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Shareholder Rights and the Equitable Treatment of Shareholders

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From Stocks to Stakes:
The State as Shareholder in Asia

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It is fortuitous indeed to be invited to address our present theme, the state as shareholder, on the occasion of a conference on this subject in Mumbai. If there is a more appropriate setting to explore such a subject, I cannot think where it might be.

What is the most effective role for the state to play in a national economy? How should the state conduct itself as a shareholder and stakeholder—and based on what principles are solutions to these questions to be determined? Nowhere in our time are these matters settled. If I may say so, the one nation that thought it had resolved such issues, the United States, turns out to have rather spectacularly overestimated itself during the past decade—and precisely because it underestimated the necessity of a public role in the economy and, indeed, a very direct role in industries such as power generation. So the Americans, like the rest of us, must again wrestle with the problems raised here. Nowhere else but Asia, however, do these matters seem so immediate, so directly engaged at the moment, and nowhere else is new thinking being done and (at least in some cases) applied so swiftly.

It is new thinking that is the principal subject of this paper. I bring a correspondent's perspective to it, and lately the perspective of a commentator on Asian affairs—a position that, whatever its shortcomings may be, enables me to move through the region frequently enough to gauge its progress. Everywhere one travels today in Asia, from South Korea to China and southward to Indonesia, and then westward to India—across the region one finds societies in search of new economic and social models for themselves, and in every case the state's place in the economy, the state as shareholder, is being reconsidered. New relationships between the state and the private sector are being explored—relationships not even imagined a few short decades ago, when most of the nations of Asia were concerned primarily with gaining and managing their political independence, when the role of the state was large and assumed to be necessarily so, and to which time the roots of our present circumstances reach back.

I have implied the need for a chronology. Let me begin with one, and upon re-arriving in the present I propose to consider some of the new thinking I find getting done among Asians, and the consequences of it in terms of where Asia might be headed in the context of our subject.

"I am convinced that the only key to the solution of the world's problems and of India's lies in socialism." So spoke Jawaharlal Nehru six and a half decades ago in an address to the Indian National Congress. Asia has always been a mixed picture, of course, with exceptions ever available to disprove every attempt to generalize about it. But Nehru's statement is an apt summation of the ethos prevalent during what we generally call the era of independence—the late-1940s through the mid-1960s or so. "I see no way of ending the poverty, the vast unemployment, the degradation, and the subjection of the Indian people except through socialism," Nehru elaborated in the same speech. (1)

The logic was plain. India, China, Indonesia, Malaysia, Singapore—such countries inherited large populations of uneducated, underprivileged citizens. Infrastructure, institutions, and all of what we call public goods, bureaucratic competence, and private-sector enterprise—all these were underdeveloped or nonexistent. In this context, the state could hardly avoid assuming a large and direct role in these nations' economies. It was the investor of last resort, in effect. We may also wish to note the considerable influence Fabian socialism and other creeds then current had on such British-educated leaders as Nehru and Singapore's future prime minister, Lee Kuan Yew.

Today, then, more than half a century after Nehru boldly stated his position, more than forty percent of India's capital stock, according to a study published earlier this year by McKinsey and Company, the global consulting firm, is still owned by the government. (2) In Singapore, the region's other notable case, a report by the U.S. embassy posits that more than sixty percent of the economy is state owned, largely through Temasek, the government's investment holding company. The Singapore government puts the figure at less than twenty percent, but the point remains pertinent.

Direct state shareholdings is the start of the story, and it reached its logical extreme, of course, in post-1949 China. Then came the Cold War, and another part of the picture was filled in. Strong anti-Communist governments, with important backing from the United States, began to develop private enterprise through select groups of home-grown executives who were much favored by successive administrations. So did the region's governments move on from the business of shareholdings, though often in these cases, as in South Korea, they did so by directing bank credits from state-owned banks toward the companies of their choosing. In the great "miracle" years of the East Asian economies—which I have never accepted as much of a miracle at all—this was called government-business coordination, among other things. We have lately come to term these executive elites and their successors "cronies"—a term I reject because it obscures, simplifies, and misleads more than it reveals.

