market failure, to produce positive externalities to the whole economy and to secure the delivery of vital services which usually take the form of natural monopolies.

Governments tend to have close connections to certain industries. Key or strategic industries are industries that provide vital and important contributions to the national economy or security (OECD 1991). This is not a straightforward definition since economic importance is defined differently by different countries. In fact, it is such an ambiguous term that the OECD (1991: 36) suggested that ‘[t]hey (observers) know a strategic industry when they see one’. Industries which usually fall into this category are technology, industry and trade (OECD 1991: 54). However, a company deemed important to national welfare is not necessarily an SOE but a company with a special relationship with a ministry or other government department. The Japanese keiretsu or Korean chaebol are good examples. In later sections, I use the term, SOE, as a synonym for a public sector company.

Dimensions of privatisation

To analyse privatisation experiences in East Asia, I have identified three opposite dimensions of privatisation; the first two are taken from the OECD report of 2003 (pp. 11-13) and the third from the OECD report of 2010 (p.26) on privatisation. My reasons for using the OECD’s criteria in analysing privatisation experiences are the organisation’s extensive research experience and leading expertise in the topic and its important position in monitoring and advising government policies throughout the world. There are, of course, other important institutions conducting privatisation research such as the World Bank, whose resources and results I have also used extensively in this paper.

Programme and ad hoc privatisation: Governments may devise a specific programme to carry out privatisation or privatise their assets on the basis of temporary needs and improvisation. Where the companies to be privatised are small and few, the improvised ad hoc approach tends to be applied and vice versa.

Centralised and decentralised privatisation: Centralised privatisation is a process dictated and managed by the central government or its ministries, whereas decentralised or local privatisation refers to a form of privatisation where the most important decisions are carried out by local government. According to the 2003 OECD report, centralised privatisation can be conducted through ‘(a) a unit within a financial ministry or a central agency of the government; (b) a dedicated privatisation body; (c) a holding company of the government’ (OECD 2003: 13). There also ex-
ists a mixed approach which usually reflects a large number of diverse assets owned by the state.

*Rapid and gradual privatisation:* Rapid and gradual or partial privatisation reflects the speed of privatisation and usually depends on the size of the company to be privatised. The smaller a company, the quicker it can be privatised. However, there are notorious instances of rapid privatisation, the overnight privatisation of state assets in Russia being a prime example. In addition, there are two partialities: one adheres to a single company and whether the government is selling parts of it and how fast the process is carried out. The other refers to all state-owned shares and whether the government in question gradually privatises parts of them all or chooses only from a selected group of a few companies.

In fact, only a few governments have resorted to rapid privatisation. The concepts of rapid and gradual privatisation, moreover, are only approximations, and countries tend to apply a mixed approach to privatisation. These concepts are also less concrete than the other two discussed, i.e. centralised and decentralised privatisation, and programme and ad hoc privatisation. In addition to examining the dimensions of privatisation, I will also analyse privatisation by comparing the methods used in the process. The following section lists the most common types used in selling public assets to private investors.

**Methods of privatisation**

**Share issue privatisation:** Share issue privatisation (SIP) is carried out by corporatising SOEs into joint-stock companies whose shares can be publicly traded on the stock market (Megginson, Nash, Netter and Poulsen 2001: 2). SIP is the most prevalent type of privatisation in the world on account of its effectiveness in accumulating capital (Jones, Megginson, Nash and Netter 1999) and because of its contribution to the building-up of domestic financial markets (Subrahmanyam and Titman 1999). Often, SIP is the only alternative to privatising very large SOEs whose market value can be too high for any one single buyer to acquire (Megginson and Netter 2001: 19).

**Direct sale:** In direct sale privatisation, assets are sold directly to insiders such as managers or employees. In these cases, the method of direct sale is called respectively manager buyout or employee shareholding. Alternatively, companies can be sold to outsiders like private companies or to several investors through an auction without much publicity or a mediating institution such as a stock exchange (Megginson, Nash, Netter and Poulsen 2001: 2). This method has mainly been used in former communist countries (Jones, Megginson, Nash, and Netter 1999: 2).
Leasing: Privatisation through leasing (contracting out) occurs when the government transfers some of its tasks, such as garbage collection, to private parties. Leasing does not usually entail private actors buying state property, which is why some researchers do not consider leasing a real form of privatisation because there is no transfer of assets from state to private actor (Ramanadhan 1993: 248). Corporatisation implies transformation of the structure of SOEs or government departments into an enterprise structure as found in publicly traded companies. Corporatisation does not imply that the government divests itself of its ownership.¹

Privatisation from below: In comparison to other types of privatisation, privatisation from below is the most distinctive form of privatisation as there are no ownership changes but the emergence of private businesses. Privatisation from below mainly applies to transitional economies where restrictions, bans and obstacles to opening a business or market entry have been relaxed (Naughton 1994: 266), but it could also be applied to developed economies where removal of the creation of standards and regulations by the state, that is, deregulation, is taking place (Gormley 1996 and 1997). Privatisation from below is also known as spontaneous privatisation as opposed to calculated and planned privatisation from above or centrally directed privatisation (Cui 1997).

