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ON FOREIGN PARTICIPATION AND HIRING PATTERNS AFTER PRIVATIZATION

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Abstract¹

Critics of globalization claim that foreign ownership of privatized firms is linked to negative post-privatization labor outcomes, such as more firing and less hiring. This paper uses new firm-level data for a cross section of countries to test this idea and provides evidence that foreign purchasers of state-owned enterprises tend to acquire firms that were already better restructured before privatization. Additionally, this paper does not find evidence that foreign participation in privatized firms is linked to negative labor outcomes.

JEL Classification: O1

Key Words: Privatization, Foreign Investment, Ownership, Employment, Restructuring

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1. Introduction

Despite the fact that economic theory predicts that foreign investment is clearly beneficial for countries, foreign participation in privatizations around the world tends to be controversial and quite unpopular in the public domain. Anti-globalization proponents claim that foreign participation is, perhaps, responsible for both employment losses and a subsequent lack of hiring by firms in emerging markets. Furthermore, privatization is often used as a classic example of what is wrong with globalization (Kuczynski and Williamson, 2003; Feffer, 2005).

This belief is particularly persistent in developing countries and has its roots in the old center-periphery view of developed and developing countries. In this view, the developing periphery countries act as satellites of the developed center countries by providing raw materials for processing and manufacturing without being able to develop their own domestic industries. They thus end up being exploited and tied to industrial countries either directly or indirectly (Prebisch, 1980; Myrdal, 1989). A somewhat related—although less-structured—view has emerged, propounded mainly by the so-called anti-globalization groups. This view, which is based on political economy considerations, claims that prospective foreign and domestic buyers do not compete on a level playing field since the former frequently receive substantial implicit or explicit political support from foreign governments with the aim of influencing and skewing domestic government policies towards their interests, either as a result of outright corruption, or simply because of the political economy implications in a developing country of having to deal with an industrial country (Henwood, 1996; Feffer, 2005). The interaction between developing and developed countries is likened to a potential David and Goliath predicament, a situation in which smaller, less powerful countries find it particularly difficult to deal with bigger countries and tend to acquiesce to the pressures of countries on which they depend economically.

Very broadly speaking, there are two variants to this argument, one at the firm level and the other at the country level. The argument at the firm level maintains that because foreign firms tend to be economically more powerful than domestic firms, they may be able to pick and choose from among the available state-owned enterprises for sale. Furthermore, several anti-globalization critics argue that smaller domestic firms may not want to upset any future working relationship with bigger international firms since both are typically in the same economic sector, a fact that places the domestic firm at disadvantage in the potential bidding. The second argument has to do with the political pressure exerted by foreign government lobbies (Henwood,

1996; Feffer, 2005). This is not uncommon in the case of firms from industrial countries that invest in emerging market economies. Foreign legislators, foreign ministers and even foreign heads or ex-heads of state may exert pressure on domestic governments in order to receive information on or support actions by particular firms. Prospective foreign buyers may end up obtaining inside information or may simply benefit from outright corruption, with the result that they bid on the firms in best economic shape, with the highest potential or with more favorable labor conditions (Feffer, 2005).

There is little empirical evidence on the link between foreign ownership of privatized firms and post-privatization labor outcomes,² despite the fact that it has been a recurring theme in both international economics and development economics, albeit mainly at a macroeconomic level. This paper takes advantage of recently collected data by Chong and López-de-Silanes (2003), which helps provide empirical evidence to assess whether some of the key arguments made by anti-globalization critics have any bearing with the facts. In particular, it explores the post-privatization hiring patterns of privatized firms as well as the somewhat more limited measures of post-privatization firing and wages. This paper is organized as follows. Section 2 describes the data used. The third section describes the findings of the paper. The last section summarizes and concludes.

