Comments

Luis F. López-Calva: The paper by Chong and López-de-Silanes is extremely valuable for understanding economic reform and its effects in Latin America. Although establishing a true record is an ambitious task, the paper does review a series of robust results from careful research carried out by several authors using Latin American data. Specifically, the authors review exercises carried out for seven Latin American countries following a methodology first used by La Porta and López-de-Silanes with Mexican data.[1] They describe the main data limitations in each case and then establish some empirical regularities, which can be summarized as follows:

—As a general result, profitability and operating efficiency improved, while both output and investment grew in privatized firms in most countries;

—Employment trends after privatization are mixed, though the average tends to go in the direction of a reduction in employment;

—High bureaucratic quality and absence of corruption increase privatization prices;

—Evidence for Mexico shows that restructuring is not worth pursuing, for it has a negligible net effect on final privatization prices, whereas it pays to sell via a fast process;

—The net effect for the government is positive, mainly because money-losing firms are sold and turned into profitable enterprises that pay taxes, although a number of bailouts have had a high fiscal effect;

—Profitability gains do not come from reduction in wages, but from an increase in efficiency;

—Profitability is higher in less competitive sectors, but the evidence does not support the hypothesis of market power exploitation;

—Welfare gains are progressive, and quality improvements are also important, as in the case of water privatization in Argentina; and

1. La Porta and López-de-Silanes (1999).

—Corporate governance and regulatory laws are key complementary policies in the process.

The positive net effect of privatization described in the paper strongly disqualifies the general disapproval found in public opinion polls and mass media. The disparity between the position of the paper and common belief has two possible explanations: either economists have failed at communicating the positive effects of these reforms, or the reforms have effects that go beyond what is shown in the paper, in which case more research is needed to understand the political economy of privatization. I tend to support both explanations, with a strong emphasis on the second. The microeconomics of privatization are relatively well established, and the evidence is now strong in this respect, partly as a result of the research carried out by López-de-Silanes and other economists.[2] That, however, is only one piece among many others for fully understanding the political economy of the process. I now discuss some of the issues that need attention.

Do Higher Proceeds Indicate a Better Process?

Evaluating the scope of a privatization process based on the amount of money received by the government is a common mistake. This mistake can be seen in the paper in the description of the process and the strong emphasis on privatization prices. In principle, if proceeds were the variable to be maximized, an optimal policy would be to sell firms under a noncompetitive environment. This is, of course, contrary to the real objective: achievement of microeconomic efficiency. Perhaps the bias comes from the fact that privatization has also played an important role in terms of strengthening public finances by bringing resources to the treasury. However, this is only a side effect—albeit an important one—and never the main purpose.

The focus on prices is linked with the discussion on restructuring. Labor restructuring is often a necessary condition for the process to be feasible, even if it does not have a net effect on prices. Labor liabilities are an important deterrent for participation of bidders for financial and political reasons. Nobody would suggest that other kinds of restructuring, like new investments, should be made before the sale.

2. See Sheshinski and López-Calva (2003).

Looking for a True Record

An understanding of public opinion and reactions against privatization must take into account not only net gains and losses, but also the nature and distribution of the losses for different groups. The social concern about and opposition to privatization come from a variety of sources, such as the incapacity of politicians and the media to communicate the outcomes; the strengthening of groups that lose in the process and have a good political organization; a general feeling that the process is not transparent and quite corrupt; and real welfare losses of groups that have the means to act politically in the public sphere.

The paper in question does a great job of showing the strong evidence in favor of privatization from the point of view of shareholders, investors, and workers who managed to keep their jobs in the privatized companies, typically those with higher skills.[3] However, if one is to understand the political economy of the opposition to privatization, it is impossible not to think of the relevance of the distribution of gains and losses and map those onto the structure of political voice and power. Privatization has frequently been pro-poor.[4] Even that piece of evidence, however, is consistent with the observed resistance to new reforms given that the gains have generally been appropriated by the tails of the distribution of income—and disproportionately so by its upper end.

If the effects of privatization are divided into several dimensions—namely, fiscal effects, employment effects, ownership effects, and consumption effects—the literature tends to favor the fact that the employment and ownership effects could be regressive. The effect in terms of distribution can be positive only if the consumption and fiscal effects more than offset the other two. The fiscal effect is difficult to isolate given that there is a series of reforms taking place at the same time.

Can Privatization Be Blamed?