Impetuses for privatisation

Apart from analysing privatisation itself and how it has unfolded, I will also look at the factors and impetuses for privatisation. In short, I will explore the causal and structural mechanisms behind privatisation and seek to understand their role in the East Asian privatisation.

According to Bortolotti, Fantini and Siniscalco (2004 and 2001), commonplace factors which either cause and correlate with privatisation include economic development, government budget constraints, financial markets, business cycles, political majorities, legal origin, political institutions, concerns for efficiency, and public debt. For the analytical purposes of this paper, I have chosen four parameters with which to analyse the causes of privatisation: economic development, public debt, business cycles and budget constraints. Further to these, I have added a parameter of my own: external influences.

The intention in measuring the level of economic development as a ratio of gross domestic product (GDP) per capita is to compare the initial level of GDP with the

¹ See Investopedia, definition of corporatisation, http://www.investopedia.com/terms/c/?page=12, accessed 2 August 2013.
first privatisations. The purpose is to explore whether privatisation is actually linked to a particular level of economic development in East Asia or whether it is a feature of the current global economic order.

High public debt correlates with privatisation. The purpose in this paper is to find out whether the levels of debt in China, Japan and Korea remove a domestic, political threshold to privatisation or whether surpassing that threshold is universal.

Economic growth tends to increase the value of assets, making it more attractive to the owner of these assets to sell them. I seek to find out whether incidents of privatisation have increased during times of expanding economy or whether the timing of privatisation has been indifferent to fluctuations in the economy in East Asia.

As a fourth factor influencing privatisation, budget constraints are analysed and broken into their constituent parts to form a comparative understanding of these factors in each country. Which budget constraints have contributed to privatisation in East Asia?

The final factor is formed by external influences, which I have added into the analysis to see whether privatisation decisions are influenced by external actors or factors and to what extent this influence has been realised.

Apart from analysing the factors behind the determinants of privatisation, this paper also looks into the results of privatisation, although less extensively. The results of privatisation are usually much more similar than the political imperatives leading to privatisation. The results of privatisation are constituted by comparing the post-privatisation profitability of SOEs and the revenue governments have raised from privatisation.

**Overview of privatisation in East Asia**

**China**

In general, the development of Chinese privatisation has proceeded in three steps. The first one was the emergence and expansion of state-owned enterprises outside of the plan in the 1980s. Before then, there were no companies operating with a profit motive. Some of these companies were known as township and village enterprises and some of them were traditional SOEs producing both for the plan and for markets. Despite their still being technically state owned, they were controlled by private persons and were used to make a profit. The process was fostered by managerial reforms and the creation of monetary incentives and support for the establishment of collective firms, policies strengthened in 1982 by the 12th Central Committee of the Chinese Communist Party (CCP). The more traditional, industrial SOEs were, however, strictly state owned and controlled, but they went through significant re-
forms that subordinated them, although only partly, to the rules of a market economy. As a result, the operational environment of SOEs changed. Their profitability started improving, albeit from a really low starting point and they got a great many competitors from the collective and town and village enterprises. Throughout the 1980s, their economic importance started declining and they employed fewer and fewer people (Chow 2007; Naughton 2007; Garnaut, Song and Yao 2006; Sachs and Woo 1994).

Privatisation, in the real sense of the word and on a larger scale, was not realised until the early to mid-1990s. The second significant phenomenon was a successful privatisation process among small and medium-sized enterprises (SME). In this process of ‘Protecting the large and releasing the small’, the ownership of SMEs was transferred from central to local governments, which for their part allowed some of them to become private in order to curb manager buyouts and over-the-counter sales at local levels that were leading state assets to be sold at deflated prices (Naughton 2007: 301-302; Li 2001).

The third important phase in privatisation was the successful completion of the institutional framework. The privatisation of large, important and well-managed SOEs was started already in the early 1990s under the framework of the reduction in holding of state-owned shares (RHSOS). Enterprises were encouraged to list themselves in order to gain access to more financial resources. However, this practice threatened to bring down their market value and even reverse economic reforms. The RHSOS through share issue privatisation went through a couple of failures and did not take place until the state was able to create a concentrated institution for managing state assets, which up to that point had been dispersed among various government institutions and levels. The establishment of market institutions, the Shanghai and Shenzhen stock exchanges, the State-owned Assets Supervision and Administration Commission (SASAC) and the share conversion programme, imposed uniformity and brought previously unclear ownership rights under more effective control by the state.