2. Data

Our sample is based on data first collected by Chong and López-de-Silanes (2003). These data were collected from a list compiled by the authors of about 1500 privatizations around the world occurring between 1982 and 2000. The two main sources for this list are the World Bank Privatization database and Privatisation International, which together provide arguably the largest source of privatization transactions in the world. From this original list, Chong and López-de-Silanes (2003) selected a random sample of 400 firms to whom they sent a detailed questionnaire. Of the 400 cases targeted, the authors were able to obtain data for 308

² Haltiwanger and Singh (1999) analyze the relationships between the factors leading to retrenchment and the scope and nature of the retrenchment. Although their quantitative information is limited, they focus on the factors leading a significant fraction of programs to rehire workers separated from the public sector, thereby defeating the objectives of the program. Chong and Lopez-de-Silanes (2003) test the wisdom of retrenchment programs and their effect on re-hiring policies by private owners after privatization. They show that adverse selection plagues retrenchment programs carried out by governments before privatization since various types of downsizing policies lead to a higher frequency of re-hiring of the same workers by the new private owners.

privatizations from 84 countries, accounting for 97.21 percent of total privatization sales during the relevant period.³

The questionnaire was addressed to each firm's CEO with a recommendation to direct it to the firm's chief financial officer and the director of human resources. In order to ensure the quality of the data, the authors employed four additional sources. First, they took advantage of the fact that in several developing countries, many privatizations were performed as part of structural adjustments or other lending programs supported by the World Bank. They were able to access a wide range of the World Bank's internal documents to verify and in some instances, complement the information collected in the survey. In particular, they made extensive use of the World Bank's electronic Intranet system called *ImageBank*, which allows full access to such documents. Second, they also made broad use of *NEXIS* to examine a number of national and international publications. Third, whenever possible, the authors interviewed officials from international organizations who were directly associated with the privatization programs in different countries. Finally, when necessary, they contacted the privatization offices or corresponding ministries of each country to request specific pre-privatization information that was missing.

Table 1 provides the definitions and sources of all the variables used in this paper. Whereas Chong and López-de-Silanes' data include pre-privatization firm characteristics such as sales, the presence of unions and the privatization price, we focus on post-privatization outcomes such as foreign ownership and related labor outcomes, firm rehiring and new hiring and basic characteristics of such post-privatization employment. In this case, the available observations vary depending on the specific variable considered. For instance, while the total number of observations for rehires after privatization is 225, there are only 61 observations as to whether such rehires are white collar or not. Although some variables may be interpreted in a more tentative manner than others because of this issue, the consistency of our findings is quite

³ The countries included are Benin, Cape Verde, Côte d'Ivoire, Egypt, Gabon, Ghana, Kenya, Lesotho, Senegal, South Africa, Tanzania, Uganda, Zambia, Madagascar, Argentina, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Dominican Republic, El Salvador, United States, Grenada, Guatemala, Guyana, Jamaica, Panama, Mexico, Saint Vincent, Peru, Puerto Rico, St. Kitts and Nevis, Trinidad and Tobago, Venezuela, Barbados, Bahrain, China India, Indonesia, Israel, Japan, Jordan, Korea, Kuwait, Lao, Malaysia, Pakistan, Philippines, Qatar, Singapore, Sri Lanka, Taiwan, Thailand, Yemen, Albania, Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Finland, Estonia, France, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Russia, Serbia, Slovakia, Spain, Sweden, Switzerland, Turkey, United Kingdom, Australia, and New Zealand.

remarkable and provides some assurances on the very little evidence found in the literature (Haltiwanger and Singh, 1999). Table 2 provides summary statistics.

3. Findings

Table 3 provides a test of means between foreign participation/no foreign participation and post-privatization labor outcomes. We divide the sample of firms into two groups according to whether the variable of interest equals 1, in which case it is a dummy variable. Similarly, when the variable of interest is a continuous variable, we divide the sample in two groups depending on whether the mean of the variable of interest is above or below the sample average. We do find statistically significant differences in some post-privatization labor outcomes that appear to be linked to foreign participation in privatized firms. In particular, we find that in firms where foreign ownership was allowed, the proportion of workers that were rehired after privatization was lower than in those privatized firms where foreign ownership was not allowed. We obtain analogous findings in the case of temporary rehires and permanent rehires as well as weakly statistical significance in the case of white-collar rehires. These results are consistent with the view that foreign prospective buyers have an informational advantage or, as described above, may be able to exert compromises from domestic governments. Still, as revealing as these results may be, they are at most suggestive of a relevant link between foreign participation and labor outcomes. Since there are no additional controls included in these tests, they can hardly be construed as definitive evidence.