To continue through our too-brief chronology, the 1980s brought Asia to another turn in the road. Being a correspondent with regional responsibilities by this time, I recall very vividly how the new fashion in the United States and Great Britain swept through Asia. Suddenly, privatizing state enterprises was on everyone's mind. Electricity grids, airlines, toll roads, government-owned industrial corporations of every kind—all began to be considered as candidates for sale either by way of public share listings or to one or more strategic investors. Malaysia was notably enthusiastic in this exercise.

So by the 1980s and through most of the 1990s, we had come full circle: From theories of "private failure," to cast the thought in economists' terms, Asia went through to theories of "public failure." In my view, there were positive and negative sides to this progression, this march of trends. Bureaucrats and policy planners were clearly cognizant, by the 1980s, that a new formulation had to be reached—a new relationship between private and public enterprise. This was salutary; it suggested that the age of government as shareholder was to be superceded by another, and it reflected the very considerable distance the Asian nations had covered since Nehru's day.

But it seemed to be a perilous advance at the same time. In almost all cases, privatization policies were taken straight off-the-shelf—imported and adopted without reference to the surrounding economic circumstances. Was the privatization of this or that enterprise appropriate in the context of the domestic per-capital income? Were the right welfare structures in place, and the right regulatory regimes? Were the markets prepared? I don't recall these questions being posed. And at the risk of seeming impolite, this suggested to me at the time that Asia's bureaucrats and planners had not yet acquired the habit of thinking for themselves. They seemed unaware of the importance of letting specific problems suggest the shape of their own solutions. You can import economic strategy, it came to me then, just slightly more successfully than you can import democracy, which is a logical impossibility.

Joseph Stiglitz, the Nobelist and former World Bank economist, once advanced three conservative propositions to describe what he called "the view from the market" during the 1990s, the decade of the "Washington consensus," as he and others have come to call it, when the market gained acceptance as the preferred economic mechanism to such an extent that its powers became exaggerated. Stiglitz's propositions were these:

- Government is unnecessary because anything the government can do the private sector can do better;
- Government is ineffective because anything the government does, the private sector can and will undo;
- The incentive structures inherent in public institutions imply that government actions generally decrease societal welfare, or at the very least, inhibit productive economic activity by taking resources away from one group and giving them to another, often less deserving, group. (3)

All of these propositions are of limited use at best. The first and second are simply untrue. The third proposition, while problematic, cannot be advanced as anything like an infallible law. Markets are not always efficient; they are in essence reactive. In addition, markets are eminently capable of misallocating capital, as any student of either the East Asian property scene or the high-tech sector in the United States must readily acknowledge.

There are monuments to the mistakes of the 1990s that litter the Asian landscape from Mumbai eastward to Indonesia and the Philippines. Let me mention two in passing. One is the debacle known as Dabhol, the $3 billion power project entered upon by the Indian government, the state of Maharashtra, and a foreign consortium headed by Enron Corp., by which the now-infamous U.S. energy company was to build and operate a power plant intended to serve the industrial belt outside of Mumbai. Enough has been written about this project to obviate the need to great detail here. The price tag on this project is now generally put at $3 billion, and as is generally known, the cost and tariff structures at the Dabhol Power Company are vastly out of line with what the market will bear. Dabhol represents the largest foreign investment ever made in India, and we must also count it the largest failure.

Let us look now at the Philippines. The Philippines power sector was haphazardly liberalized in 1987, and by the early 1990s the country faced an acute shortage of power. As president at the time, Fidel V. Ramos got emergency powers to negotiate "fast track" contracts with independent power producers. There are now 48 contracts with IPPs, and they are instructive to behold.