This enabled a more sustainable framework under which partial privatisation of large SOEs could continue. The reduction of state assets became more stable and speedier but the state still retained a certain amount of shares and the right to purchase more. In addition, the state still exercises significant influence over some of its enterprises (Ma 2008; Chow 2007).

Overall, the number of SOEs has been decreasing. In 1980, the number of state-owned companies remained at slightly more than 80,000. In 1998, the number stood at 64,000 and by 2001 it had decreased to around 46,000. The rapid decrease in companies also occurred in collectives, where they numbered more than 300,000 in 1997. In 2001, their number had dropped to 31,000 (Jefferson, Su, Jiang and Yu 2003). In terms of production, the output of the SOEs in relation to GDP has fallen from 80 percent in 1978 to around one-fifth of GDP in 2003. In spite of this, the
sector has grown in absolute figures but not as fast as the collective and private sector. However, the state still owns significant shares in companies which are traditionally considered private. In terms of labour and in certain key industries and sectors, their dominance has decreased but still remains strong. After a growth in employment up to the mid-1990s, the number of workers employed by the SOEs has since halved from around 75 million in the mid-1980s to approximately 30 million in 2004. Regarding industrial entities, the SOE sector still owned 57 percent of industrial assets in 2003. Since the mid-1990s, the majority of SOEs have been largely in the ownership of local government, while the central government exerts control over 150 or so of the biggest SOEs. In addition to the reduction of state holdings through selling, the legislation adhering to the SOEs has also been constantly changed, and they have been merged and allowed to go bankrupt (McKinsey Quarterly 2004; McKinsey Quarterly 2008; Naughton 2007: 106)

Japan

It is important to note that companies in the Japanese public sector have been few and that their significance to the economy has been marginal. Privatisation was started as a response to the deteriorating performance of the SOEs. Susceptible to political interference but unable to expand or innovate, the political will was there to change their rigid legal standing to something more flexible and responsive to market signals. This process was influenced by the oil crises, the rise of neoliberalism, international trends of privatisation and deregulation, and U.S. pressure (Cheung 2002; Toyama 1998)

The low number of important Japanese SOEs has meant that privatisation has focused on a rather small group of companies: Nippon Telegraph and Telephone (NTT), Japan Tobacco and Salt Public Corporation, Japan National Railways (JNR), Japan Airlines (JAL) and Japan Post. Despite this, the monetary value of the initial public offerings (IPO) launched by the new, separated entities has been significant. New IPOs from the dissolved Japan Post are expected to follow their predecessors but, despite the final decision to privatise in 2007, the process has suffered from setbacks (Financial Times 2009).

Despite the expected political opposition and some natural impediments, privatisation in Japan has proceeded in a rather straightforward manner and the Japanese economy has been able to adjust to these changes with not much trouble. From time to time, privatisation plans have encountered political opposition, of which the most recent incident was the halting of the privatisation of Japan Post. The Koizumi administration had to order a new election in order to secure the privatisation. The relative ease and lack of structural problems might be due to the already sophisticated legal and institutional framework of the Japanese economy, the small number
of the companies privatised, their marginal share in the labour market and the effect on the economy. On the other hand, it should be noted that even though privatisation has started, the government still retains significant numbers of shares in these companies (Yanagawa, Yoshino and Harimaya 2010; Imai 2009; Porges and Leong 2006; Toyama 1998).

In comparison with other developed nations, the Japanese public sector companies have experienced very few changes and the overall number of SOEs has remained more or less the same. In 1998, the total number of SOEs stood at around 80 (OECD 2003). If the privatisation of Tokyo Electric Power Company (TEPCO) is excluded, there has been only one full privatisation in recent times, that of JAL in 1987, an airline company where the state had only partial ownership. The privatisations of JNR, Japan Tobacco (JT) and NTT have been going on for nearly 25 years now, but the process has been slow and privatisation only partial. Perhaps the reason for the slow rate of privatisation has been the traditionally less important role of SOEs in the economy.

In the 1970s, Japanese public sector companies produced only 5 percent of GDP and 10 percent of gross domestic fixed capital formation. At the same time, the public sector employed only 5 percent of the work force (Cheung 2002; Toyama 1998: 388; Young 1987: 192). The unavailability of statistical information on the number of employees of SOEs before the 1990s makes it hard to present any precise figures. Despite this, there is good reason to assume that the number of workers employed by SOEs has been much lower than the total number in public sector employment. For instance, at the beginning of the 1990s, the workforce employed by the public sector stood at 3.5 percent, of which the share of the SOEs was a mere 0.1 percent (UNDESA 2006).