Important groups, mainly middle class workers, have lost their sense of job security and feel betrayed by their government. Although people who left public enterprises after privatization managed to maintain their

3. Andalón and López-Calva (2003).
4. McKenzie and Mookherjee (2003).

income levels, on average, the number of hours worked per week increased and they had to give up certain safety nets.[5] People associate events and act accordingly, so it is difficult to explain public perception based on objective data. In the case of Mexico, bailouts of banks and toll roads represented more than 20 percent of GDP; this offsets, in terms of public opinion, all the evidence of success in hundreds of small sales.

It is not a coincidence that a good share of the nontradables sector in Mexico (as in other countries) is intact after a long period of reforms. Sectors like energy, labor markets, education, and telecommunications are still unreformed. Inefficiencies, market power, and rigidities are pervasive in these areas, and they prevent the showing of efficiency gains for the economy as a whole. The growth promised by the original reformers has not materialized.

Privatization took place in those sectors where the political balance had already been solved, and reform is not politically viable in the cases that are left. Lerner said in the 1970s that all market transactions are politically resolved issues. "Economics has gained the title of Queen of Social Sciences," he continues, "by choosing solved political problems as its domain."[6] There is, indeed, a meta-selection bias: all the observed variance is conditional on a previously resolved distribution of gains and losses. Perhaps policymakers should ask themselves what scope for reforms is truly feasible and whether such partial reform is enough to deliver growth and employment.

Final Comment

Privatization has delivered. Efficiency gains are robust, productivity has increased, and shareholders, investors, and workers who stayed with the companies have generally benefited. Poor groups have also experienced welfare gains through increased access to public services.[7] Other groups have suffered losses, however, and they tend to have ways to organize and oppose the new reforms. Moreover, the political balance makes reform unfeasible in some sectors, and the opposition has unintended allies among policymakers who design contracts poorly, are weak to regulate market power, or collude and profit from the reforms.

5. López-Calva and Rosellón (2003).
6. Lerner (1972).
7. Galiani, Gertler, and Shargrodsky (2002).

Welfare gains seem to be generally progressive, but those who lose are typically in the urban middle and lower-middle classes, which have an important capacity to organize and influence the political process. Their losses stem, sometimes, from higher prices (which were previously subsidized), lower job stability, lower social protection (those who leave the privatized firms often join the informal sector or become self-employed), and worse working conditions. It is time that those who stay receive a wage increase, though evidence shows a growing skilled-nonskilled wage gap and longer working shifts.[8] A number of reforms that have been aborted could have helped buffer the labor effect of restructuring, such as a labor reform that creates a more dynamic labor market.

Capitalism cannot function well without a strong state. Privatization seems to have strengthened the state in many cases by contributing to a healthier fiscal situation and a more focused mission. A market economy with a weak or captured state is the opposite of what the reforms pretend to achieve.

The paper by Chong and López-de-Silanes is a very good recount of the effects of privatization in specific dimensions. The profession will have to wait longer, however, to see what the "true" record of the process has been in the political and public policy spheres, and perhaps—one must accept it—it will never know for sure.

Eduardo Bitrán: This article aims to rebut the increasing wave of attacks from various sources on the privatization process that has been carried out since the 1980s in several countries of the region. Specifically, the authors tackle certain alleged concerns about the results of individual privatizations and indeed about the process itself. These concerns are leading to a heightened questioning of this reform that reduces the role of the state in the economy.

First, the authors show that there is no selection bias in the results from the available literature with regard to the increased profitability of privatized firms. Second, they show that the increases in profitability arise principally from increases in factor productivity and only to a lesser extent from price increases in the products and services of the privatized companies. Third, they put forward a strong case against restructuring companies before privatization, since these processes actually retard the

8. López-Calva and Rosellón (2003).

profit generation period and do not lead to a greater sales price. Finally, the paper looks at the need for complementary microeconomic reforms that foster competition and improve corporate governance in order to reduce the risk of negative welfare effects from privatization.

The first question that should be posed here is whether the criticisms addressed by the authors are really the most relevant ones, given the concerns of policymakers on the subject. To ensure a productive debate, it is necessary to distinguish between industries in tradables sectors subject to international competition and industries in nontradables sectors characterized by various industrial organization imperfections. In the former, the performance of private companies—from an efficiency perspective—will exceed that of public ones to the extent that there is a policy of trade liberalization. Competition plus the discipline set by shareholders and creditors will contribute as much as the independence from political pressures. The eventual reduction of the labor force in privatized companies, which the authors consider to be a criticism that should be addressed, is actually one of the objectives of privatization, since it is one of the main factors increasing productivity within a company and permitting the reallocation of resources to other sectors. Consequently, privatization in tradables sectors does not represent a significant dilemma from a technical point of view in open economies.