Tax holidays, duty exemptions, "take-or-pay" provisions covering generated power, freely repatriated profits for foreign investors, government loan guarantees, exchange-rate protection—it's all there in the contracts. By the mid-1990s the power shortage was a surplus, and the Ramos government was signing contracts for projects on which it hadn't even solicited bids. Fixed fuel costs and guaranteed offtake turned the law of supply and demand on its head: The more power produced, the more expensive it got. So far, Manila's deals with IPPs have cost the government roughly 700 billion pesos ($14 billion)—not including the 35 billion pesos the National Power Corp., or Napocor, the former monopoly, pays annually for fuel to run the plants. Napocor now pays IPPs about 4 billion pesos a month in fixed energy charges—whether power is generated and consumed or not. That gets tacked onto the ordinary Filipino's electricity bill as a "purchased power adjustment." This usually adds 30 percent to 50 percent to the monthly charge. (4)

With such examples in view, it is not too simple to conclude that in many respects the 1990s simply did not work in Asia. In these cases we find off- the-shelf solutions applied without proper oversight, in which it was implicitly assumed that the efficiencies of the private sector would solve a major problem that the state had found insoluble.

The core lessons are these. First, the state as shareholder may not be the answer to Asia's challenges, but the state as bystander is not the answer, either. Something new must be devised. Second, ownership is not the core issue; in this respect, the stress on privatization is misguided. The core issues concern regulatory frameworks, oversight mechanisms, accountability, and process. By the last I mean the political and decision-making processes necessary to make sure policies reflect the interests of the population they are intended to serve.

We arrive now at the end of our chronology. Since the late-1990s, Asia has taken another turn, it seems to me. In effect, it has gone back again, at least partly, toward theories of private failure. No, the private sector and the market cannot be left to solve all of the region's economic problems. Yes, there is a role for the state, after all. If these are not high among the conclusions to be drawn from such calamities as Dabhol, then we have not learned our lessons at all. Each stage in the evolution of Asia's thinking outlined above has left its mark. Now I think we are witnessing the emergence of a synthesis that may well prove to be altogether new. At the risk of oversimplifying, Asia seems to have concluded that the age of the state as shareholder is by and large over. Gone, at least, is the era when direct state shareholdings in economic enterprises was the logical, preferred starting point to spur economic growth. What will replace this era, I suggest, might usefully be termed the age of the state as stakeholder.

Before explaining this shift in thinking, it is important to note the rites of passage that have produced it. One was the Asian crisis of the late-1990s. After the Thai baht collapsed in the summer of 1997 and financial crisis turned to economic crisis and swept through most of the region, there was plenty of advice available to Asians, notably from the International Monetary Fund. But most of what the West had to say was inappropriate to the circumstances. Malaysia, South Korea, and Thailand—the three nations to reject the fund's prescriptions most explicitly—ended up leading the region out of the post-1997 recession—even as they are now noted for their commitments to economic reform.

The point here is that Asians were effectively left to think for themselves, and this, it seems to me, marks the region's crisis as an important moment in its maturation. The second point of passage has been the corporate scandals and systemic shortcomings that have shown up in the American corporate and financial sectors over the past year or so. Some of these have touched Asians directly—again, Enron is the example here. But the point is a broader one: Once again, these events have had the effect of encouraging Asians to consider their problems and challenges in their own terms, no one else's. To put it another way, there is no model, as there was presumed to be in the 1990s, and indeed for many decades prior to that, and this, I think is a big step in the correct direction. There are only challenges, and solutions to be sought that answer specific needs and problems.

To me this suggests a fundamental change the significance of which would be difficult to overstate. It is a sign—one among many, I believe—of the waning influence of the West among Asians, an influence we Westerners have enjoyed for so long as to assume it is permanent. It isn't. Solutions to problems such as those considered in this paper will increasingly bear the stamp not of technocratic judgments but of local conditions, traditions, customs, and established practices. To outsiders it may look like a turning inward, but if it is so, it stems from a laudable impulse.

One small story illustrates the psychological change I am attempting to describe. In South Korea last year, I once asked one of President Kim Dae Jung's economic and financial advisers where he turned when he needed to consider his administration's policies. This was a man schooled in American universities, who had returned to South Korea in the 1980s with a doctorate to join the government. His answer was most curious. "When I began my work in government, I watched as the Anglo-American standard became the global standard," he told me. "But frankly, the U.S. economy does not provide us with answers anymore. I come from a small village far south of Seoul. When I want to think, when I want advice, I go home to talk with my old schoolmates, most of whom work in factories and on farms." It would be difficult to describe this change in thinking more succinctly.