Korea

As in China and Japan, public sector enterprises in Korea have also followed the pattern of decreasing importance in their share of GDP and labour, a consequence of both government divestments and private sector growth. Privatisation in Korea has been gradual and has proceeded in six phases. While the privatisations of the earlier periods were few and modest until the end of the 1990s, the overall development of Korean privatisation seems to have followed economic growth and development (KDI 2010; Junki Kim).

Apart from structural impetuses of inefficiency and lack of competition for privatisation, the single most important event affecting privatisation in Korea was the Asian financial crisis, which resulted in a series of privatisations of government enterprises. Although the Korean government had privatised before, the post-crisis privatisation plan was the most extensive one. Quick privatisation and revenue
gained from divestment were probably among the reasons why Korea was able to recover its economy and return to growth within a year. Another major event affecting privatisation was the 1983 Government-invested Enterprises (GIE) Basic Management Act. In itself, the act did not directly prompt privatisation but it restructured and streamlined public enterprises, which resulted in PEs becoming more profitable and competitive. Prior to that, government had been divesting its assets. Finally, the People’s Share Programme at the end of the 1980s also facilitated selling government divesting (KDI 2010; Cheung 2002; Shirley 1989).

Similarly to the Japanese public sector enterprises, the Korean PEs produced only a small part of GDP and investments but, unlike in Japan, they had been reserved for experimental purposes in the Korean industrialisation plan. Privatisation started at the end of the 1970s. Since then, the pace of privatisation has accelerated and slowed down but has always maintained its use as a policy choice. Although the exact number is difficult to assess, between 1968 and 2008 Korea privatised fully or partially somewhat over one hundred enterprises, including PEs, GIEs and government-backed enterprises (GBEs). Shirley (1989), for example, estimates that there were around 90 public enterprises in Korea: 26 GIEs and 54 subsidiaries of GIEs plus certain government departments. By 2003, the number had dropped to 23 SOEs, which were subject to further privatisations (Lim 2003: 22-23). The total number of government-owned corporations stood at 22 in 2010 (Ministry of Strategy and Finance 2010). A 2011 OECD report on the changes in SOE governance put the number at 21, of which eight were purely commercial and 13 semi-commercial (OECD 2011).

Because privatisation has been relatively consistent, the importance of the public sector enterprises has declined in a similar manner. In the mid-1960s, PEs produced 5.5 percent of GDP and, a decade later, 6.3 percent. However, their share of the output of manufacturing during the same period of time stood at around 15 percent (Schmitz 1996). In 1986, the GDP share of PEs was 10.4 percent (Shirley 1989), a proportion that decreased to slightly more than 3 percent in 1998 and slightly more than 2.5 percent in 2003 (OECD 2003). Although the PEs had not been very important employers, the declining importance of PEs is also evident in terms of employment. In 20 years, the number employed by PEs was reduced from 1.5 percent in 1982 to 0.5 percent in 2000 (Shirley 1989; UNDESA 2007). This development has continued, and the percentage of people employed by SOEs in 2009 stood at 0.33 percent (OECD 2011).
Public enterprise types in East Asia

China

Almost all large Chinese companies have a past of state ownership and, still, very few of them are fully private. Because of this background, there are four types of Chinese corporations. The first group is formed by large, listed SOEs which have offered a small amount of their shares to the public. The companies in this group also tend to be monopolies or in sectors with little competition. Domestic foreign joint ventures are in the second category. They provide new technology in order to enter the markets. The third group is composed of largely private companies in sectors with little or no SOEs. Finally, the fourth category of companies is formed of those funded through a mix of public and private money (McKinsey and Infinity Group, cited by the Economist, September 3, 2011).

Japan

The Japanese public enterprise sector has traditionally consisted of four types of companies of which three are important from the viewpoint of privatisation. The first category includes governmental departments belonging to their corresponding ministries. These types of enterprises include the National Forestry Service, the Mint Bureau, the Printing Bureau, and the Bureau of Postal Services. In terms of privatisation, this last bureau is the most important. The second category, government-controlled companies, is the most important one. It is comprised of public corporations governed by the same commercial laws that adhere to private companies. Nippon Telegraph and Telephone and Japan Tobacco, as partially privatised companies, belong to this group. The third category includes statutory companies which operate under specific laws. These companies also tend to be non-commercial. The fourth category is comprised of autonomous bodies founded on government decisions (Mizutani and Uranishi 2006; ASOSAI 1998).