Table 4 presents the results of the basic heteroscedasticity-corrected probit regressions in which the dependent variables are post-privatization labor outcomes. We find that foreign participation in the privatization of state-owned enterprises is linked to a lower probability of rehiring previously fired workers. This is shown in the first column in Table 4. When the privatization process allows the participation of foreign firms, the probability of the firms rehiring previously fired workers decreases drastically; the coefficient of this variable is 0.46 and is statistically significant at 5 percent. This result is quite revealing since rehires are an indication of the quality of the retrenchment process before privatization and the results suggest adverse selection in the labor restructuring process of the firm. However, there is no economically sensible reason why a worker who was fired, possibly as part of the restructuring process before

privatization, should be rehired after privatization unless he/she was really needed for the adequate functioning of the firm (Haltiwanger and Singh, 1999; Chong and López-de-Silanes, 2003).⁴ This finding appears to suggest that foreign firms benefited from high-level political pressure, or corrupt officials allowed them to purchase the most efficient state-owned enterprises, or they had better information on the quality of the restructuring of the state-owned enterprises than did the domestic firms before privatization, or simply that foreign firms were more diligent when scouting purchase possibilities.

As Column 1 also shows, foreign participation from firms in industrial countries is not linked to a different probability of rehiring workers. This somewhat weakens the claims related to political pressure and, to some extent, corruption. In this context, the revised center-periphery hypothesis put forward by anti-globalization proponents does not appear to be supported by the evidence.⁵ Similarly, since all prospective purchasers are provided with the same information, which is typically put together by reputed investment banks and advisors, it appears unlikely that foreign firms may have received undue informational advantages in the bidding process. If anything, one may claim that it is more reasonable to expect that domestic firms, not foreign ones, would have easier access to inside information. It may simply be the case that, on average, and given their expertise and prior experience, foreign firms may be better able to more accurately assess the potential performance and profitability of a state-owned enterprise for sale. Table 4 shows that whereas there is also a significant link between foreign participation and other categories of rehires, such as white collar and permanent rehires, there is no statistical link between foreign participation and the wages of rehired workers, as shown in Column 2. This gives further credence to the idea that foreign firms somehow manage to purchase state-owned enterprises that were better restructured before privatization. Furthermore, according to the evidence presented in Table 4, allowing foreign ownership of privatized firms does not increase the probability that new workers will be hired after privatization, since the corresponding coefficients of the probit regressions are statistically insignificant regardless of the type of new hiring considered, whether permanent new hires or white collar new hires. These results are shown in Columns 5 to 7. Finally, foreign participation does have a statistical bearing on the probability of temporary rehires, but has no link with post-privatization firing, as shown in

⁴ Please see Table 1 for the precise definition of rehires.

⁵ Also, when including an interactive variable between corruption and foreign ownership, we obtain negative coefficients that are, however, statistically insignificant.

Columns 8 and 9. In fact, contrary to conventional wisdom, we find a negative link with temporary hires. These results are not consistent with the anti-globalization argument that foreign firms tend to “exploit” workers.

Table 5 repeats the same exercise as above, but instead of using a foreign participation measure, it uses a variable that captures foreign control.⁶ The results are similar to those in Table 4 in that rehires are negatively linked with foreign control, wages yield no statistical link, different categories for new hires yield no statistical link, temporary hires yield a positive and statistical significant link and interactive dummies between industrial countries and control yield no statistical significance with respect to foreign control. The only difference is that the sub-categories of rehires (white collar and permanent) are not statistically significant in this case, although this may be due to lack of power in the regressions, as explained in footnote 6.