Let us look at a few examples of post-crisis Asia and how nations once in crisis have conducted themselves. Then we will identify the common threads, and draw some conclusions.

By any reasonable measure, Korea has done an outstanding job coping with a crisis that hit it hard in the late-1990s, when it was still operating an economy based on the powerful exporting conglomerates known as *chaebol*. Many structural weaknesses have been excised from the economy, and the government's role considerably reduced. About half of the nation's thirty leading *chaebol*, once gorged on cheap credits from state-controlled banks, have been shut down. Korea is also well along with a bank reform policy that is intended to make banks independent while encouraging a shift in lending away from the *chaebol* and toward open markets and domestic borrowers. But it will retain a considerable presence in the banking sector even when its policy is completed. There are also many signs that the government is mindful of what it considers its social and welfare obligations during a period of basic economic transition. Seoul negotiated a tough deal with General Motors for the sale of the bankrupted Daewoo Motors, the auto producing subsidiary of the Daewoo *chaebol*, not least in response to the demands of South Korean labor unions.

Malaysia was considered one of the sinkholes of corruption and cronyism after the Asian crisis hit—especially after Prime Minister Mahathir bin Mohamad instituted capital controls to discourage the flow of short-term speculative capital amid the crisis. When the IMF advised Kuala Lumpur to raise interest rates, reduce government spending, and force over-borrowed companies into bankruptcy, the Mahathir administration did the opposite in all three policies: It reduced interest rates, went into deficit spending, and negotiated with companies and their lenders.

Malaysia now boasts one of the strongest regulatory regimes in Southeast Asia—a remarkable achievement. Not long ago, the asset-management company Malaysia formed to handle its bad loans announced that it had restructured or sold almost all of the 47.7 billion ringgit in non-performing loans that went on its books after it began operating in August 1998. Also this year, after completing corporate workouts worth 40 billion ringgit, the Corporate Debt Restructuring Committee, formed along with the asset-management company, closed its doors, its mission executed. For both government agencies, the approach was cautious—and came in for much criticism from abroad. “A systematic cleanup at the beginning and you'd have a massive degree of social dislocation,” Azman Yahya, the CDRC's chairman, told me lot long ago. “We understood that our approach was not the most efficient economically, but we were prepared to accept the inefficiency to preserve social stability.”

Thailand under Thaksin Shinawatra, who was elected prime minister not quite two years ago, has proven to be the most interesting experiment in post-crisis Asia. Thaksin, to put a complex set of ideas too simply, considers the East Asian export model—the EAEM, as it's coming to be called—not merely outdated but inappropriate. It is too dependent on low wages and ignores too many comparative advantages—traditional skills, the capacity to compete globally at the high end of such industries as textiles, jewelry and ceramics, a fertile environment for small and medium-sized industries, or SMEs. Prosperity under the EAEM, says Daniel Lian, Morgan Stanley's Southeast Asia economist, “was largely an illusion.” (5) At the very least it lacked the balance Thaksin is looking for. He proposes to do nothing less than turn the Thai economy upside down: from a two-thirds dependence upon exports to a one-third dependence, with domestic demand taking up the rest.

“With the crisis of 1997 we saw some problems,” Thaksin told me once in an interview. “We had been neglecting the domestic economy. We weren't creating new entrepreneurs, we were careless of the SMEs and, especially, community development and poverty eradication. Now we're doing something different. The economic crisis of 1997 forced us to evaluate the failures of the past.”

In India, the obstacles to growth—not least in the area of infrastructure—are especially dramatic. But after fifty years of Fabian socialism, the shift in attitude I describe here promises to be so, too. Economic reforms have been unfolding for more than a decade, but only gradually; at the moment, its privatization drive has been put on temporary hold because of political conflicts in New Delhi. But a fundamental change in ethos is clear. Between the federal government and the 28 states, there are almost one thousand two hundred and fifty public enterprises. The state is a miner and a maitre d', a marketer of farm products and an instructor in computer literacy. But now it is recognized that the government can't do everything: Even non-governmental advocacy organizations are coming to accept that to do the things it must do, it must get out of the things it can't do. This is prompting all manner of new thinking as to how the government can collaborate with the private sector while at the same time drawing together what is often described as a nation of 300 million "insiders" and 700 million "outsiders'—the poor majority of village dwellers.