Korea

The Korean economy is dominated by the large Korean conglomerates, chaebols, which form either a single, large entity or company groups. They are operated and, usually, owned by powerful families (Investopedia, Chaebol Structure). In addition to the chaebols, there are also independent firms and public enterprises.

There are three types of public enterprises in Korea. The first type is formed by government enterprises of which there are four: Korean National Railroad, the Post
Office, the Public Procurement Service and the Grain Management Enterprise. These government enterprises are governmental departments and are or were wholly owned by the state. The second type of companies is public corporations. They are entities judicially separate from the state and enjoy more freedom than the government enterprises. Despite their flexibility, ultimate ownership remains within the state, although the piecemeal privatisation of the public corporations has obscured the definition between public and joint-stock corporations. The third corporation form is that of a joint-stock company. These companies are judicially governed as dictated by commercial laws. The government’s authority in these companies is of limited liability or is limited by its ownership of shares. The public corporations and joint-stock companies subsequently fall into three categories: government-invested, government-backed and indirectly invested enterprises, which are subsidiaries of either GIEs or GBEs (Lim 2003; Shirley 1989).

**Causes of privatisation**

**Economic development**

The evidence shows that privatisation has little to do with economic growth or a maturing economy. If there is a link between economic development, understood as growth, and privatisation, that link must be very weak and different across countries and regions.

The importance of SOEs in China, Japan and Korea before privatisations varied to a great extent. China had the biggest number of SOEs and their share of GDP was also the highest. Their contribution to employment was also highest in both relative and absolute terms. Japan had the fewest SOEs measured in their contribution to both GDP and the workforce. However, the share offerings in Japan have been the most profitable, depending on the calculations. By this measure, China is second and Korea third by reason of the small size of its economy. In the category of SOEs, Korea falls somewhere between China and Japan. There were substantially more PEs in Korea than in Japan and the Korean PEs’ share of GDP and labour was higher than in Japan but clearly lower than in China. These differences are all rather self-evident when one takes a look at the respective economic histories of China, Japan and Korea. China emerged from a communist planned economy, whereas Japan had already industrialised by the turn of the 20th century. Prior to the end of the 1980s, Korea was a military dictatorship recovering from the Korean War. Des-

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2 Also called government-invested institutions (KDI 2010).
3 Also called government-contributed enterprises (KDI 2010).
4 Also called subsidiary companies of the GIEs (Shirley 1989: 5).
pite these differences in the level of economic development, all countries started reforming their economies and corporate policies, albeit differently due to different economic structures, at approximately the same time. The early 1980s marked the beginning of corporate reforms in China (12th Central Committee of the CCP in 1982), Korea (the 1983 GIE Basic Management Act) and Japan (the Provisional Commission for Administrative Reform in 1982). The level of GDP being radically different in all countries, this development, in my opinion, points to changes in the wider international system of political economy.

Fiscal distress

When comparing the impetuses for privatisation, it is clear that fiscal distress has been among the key factors behind privatisation. However, the strain on public finances has manifested itself very differently in China, Japan and Korea. In China, fiscal constraints had to do with the banks, which had been lending cheap credit to the SOEs to the extent that the outstanding debt threatened the stability of the banks. The budgets of many SOEs were hardened by limiting the banks’ right to lend money. A related objective was to make SOEs more efficient and, thus, less dependent on the government and bank funding (Guo and Yao 2005; Yusuf, Nabeshima and Perkins 2005; Sun, Tong and Tong 2002; Brandt, Li and Roberts 2001).

In Japan, the situation for many SOEs prior to privatisation was deadlock. On the one hand, they were subjected to rigid regulations governing their production, expansion and monopoly status in order to guarantee government revenue. Furthermore, they were also used for purely political purposes. On the other hand, the role of SOEs as revenue had started to decline as a consequence of their growing fiscal dependency on the government brought about by their protected status. In short, the revenue gained from SOEs was decreasing in relation to their costs. This happened in tandem with the companies being themselves unable to turn their losses into profits without a change in the legislation governing their market status (Mizutani and Uranishi 2006: 534; Cheung 2002; Shumpei 1984: 146).

In Korea, the reasons behind privatisation have been diverse. The more structural factors were the economic growth and maturation of the Korean economy and consequent liberalisation and internalisation of the 1980s. The rationale for privatisations prior to 1997 changed from supporting a market economy, financial markets and employee shareholding to gaining extra revenue for the state, but such privatisations had all been moderate in comparison to the magnitude of those of the late 1990s and early 2000s. In addition to concerns for the efficiency and development of the telecommunications sector and for raising revenue for the government, privatisation was also pushed by foreign and domestic interests, namely the United States (US) and the chaebols. In terms of motives for privatisation, Korea has probably
been the most influenced by foreign pressure to privatise in East Asia (see the section below on External influences) (KDI 2010; Kim 2009: 117; Junki Kim; Lim 2003).