A potential problem with these empirical results is that they do not take into account potential endogeneity issues. While the dependent variable always captures post-privatization labor outcomes, it may be the case that foreign firms have specific expectations about state-owned enterprise restructuring before privatization, which may have been fed by the fact that not all firm restructuring in one country is done at the same moment. Governments try to restructure state-owned enterprises before the sale in order to raise the privatization price, but the negative sign may simply reflect the fact that the firms in the worst shape are in need of restructuring. For instance, if the unobservable characteristics of a firm are positively correlated with the presence of strong unions, the government may be particularly interested in dismantling such unions. Following López-de-Silanes (1997), we apply a two-step instrumental variables approach and estimate a non-linear reduced-form equation that describes the probability that firm restructuring will be implemented.⁷ As required by this procedure, none of these variables is statistically

⁶ While legislation as to what percentage of ownership leads to firm control varies among countries, we impose a high threshold by assuming that such control is reached at 50.1 percent of ownership, which in all cases is the highest minimum level that allows control. By doing this, we lose about 20 percent of observations and thus, degrees of freedom, in the following categories: white collar and permanent rehires and white collar and permanent new hires. We also repeat the exercise in Tables 4 and 5, but we use percentage of foreign ownership. The findings are identical to those presented in Table 5 but are not reported.

⁷ The instruments used are firm-level and macroeconomic-level determinants. Among the first, we use (i) a dummy variable to reflect whether a leading agent bank organized privatization, (ii) the involvement of the Ministry of Finance or Economy before privatization and (iii) whether the country was undertaking a structural reform during the privatization of the firm. The macroeconomic variables are: (iv) the average fiscal deficit in the three years prior to privatization, (v) the legal origin of the country and (vi) the average degree of openness in the three years prior to privatization. (i), (ii), and (iii) are from Chong and López-de-Silanes (2003); (iv), (v) and (vi) are from the World Bank (2004).

significant when included in the price equation. Also the F -statistic for the excluded instruments is statistically significant at 1 percent in all cases. Regardless of the use of a broad combination of possible instruments, the findings do not change the original probit estimates in Table 4 or Table 5. That is, rehires and temporary hires remain statistically significant at 5 percent or better.⁸

4. Conclusions

Whereas many empirical studies show that firms shed labor before and during privatization as part of radical restructuring processes, little is known about what happens with labor after privatization. According to anti-globalization critics, labor outcomes will be negative when foreign firms are allowed participation in the privatized firms. We use cross-country new data to show that post-privatization labor outcomes are essentially the same regardless of whether purely domestic or foreign firms own the companies. Whereas the evidence presented here points to the fact that foreign purchasers of state-owned enterprises manage to acquire firms that were better restructured before privatization, it cannot be said that their participation is linked to negative labor outcomes.

⁸ Given space restrictions, these findings are not reported but they are available upon request.

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Table 1. Description of Variables