The question in India, then, is not so much reducing the public sector as shifting its spending priorities. The resorts and restaurants and mines should go—they are relics of an era and a set of circumstances that no longer obtain. But much more needs to be spent, and spent more efficiently and transparently, on schools, hospitals, roads, and other infrastructure projects, the kind of things that will release the energies of ordinary Indians in the countryside—energies that everyone knows are the single most important key to India's future.

Two examples will suffice. Jean Dreze, a scholar at the Delhi School of Economics and a noted writer on India, often in collaboration with the Nobel economist Amartya Sen, tells the following story. A few years ago in Madhya Pradesh, a state in central India, the government announced that any group of forty or more families farther than a kilometer from a primary school could apply for one of its own. Sixteen thousand facilities opened within a year.

Another remarkable project, now under consideration in New Delhi, is called "rurbanization." This involves linking isolated villages into a larger entity and then linking the larger entity to the cities and industrial belts. "We can't be healthy in India if rural people don't have higher disposable incomes. So long as demand is concentrated in the cities it will not give rise to further growth." That's not a development activist talking, but the chairman of a manufacturer of motor scooters.

I've left out Japan, and for a special reason. The roots of the Japanese state's role as a shareholder reach back far deeper into the past than the era of independence—back to the Meiji era in the 1870s, when Japan began to modernize. One way to date the advent of the state as a shareholder is to note the institution of the postal savings system in 1875. Its balance that first year was fifteen thousand yen; at four hundred and forty trillion yen, it is now the world's single largest pool of savings, and the government is responsible for investing it. From this has grown a plethora of public-sector agencies and companies so complex and so poorly accounted for that few in the Tokyo bureaucracy itself understand it in its entirety. Among the core public entities are nine financial corporations, including seven public-sector banks, and 45 corporations that range from the successful and necessary to the failed and useless: highway corporations, a scholarship foundation, rural-development, small-business, and municipal enterprise corporations, a "green resources" company, a mining agency, airport authorities—the list goes on for pages. It is an unmapped continent. Neither are many Japanese officials able to total the debts accumulated by these companies. The soundest estimate, by a private-sector financial research corporation, is five hundred forty-five trillion yen—one hundred and twenty-nine trillion yen of which is likely to be irrecoverable. That is the equivalent of twenty-five percent of gross domestic product in bad public debt.

We are all frustrated with the pace of economic reform in Japan—and I include the Japanese themselves in this. But to a certain extent we have been looking in the wrong place for reform. In the mid-1990s, Tokyo instituted a public-sector reform plan that is intended to extend until at least 2010. In essence, government funding is to be replaced by massive bond offerings and the privatization of those companies that are judged commercially viable. Useless entities will be jettisoned, and agencies providing public goods without the prospect of profitability will continue to receive public subsidies. The plan has many problems—it is complex, it has encountered considerable bureaucratic resistance, it could raise government debt levels to more than two hundred percent of GDP—Japan's public debt is already some one hundred and forty percent of GDP, an extraordinarily high figure—and it is not yet clear how well the markets will accept it once they understand it. But the plan is in place, and it is a germane example of the kind of change taking place on a smaller scale throughout Asia. (6)

It is not especially easy to discern a pattern in all of what we see unfolding before us in Asia. The shape of things to come is not at this point readily evident. But we can perhaps detect a few common threads in the weave to emerge in coming years. The role of the state is likely to manifest itself differently everywhere in Asia, but it will reflect both accumulated experience and new ideas—ideas from which I am confident the rest of us have much to learn. As I have already suggested, this new role for the state in Asia may best be understood as that of stakeholder. The term may not prove perfectly appropriate over time, but it serves now to indicate something of the transformation I wish to point out.