**Business cycles**

Timing privatisation accurately is as easy as predicting future economic growth. There are clear differences in the timing of listing: thus it is no wonder that there were clear differences in the timing of privatisation. Moreover, even though the timing might be accurate, nothing can guarantee a favourable outcome for the stock prices. In Japan, the privatisations of NTT and JT were less successful than the share offering of JR East despite the fact that JR East went public during a period of low economic growth. In Korea, the first privatisations of Korea Electric Power Corporation (KEPCO), POSCO and Korea Tobacco and Ginseng Corporation (KT&G) were implemented after economically favourable years. The later privatisations also took place during good years but were caused by a severe fall in the Korean economy (Brada and Ma 2008; Bortolotti, Fantini and Siniscalco 2004; Highbeam Business 2004; Dewenter and Malatesta 1997: 4; East Japan Railways Company, 2004; KEPCO; POSCO 2010; Reuters Finance; West Japan Railway Company; World Bank 2008).

So, are there more privatisations during high growth years? Based on this unstatistical analysis, one could say that governments tend intentionally to avoid share offerings during bad years but might be compelled to do so, as Korea was in 1997. Also, timing privatisation in a high growth period is desirable but, because of unknown variables, it might also be unattainable.

**Government debt**

During the past 30 years, all three countries have increased their loan-taking, and the accumulating debt has had an effect on the privatisation of state-owned assets. Both in Japan and Korea, the rising levels of debt in the early 1980s were countered with corporate reforms and privatisations. As a result, the growth in debt was tamed and both Japan and Korea went through a period of decreasing government debt. In the early 1990s, Japanese government debt started growing again and the government resorted to further privatisations which, however, did not reduce the national debt further. The Korean and Chinese national debt began rising as a result of the Asian financial crisis. In China, privatisation occurred through the transfer of ownership rights from central to local government and the bailing-out of state-owned banks by the central government. In Korea, the harsh privatisation programme was set up mainly to gain revenue for the state and to restore the faith of international organisa-
tions and investors. Because of the crisis, the government debt in Japan increased as well. However, despite privatisation measures, the government debt in China, Japan and Korea continued to rise. In China, the debt was temporarily reduced in 2004 and 2005 probably through the share conversion programme. In Japan, liabilities were also temporarily reduced in 2005 with the revenues gained from the privatisation of the highway corporations. The financial crisis of the late 2000s increased national debts drastically, which gives a reason to expect further privatisations (Institute for New Economic Thinking 2011; Laurino and Grimaldi 2010; Bortolotti, Fantini and Siniscalco 2001).

External pressures

China has been relatively untouched but not unaffected by external influences in relation to privatisation. The Asian financial crisis influenced China’s privatisation, but in Korea, the crisis forced the government to privatise. In addition, China has not been directly influenced by the US in relation to privatisation. In Korea, it was the combination of the crisis and subsequent, conditional help from the International Monetary Fund (IMF) that sped up the privatisation process. Another, although less significant external factor influencing privatisation in Korea was the country’s entry into the World Trade Organisation. In terms of external factors influencing privatisation, Japan was the least affected by the Asian financial crisis. If the crisis had any effect on the decisions to privatise, for instance, the IPO of NTT Mobile Communications Network in 1998, the causal relationship is less straightforward than in Korea. In the 1980s, Japan’s economy was undoubtedly more international than that of Korea or China and thus more susceptible to the politics, trends and pressures of global economics. In addition, unbalanced trade relations made Japan more exposed to criticism from both international trade interests and US pressure (Ha and Lee 2007; Joh 2004; Cheung 2002; Sharma 2002; Kim and Kim 2001; IMF 1998).

Processes of privatisation

Table 1 Dimensions of privatisation

| Programme | Ad hoc | Centralised | Decentralised | Rapid | Gradual |
|-----------|-------|-------------|---------------|-------|---------|
| China     | x     | x           |               |       | x       |
| Japan     | x     |             | x             | x     |         |
| Korea     | x     |             |               | x     |         |

Sources: Nakamura 1996, Dewenter and Malatesta 1997, Ma 1998, Toyama 1998, Kim and Kim 2001, Bowles and Dong 2002, Cheung 2002, Lim 2003, OECD 2003, Jefferson, Jian, Yuan and Xinhua 2003, Washington Post Foreign Service 2005, Mizutani and Uranishi 2006, Naughton 2007, Ma 2008, Asia Development Bank 2010, KDI 2010 and The Economist 2012
The use of ad hoc privatisation has been non-existent. Although the programmes have not been designated as such, it is clear that there were no single privatisations. All privatisations have occurred as a result of political planning and in tandem with other privatisations.

