ORIGINAL RESEARCH PAPER

Economics

KEY WORDS: Privatization, Competition, Productive Efficiency

Relative Importance of Ownership and Competition for Productive Efficiency

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ABSTRACT

Privatization is defined broadly as a shift of ownership of an enterprise from public to private, done by the government. Although popular preference seems skewed towards private rather than public ownership, an unambiguous superiority of the former over the latter cannot be established. Competition is another major factor contributing towards improvement of productive efficiency of the firms. It may be defined as number of comparable sized firms contesting in the same market. The case of Indian Telecom Industry proves that both contributed to increase the efficiency of the industry.

Introduction

Privatization is defined broadly as a shift of ownership of an enterprise from public to private, done by the government. It is believe by many that it can prove to be advantageous in terms of flexibility, scope of innovation, cost savings and it is considered to be a well-known feature to enhance competitive characteristic in the market. Often the phenomenon of privatization is described to be an efficient way of allocating resources in the economy. Hence the phenomenon has become global and is now in use worldwide, since it was first introduced by Thatcher government in Britain in the early 1980s.

Privatization Vs Competition

In the contemporary scenario of a highly globalised world order, the persistent contention between diverse ownership arrangements continues to gather momentum. Mammoth amount of literature has been devoted to the relative merits and limitations of State-Owned Enterprises vis-à-vis privately operated entities, and more recently on the innovative concept of Public-Private-Partnerships. Yet, a consensus seems far from achieved.

Although popular preference seems skewed towards private rather than public ownership, an unambiguous superiority of the former over the latter cannot be established (Nayak 2012). According to Sappington and Stiglitz (1987), the public and private modes of resource/product provision are, in fact, rather similar in terms of the delegation of authority. In their discussion pertaining to the Fundamental Privatisation Theorem, while highlighting optimum conditions for privatisation, they arrive at the conclusion that such conditions are "rather stringent" and that "neither public nor private provision can fully resolve the difficult incentive problems that arise when considerations of imperfect information result in delegation of authority." Here, the authors refer to the familiar principal-agent problem while citing the example of a manager at a PSU who does not have sufficient incentive to ensure efficiency by say, reducing costs as he/she is aware that the higher costs will ultimately be borne by the government in its fiscal bill. An analogous example can be drawn for a private firm; consider information asymmetry between the shareholders (owners) and the Board of Directors.

In light of the above discussion regarding the inefficiency contingency arising in both public and private set-ups (as opposed to the popular opinion of them being present solely in the public sector), one is led to contemplate the conditions relevant for achieving productive efficiency, a situation in which the economy can produce more of a good only at the cost of another good. Thus, another line of reasoning proposes that ownership or the mode of provision of resources is irrelevant to the objective of achieving productive efficiency; what matters instead is contestability within the particular industry.

In order to ensure a holistic approach to the study of privatisation (or more specifically, the rationale for privatisation); it is imperative that we delve into the aforementioned argument. Using rudimentary microeconomic theory to link productive efficiency directly to the degree of competition in an economy, the argument makes ownership aspect rather redundant in the endeavour to attain improved enterprise performance and efficiency. In essence, it is implied that a private or a public entity will be equally efficient in production as long as there is sufficient competition in the market. Nayak notes that "under perfectly competitive conditions, absence of information asymmetries, and complete contracts" the public-private debate no longer attracts interest as efficiency is ensured without any market failures. As an extension to the argument, he adds that even in empirical studies where privatisation does appear to enhance efficiency, one can identify the presence of simultaneous deregulation policies or other competition-promoting strategies. This is to highlight the failure of concerned statistical analyses to control for the economic environment; ceteris paribus does not always hold.

The case of Indian Telecom Industry

Having discussed the theoretical relevance of competition for efficiency in some detail, it becomes important to verify the practical application of such a situation through empirical evidence in the Indian context. The Indian telecom industry becomes a case in point.

According to an IBEF Sectoral Report, India is presently the second-largest telecommunications market in the world, having registered colossal growth in the past decade and half. The growth has been credited to the government's liberal and reformist policies as well as to the strong consumer demand. Ease of access to telecom equipment and a proactive regulatory framework have ensured availability of telecom services to consumers at highly affordable prices. Moreover, the deregulation of FDI norms has made the industry one of the fastest growing and a top five employment opportunity generator.

However, such a scenario did not always exist in India's telecommunications industry. The Indian telecom sector's evolution can be divided into 3 phases;

- Phase I- Pre-Liberalisation Era (1980-89)
- Phase II- Post-Liberalisation Era (1990-99)
- Phase III- Post 2000

In the industry's nascent stage, the government held a monopoly owing to the colonial Telegraph Act of 1885. Until the industry was liberalised in the early 90s, it was a heavily government-controlled and small-sized market with a handful of players (MTNL and VSNL, for instance). The New Telecom Policy (NTP-99) provided the much needed impetus to sectoral growth as it initiated the liberalisation and deregulation process. Today, as a result, the industry is characterised by intense competition, and incessant price wars. Needless to say, competition and the subsequent depression of tariffs have attracted myriads of subscribers every year. As the D&B Report (2009) states, "When cellular phones were introduced, call rates were at a peak of Rs. 16 per minute and there were charges for incoming calls too. Today, however, incoming calls are no longer charged and outgoing calls are charged at less than a rupee per minute." While price wars have indeed had a negative impact on telecom providers' revenues, the industry remains highly optimistic due to the immense potential of new users (volume).

Conclusion

In his book, Whither Socialism?, Stiglitz writes, "More imp ortant…than changing the 'ownership' is changing the market structure - subjecting these enterprises to competition." India's telecom industry experienced exponential growth owing to regulatory liberalisation, structural reforms, and competition. The experience of the sector under study does indeed ratify the argument made by Stiglitz. However, just as privatisation is not a panacea for every predicament (Nayak 2012), neither is competition. Research avenues remain open in areas where encouraging competition is not a highly feasible option; for instance, natural monopolies in several utility and strategic industries are a case in point. A pertinent question then perhaps would be whether a natural monopoly is better under the ambit of a public player or a private one.

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