A relevant point for privatization in any sector is whether sales should be carried out with the broadest possible distribution of ownership or whether a significant stake should be sold to a strategic controlling investor. Empirical evidence indicates that agency problems are best resolved when a strategic investor takes control and that the purported benefits in terms of improved corporate governance arising from broad shareholder bases are not real. In Chile, the most noteworthy examples of minority shareholder rights expropriation occurred in the case of companies privatized with popular and labor capitalism schemes featuring a broad diffusion of ownership.

The most interesting policy dilemmas have surfaced with regard to companies that operate in sectors with significant market imperfections, be they due to monopolistic structures in nontradables sectors, public goods, asymmetries of information, or externalities. In most of these cases, privatization remains a good policy option. The privatizations need to be well designed, however, and should be part of a greater microeconomic reform effort undertaken before or in conjunction with the privatization process.

The case of public utilities is a good example involving considerable sunk costs, economies of scale, and network externalities that generate market failures. This category includes basic services such as electricity, transport, telecommunications, drinking water, and sewerage. In all of these cases, the same failures that lead to a poor performance by state-owned enterprises lead to poor regulation of privatized public utility services. Therefore, if the privatization policy option is chosen, social welfare will not necessarily be improved if regulatory and competition issues are not properly addressed. The evidence shows the serious difficulties of efficiently regulating private monopolies. The main problems arise from the monopoly of information, which obliges the regulator to allow the firm to earn rents in order to provide incentives for the provision of the service. Political and company capture of the regulator can yield rent seeking by the new owners, creating a regulatory risk. Those prone to rent seeking are attracted to these regulated sectors.

Market structure also has implications for social welfare. Monopoly power is influenced by the extension of the horizontal and vertical integration of the regulated company. The lack of ex ante restructuring strengthens monopoly power ex post. The higher the monopoly profits expected, the higher is the value of the privatized asset. Consequently, the authors' conclusion that the price of the asset will be higher if restructuring is not implemented ex ante is to be expected simply because the lack of restructuring increases the firm's market power ex post and thus raises the monopoly profits.

The best policy is promoting competition. The process of privatizing public utilities should be structured with this fundamental objective in mind. Competition can be promoted in the form of face-to-face competition, as when the privatization of electricity generation requires prior vertical and horizontal disintegration or when water rights are broken up to avoid handing over a monopoly. Another form of competition is yardstick competition to prevent the consolidation of information monopolies; here, extensive horizontal disintegration and limits on mergers and acquisitions are necessary to avoid the elimination of yardstick competition. Such measures should be carried out prior to privatization, since they are difficult to apply once property rights have been established.

A third possibility is to require firms to compete for the right to provide a service for a set period of time. In this situation, horizontal disintegration and limits on the concentration of concessions stimulate competition. The design of the bidding mechanisms is fundamental for avoiding abuses of dominant positions and renegotiations that affect consumers and undermine the integrity of the system.

Technological factors sometimes make a monopoly inevitable in sectors like telecommunications and electricity. Unbundling networks and providing adequate regulation of the access tolls are fundamental for promoting competition in the rest of the system. This is a complex and conflictive issue that can create barriers to entry if preprivatization regulation is ambiguous.

The structuring of clear and transparent regulatory frameworks prior to privatization—with independent regulators, checks and balances in the system, and independent antitrust authorities—promotes efficiency and avoids the negative selection of rent-seeking businessmen. In Chile, the greatest welfare gains from privatized companies occurred when competition took place in the sector. Firms that remained monopolies achieved significant productivity increases (albeit not different from other sectors), but customers obtained only marginal benefits. In contrast, sectors in which competition was produced experienced large price reductions and enormous consumer welfare benefits. Sectors with significant externalities, such as public transport, had to be reregulated and tender quotas had to be established in congested routes before any benefits from the privatization of the service materialized. The political power of owners was so great, however, that it took over ten years after the privatization process to introduce adequate regulations to internalize the externalities and reduce the market power of the cartel.

Capital market reforms, aimed at developing adequate corporate governance, are another essential element. These reforms must provide efficient mechanisms of funding for companies that traditionally obtained their funding with state guarantees.

At the beginning of the twentieth century, most public utilities were private, but regulatory failures led to a deterioration of the services. The subsequent political discontent led the state to take over these services. History must not be allowed to repeat itself. The emphasis in public utilities should be on the regulatory and competition issues that determine the possibility of providing adequate conditions for the development of investment, with a balance between profitability and improving consumer welfare.

The article by Chong and López-de-Silanes is excessively optimistic regarding what the privatization process can offer in terms of efficiency improvements and equity in the economy in sectors with prevailing market imperfections. A more balanced view considers privatization as only one instrument in the array of reforms designed to increase competition in an economy.

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