The degree of centralisation and decentralisation in privatisation has strongly varied between the countries. In China, privatisation of the large SOEs has been centrally managed since 2005, but the privatisation of many SMEs has been decentralised. In Japan, privatisation has been largely centralised due to the large size of the companies. Likewise, Korean privatisation has been centralised as it has been directed by the government (Cheung 2002; Asian Development Bank 2001; Kim and Kim 2001; Dewenter and Malatesta 1997; Nakamura 1996).

No country has taken a rapid approach similar to the early 1990s when Russia practically privatised all state assets overnight. Some smaller and medium-sized companies were fully privatised very rapidly, especially in China. The post-Asian financial crisis privatisation was carried out at a rapid pace, although not all companies chosen for privatisation were fully privatised. In general, the pace of privatisation in East Asia has been gradual (Economist 2012; Ma 2008; Naughton 2007: 301-302; Washington Post 2005; Jefferson, Jian, Yuan and Xinhua 2003; Dong and Bowles 2002; Ma 1998).

Table 2 Methods of privatisation

| Privateation Form | China | Japan | Korea |
|-------------------|-------|-------|-------|
| Share issue privatisation | X | X | X |
| Direct sale | X | X | X |
| Leasing | X | X | X |
| Privatisation from below | X | X | X |

Sources: Megginson and Netter 1997, Van Der Hoeven and Sziráczki 1997, Toyama 1998, Jones, Megginson, Nash and Netter 1999, Haque 2000, Ahn and Kim 2002, Lim 2003, Chow 2007, OECD 2007, Ma 2008, Gan, Guo and Xu 2010, The Economist 2012 and Shenzhen Stock Exchange 2012

With regard to methods, a variety of privatisation forms has been used. China and Korea have used more diverse methods of privatisation than Japan, which has relied solely on the use of SIP. On the other hand, China is the only country to have privatised from below. Although it did not produce private companies in the purest sense of the word, it did manage to lift the major restrictions on entering the market (Naughton 1994). However, Japan and Korea had had lower barriers to market entry than China. In China, the use of direct sales has been more popular than SIP, although in value production SIPs have been the most used method of privatisation. China was also the only country to have used the method of leasing in privatisation (Dong and Bowles 2002; Toyama 1998).
In Korea, direct sales were used mainly in the first round of privatisation, but since then their use has become much less common. Later on, methods have become more diverse, including SIPs. Similar to the experience in China and Japan, SIPs have produced the most value (OECD 2007; Lim 2003: 2; Ahn and Kim 2002: 15; Haque 2000; Van der Hoeven and Sziráczki 1997: 38; Megginson and Netter 1997).

**Proceeds and results from privatisation**

**China**

Between 1992 and 1999, the Chinese government raised US$20.6 billion through privatisation. From 2000 to 2008, Chinese privatisation projects produced US$170.7 billion. By 2008, altogether 327 companies had been privatised through share issues, generating US$191.3 billion for the Chinese government (World Bank 2008). These figures only address the share issue privatisation of larger SOEs and exclude smaller firms sold directly to their managers or employees (direct sale privatisation).

**Japan**

In the case of Japan, it appears that different proceedings from privatisation have been calculated, using different variables and historical data, by different authors. Because of the varying figures of the total value of Japanese privatisation, I cannot give an exact representation but have to make do with estimates. According to Friedrich Schneider, Japanese privatisations have generated US$146 billion in revenue for the state in the period between 1961 and 2000 (Schneider 2003: table 2). Very different figures are given by Bernardo Bortolotti and Paolo Pinotti (2003), who have calculated the privatisation proceedings between 1977 and 1999 as amounting to US$189.4 billion. The gap between these calculations amounts to US$43.4 billion. Even if direct privatisations were integrated, which were non-existent in Japan before the 2000s (Bortolotti, Fantini and Domenico 2004: PO/Deals ratio), the aggregate value of privatisations would amount to only US$183.6 billion (OECD 2002: table 1). Between 2000 and 2007, Japanese privatisation amounted to US$33.2 billion (OECD 2009: table 1). Taken together, divestment of state assets has yielded US$179.2 billion,5 US$216.8 billion or US$222.6 billion over a time-span of 45 years, from 1961 to 2007.

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5 My own calculation based on the figures given in OECD 2009: table 1; Bortolotti, Fantini and Domenico, 2004: table 2; Schneider 2003: table 2; and OECD 2002: table 1.
Korea

The exact value of total proceeds gained from privatisation in Korea is also difficult to establish due to the lack of reliable data collected on privatisation and a lack of historical data regarding the earlier privatisations prior to the 1980s. The figures presented below rest on the privatisation transactions carried out in the mid-1980s and late 1990s.