Variable	Description
Sales	This variable represents the net real value of the three-year average of firm sales before privatization, denominated in U.S dollars, as of December 2000.
Economic Sector	Set of dummy variables for the corresponding sectors: metallic minerals, nonmetallic minerals, beverages, textiles, clothing and leather, wood, hotels and restaurants, transportation; communications and recreation. The variable equals to 1 if state-owned enterprise belongs to the sector and equals 0 otherwise.
Net total liabilities	This variable equals 1 if total short plus long term debt is greater than net total assets (debt overhang) up to three years prior to privatization. It equals 0 otherwise.
Foreign participation	This variable equals 1 if bidding of foreign firms was allowed in the privatization of the state-owned enterprise. It equals 0 otherwise.
Foreign control	This variable equals 1 if foreign ownership is high enough to allow control of the privatized firm. It equals 0 otherwise.
Share sold	This variable reflects the percentage of the shares sold of the state-owned enterprise in the privatization.
Unions	This variable equals 1 if the state-owned enterprise had a union up to three years prior to privatization. It equals 0 otherwise.
Strikes	This variable equals 1 if the firm faced any protest, picketing, or strikes up to three years prior to privatization. It equals 0 otherwise.
Rehires	This variable equals 1 if the privatized firm rehired previously fired workers up to 18 months after privatization net of any post-privatization fires. It equals 0 otherwise. "Workers previously fired" include those fired up to three years prior to privatization.
White collar rehires	This variable equals 1 if the rehired worker is white collar. It equals 0 otherwise.
Permanent rehires	This variable equals 1 if rehired worker has been hired using a permanent contract. It equals 0 otherwise.
New hires	This variable equals 1 if the privatized firm hired new workers up to 18 months after privatization, net of any post-privatization fires. It equals 0 otherwise. This variable does not include rehires, but only post-privatization workers who did not work with the firm prior to privatization.
Permanent new hires	This variable equals 1 if the new worker was hired through a permanent contract. It equals 0 otherwise.
White collar new hires	This variable equals 1 if the new worker is white collar. It equals 0 otherwise.
Temporary rehires	This variable equals 1 if the rehired worker is white collar. It equals 0 otherwise. This variable equals 1 if the wages of the rehired worker are higher than the worker's wages were when fired. It equals 0 otherwise.
Wage rehires	This variable equals 01 if the firm fired workers up to 12 months after privatization. It equals 0 otherwise.
Fires	
Gross domestic product	Logarithm of the average gross domestic product for the three years prior to privatization of the country from which the state-owned enterprise belongs. Atlas method, expressed in current U.S. dollars (World Bank, 2001).
Economic Growth	Average rate of growth for the three years prior privatization of the country from which the state-owned enterprise belongs. Source: World Bank (2001).
Continental Dummies	Set of five dummy identifying variables, which each equal 1 if a particular country corresponds to (i) Latin America, (ii) Asia, (iii) Africa and the Middle East, (iv) Developed Countries, (v) and Transition Economies. It equals 0 otherwise.

Table 2. Summary Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Sales	308	1.415	3.167	0.001	21.991
Mining	308	0.143	0.350	0.000	1.000
Manufacturing	308	0.231	0.422	0.000	1.000
Services	308	0.558	0.497	0.000	1.000
Foreign participation	308	0.682	0.467	0.000	1.000
Share sold	308	0.509	0.282	0.010	1.000
Unions	308	0.844	0.363	0.000	1.000
Strikes	308	0.474	0.500	0.000	1.000
Rehires	225	0.444	0.498	0.000	1.000
Wages rehires	113	0.654	0.477	0.000	1.000
White collar rehires	42	0.428	0.500	0.000	1.000
Permanent rehires	109	0.349	0.478	0.000	1.000
New hires	99	0.484	0.502	0.000	1.000
Permanent new hires	86	0.593	0.478	0.000	1.000
White collar new hires	61	0.508	0.504	0.000	1.000
Temporary hires	292	0.240	0.428	0.000	1.000
Fires	104	0.567	0.497	0.000	1.000
Gross domestic product	308	25.40	1.851	19.448	28.856
Economic growth	308	3.028	3.811	-11.144	21.320
Latin America	308	0.328	0.470	0.000	1.000
Asia	308	0.078	0.268	0.000	1.000
Africa and middle east	308	0.208	0.406	0.000	1.000
Developed Countries	308	0.250	0.434	0.000	1.000

Table 3. Tests of Means and Medians

	SOEs where foreign participation was allowed	SOEs where foreign participation was not allowed	Difference (a)- (b)	T-statistic for change in mean
Rehires	0.3143	0.4146	-0.1003	1.625 ^c
Wages rehires	0.5826	0.5955	-0.0129	1.264
White collar rehires	0.2698	0.5788	-0.3091	3.012 ^a
Permanent rehires	0.2822	0.4821	-0.1999	2.013 ^b
New hires	0.3571	0.3780	-0.0209	0.332
Permanent new hires	0.3046	0.3355	-0.0309	1.091
White collar new hires	0.2808	0.3682	-0.0874	0.454
Temporary hires	0.2095	0.3171	-0.1075	1.940 ^b
Fires	0.6122	0.5965	0.0157	0.112

Z-statistic for change in medians yield very similar results.