The state as shareholder was always a complex phenomenon. It owned companies to do business, of course—to smelt aluminum, build cars, or supply power—but it did so in the wider interests of society. It was also always in a position of some moral hazard: It was a regulator and enforcer as well as a participant. I don't anticipate the state disappearing as a shareholder in many Asian countries—certainly not in India, to take one example. India today is alive with new ideas as to what the state should own, what it can privatize, and what it can commercialize—that is, economic enterprises that are leased out or contracted but not sold. One finds more imaginative dialogue and new, "out of the box" cogitating of this kind in India these days than one finds in the United States, where the weight of market ideology remains heavy and inhibiting. But India is by any account destined to remain a mixed economy for the foreseeable future, and to one extent or another, in one form or another, so will economies elsewhere in the region. In this regard I believe the social-market systems of Continental Europe are a better guide to where Asia is headed than the American system, which has long been presumed to be the model toward which Asia has been working.

That is one characteristic of the state as stakeholder: It will remain involved in areas where it can get the job done better than the private sector might. So as s stakeholder the state will also face some of the familiar complexities. Its regulatory function must be greatly strengthened throughout the region. As a regulator it must be disinterested; but as an actor, it will retain some of the interest in guiding the economy it has by tradition exhibited in the Asian context. As a stakeholder, it may own less but it may engender as much or more.

Let me conclude by discussing briefly the matter of ends and means. In the former category, states as stakeholders must recognize the essential role they have to play in identifying, producing, and providing public goods—domestic public goods and (an increasing theme in international circles) public goods on a global scale. They must assure that the benefits of the globalizing process are more evenly spread—a shift of such magnitude that I consider it cause to think in terms of Globalization I, a project that concerned almost exclusively the international private sector, and Globalization II, a new phase in which the globalism's publicness—key term—is recognized and developed.

As to means, there are of course many. States must develop and work from a holistic vision of society, not merely a technocratic vision. They must recognize and operate on the assumption that solutions to problems will of necessity be political, because the implications of their decisions are both political and social. States must also cultivate a greater sense of interdependence among themselves and a much greater and more meaningful dialogue between the public and private sectors, both internationally and domestically. This means participating in new political and decision-making processes at the national, regional, and global levels. It means developing and strengthening political processes at home. It means working better with numerous actors in decision-making processes—local and international private enterprises, citizens groups, regional and international organizations, and so on. It means developing innovative ways to finance both growth and public goods—and adjusting national budgets accordingly. Most of all, it means that states must take their redefined functions seriously, executing them transparently and understanding their responsibilities to their electorates and the larger community of nations. (7)

"If policies are to be sustainable," Joseph Stiglitz said in another of his speeches a few years ago, "developing countries must claim ownership of them." Stiglitz advanced this thought by way of describing his search for what he called the "post-Washington consensus consensus"—a phrase I have always admired. These are my thoughts as to how Asian states are advancing toward such a consensus. (8)

ENDITEM.

FOOTNOTES.

1. Presidential address to the Indian National Congress, 1936, in *Thoughts*, by Jawaharalal Nehru, New Delhi, Nehru Memorial Fund, 1985, pages 120 and 134.

2. *India: From Emerging to Surging*, by Amadeo M. Di Lodovico, William W. Lewis, Vincent Palmade, and Shirish Sankhe, McKinsey & Co., 2001.

3. "Redefining the Role of the State," by Joseph Stiglitz, in *The Rebel Within: Joseph Stiglitz and the World Bank, Selected Speeches*, London: Anthem Press, 2001, pages 96-97.

4. See "Trail of Power Mess Leads to Ramos," by Luz Rimban and Sheila Samonte-Pescayo, Manila: Philippine Center for Investigative Journalism, 5-8 August 2002,

5. "Understanding Mr. Thaksin's New Development Model," by Daniel Lian, Morgan Stanley Dean Witter Asia/Pacific Equity Research, August 1, 2001.

6. See *Public Sector Reform in Japan: A Position Paper*, By Stephen Church, Analytica Japan, April 2002.

7. For an extended discussion of these themes, see *Global Public Goods: International Cooperation in the 21st Century*, and *Providing Global Public Goods: Managing Globalization*, both edited by Inga Kaul, et. al. The former volume was published for the U.N. Development Program by Oxford University Press in 1999; the latter is forthcoming from the same publisher.

8. "More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus," in *The Rebel Within*, page 49.

ENDALL REGARDS SMITH NORFOLK.