The IMF estimates that the Korean privatisations generated US$15.37 billion (in 1985 figures) in 1985-99 (Brune, Garret and Kogut 2004: appendix 1). Similarly, the OECD puts the amount at US$14.3 billion, produced between 1993 and 1999 (OECD 2001: Recent Privatisation Trends, table 1; calculations are my own). A completely different figure is offered by Paul Cook and Yuichiro Uchida (2001), according to whom the Korean divestments generated a mere US$2.5 billion in 1988-99. In addition to these sums, privatisations post-Asian financial crisis brought US$10.7 billion in revenue to the Korean government (KDI 2010: 24). Added together, the total value of privatisation proceeds from the mid-1980s to 2002 amount to somewhere between US$25 and 26 billion. However, the real returns are most likely to be at least somewhat higher than that, since these calculations are based on the figures from 1985 to 2002.

Post-privatisation profitability

In general, the profitability of SOEs in East Asia has improved, but it is not clear whether the positive effects can be linked to privatisation per se or the wider corporate reforms and the favourable growth environment. In China, the corporate reforms of the 1980s and early 1990s did not increase the profitability of SOEs, whose performance continued declining until the early 2000s. However, the firms which had issued shares and thus become partially private did perform better than their fully state-owned counterparts, but SIPs were not enough to turn their losses into profits. At the end of the 1990s, declining profitability was countered by a series of corporate reforms which strengthened their performance and contributed to their growth. The profitability of the SOEs started declining again after 2007, a year before the private companies but since 2010 has returned to growth (Xinhuanet 2010; Xu 2010; Jiang, Yue and Zhao 2009; Song and Yao 2004).

In Japan, the performance-enhancing effect of privatisation has been more company specific. In short, all three core public enterprises, NTT, JR Group and JT, which are all still partly state owned, have improved their performance. In comparative terms, NTT has been able to improve its performance most through increased competition and better customer service in the telecommunications sector. JR Group was able to raise its profitability as well but to a lesser extent, while three of the six
separated transportation entities still belong to the state. JT has also improved its performance to the extent that it has become the world’s third most profitable tobacco company (Mizutani and Uranishi 2006; American Chamber of Commerce in Japan 2004; Toyama 1998: Japan Tobacco Inc and Japan Tobacco International 2011).

Public enterprises in Korea have also improved their performance but, as in China and Japan, it is not clear whether enhanced profitability was due to privatisation or to other corporate reforms. The 1983 GIE Basic Management Act increased the profitability of SOEs but entailed much less privatisation than reforms. Firm profitability also increased after the Asian financial crisis but again, the companies with increased profitability would have probably improved their performance even without privatisation, as did Korea Telecom, which benefited from overall growth environment (KDI 2010: 24; Kim 2009; Shirley and Nellis 1991: 69; Korea Development Institute, cited by Shirley 1989: 23).

**Conclusion**

Privatisation was initiated at a higher level of GDP per capita in Japan than in Korea or China. In China, financial constraints of local governments, firms and banks all affected privatisation. In Japan, the constraints on finances derived from the legal restrictions on SOEs. In Korea, financial distress was the sole cause of the post-Asian financial crisis privatisation.

The timing of privatisations in Japan and Korea has been both successful and a failure, whereas China’s privatisations have increased constantly with the exception of the early 2000s. The level of national debt has affected privatisation and corporation reforms in all the countries, but privatisation has not inhibited the contracting of debt. The Asian financial crisis affected privatisation most of all in Korea but also in China and Japan. US foreign policy has also played a minor role in Japan and Korea.

Privatisation programmes were used in each country and the pace has been gradual except for the late 1990s privatisations in China and Korea. Privatisation was also centrally directed except in China. China has used share issue privatisation, direct sale, leasing and privatisation from below. Japan has predominantly relied on the use of share issue privatisation. In Korea, direct sales and share issue privatisations have been the most used methods.

Japan has gained most proceeds from privatisation. The profitability of state-owned enterprises has been improving, but it is unclear whether this is due to privatisation. The profitability rates of Chinese SOEs started improving in the late 1990s and early 2000s as a result of reforms after the initial slump. In Japan, all major three public enterprises improved their profitability. In Korea, public enterprises improved their performance more through reforms than privatisation.
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## GLOSSARY

| keiretsu          | 系列          | Japanese business conglomerate |
|------------------|--------------|-------------------------------|
| chaeból          | 재벌          | South Korean business conglomerate |