Table 4. Post-Privatization Labor Outcomes and Foreign Participation

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Rehires	Wage rehires	White collar rehires	Permanent rehires	New hires	Permanent new hires	White collar new hires	Temporary hires	Fires
Foreign Participation	-0.4641 ** (0.251)	0.1074 (0.381)	-1.756 ** (0.876)	-0.2550 (0.396)	-0.0985 (0.490)	-0.1049 (0.439)	0.5150 (0.629)	-1.4915 (0.243)	** 0.2156 (0.417)
Foreign Participation*Industrial	0.0451 (0.450)	0.1388 (0.642)	1.512 (0.939)	-0.4482 (0.627)	-0.4961 (0.826)	-7.2565 (6.686)	0.5634 (1.140)	-0.2380 (0.446)	-.04697 (0.825)
Unions	0.6554 ** (0.308)	0.3507 (0.546)	0.2790 (0.974)	-0.0153 (0.634)	0.4921 (0.498)	0.4631 (0.318)	0.7117 (0.860)	-0.2354 (0.291)	-0.4104 (0.516)
Strikes	0.2288 (0.194)	0.0691 (0.296)	0.5891 (0.716)	0.3710 (0.323)	-0.2433 (0.355)	0.3087 (0.442)	0.2711 (0.436)	0.6530 (0.199)	-0.020 (0.331)
Share Sold	0.0056 (0.035) *	0.0028 (0.005)	-0.0280 (0.022)	-0.002 (0.006)	-0.0028 (0.007)	0.0093 (0.008)	-0.015 ** (0.008)	0.0108 *** (0.003)	0.0081 (0.006)
Sales	0.0032 (0.009)	-0.0246 (0.029)	-0.0379 (0.033)	-0.4529 (0.035)	-0.0265 (0.043)	0.0818 (0.029)	0.0552 (0.055)	-0.0197 (0.019)	-0.1119 * (0.076)
Gross Domestic Product	0.1850 (0.625)	0.1586 ** (0.094)	0.0434 (0.249)	0.0482 (0.106)	0.1239 (0.091)	0.1149 (0.147)	0.1599 (0.140)	-0.0930 (0.019)	0.1860 * (0.105)
Economic Growth	0.0111 (0.026)	0.0369 (0.043)	0.3932 ** (0.187)	0.0200 (0.038)	0.0290 (0.049)	-0.1719 (0.068)	0.0034 (0.061)	0.1115 (0.029)	0.1860 (0.040)
Industrial Countries	0.3012 (0.388)	-0.2832 (0.494)	-10.785 (9.776)	0.8333 (0.513) *	0.7786 (0.745)	5.5037 (4.951)	-1.4321 * (0.931)	0.3776 (0.376)	-0.1638 (0.697)
Constant	-2.3670 (1.663)	-3.4972 (2.516)	-5.2325 (4.222)	-0.2823 (2.722)	2.8224 (2.544)	-3.255 (3.786)	-3.5919 (4.112)	-0.1067 (1.600)	-3.8239 (3.823)
Pseudo R-Squared	0.07	0.07	0.413	0.11	0.14	0.24	0.06	0.18	0.21

All are probit regressions that include sectoral dummies (nine).

**Table 5. Post-Privatization Labor Outcomes and Foreign Control,
Probit Regressions**

Dependent Variable	Coefficient of Foreign Control	Standard Error	Statistically Significant?
Rehires	-0.2566	(0.104)	Yes
Wage rehires	0.1456	(0.132)	No
White collar rehires	0.0026	(0.909)	No
Permanent rehires	-0.3847	(0.348)	No
New hires	-0.4470	(0.415)	No
Permanent new hires	0.5067	(0.479)	No
White collar new hires	-0.4137	(0.488)	No
Temporary hires	-0.8463	(0.222)	Yes
Fires	-0.0385	(0.199)	No

* Statistical significance in Column 4 refers to 5 percent or higher.