Working Paper Number 87
March 2006

Privatization—A Summary Assessment

By John Nellis

Abstract

In the last 25 years many thousands of formerly state-owned and operated firms have been privatized in developing and transition countries, generating over $400 billion (US) in sales proceeds. In addition, thousands of firms have been transferred by privatization processes in which no money was raised (though a surprising number of state-owned firms remain in these regions). The vast majority of economic studies praise privatization's positive impact at the level of the firm, as well as its positive macroeconomic and welfare contributions. Moreover, contrary to popular conception, privatization has not contributed to maldistribution of income or increased poverty——at least in the best-studied Latin American cases. In sum, the technical picture is generally positive. Nonetheless, public opinion in the less developed world is generally suspicious of, and often hostile to, privatization. A good part of the problem is that privatization has proven harder to launch, and is more likely to produce errant results, in low-income, institutionally weak states, particularly in the most important infrastructure sectors. Privatization is hard to sell politically; it has become a lightning rod and handy scapegoat for all discontent related to liberalization and globalization. What is needed are reform mechanisms that give incentives and comfort to reputable private investors, that create and sustain the policy and regulatory institutions that make governments competent and honest partners with the private operators, while at the same time protecting consumers, particularly the most disadvantaged, from abuse.

Privatization in Developing Countries: A Summary Assessment*

by

John Nellis

Center for Global Development
Washington, DC

&

International Analytics
Bethesda, MD

A slightly different version of this study, with the same title, was issued by the Egyptian Center for Economic Studies as Distinguished Lecture Series No. 24 (January 2006). Thanks to Dr. Ahmed Galal, Director of the ECES, for permission to re-issue the study as a Center for Global Development Working Paper.
Portions of this study draw on previous works of the author: World Bank, 2003; Center for Global Development, 2003; Fondazione Eni Enrico Mattei/Fondazione IRI, 2005; and World Bank/ESMAP, 2005 (full titles listed in the References).
The author acknowledges the valuable comments and suggestions of Ms. Nilgün Gökgür.

I. Introduction

Almost 25 years have passed since Margaret Thatcher (along with some lesser-known pioneers) introduced, or reintroduced, privatization into economic affairs.

In the ensuing quarter century, privatization— the divestiture, or transfer of ownership and/or operational control, of productive economic entities to private owners, operators and investors—has swept the world. Perhaps as many as 100,000 firms and business units formerly owned and operated by governments, in every industrial, commercial and service sector, in every geographical region of the world, have undergone some form of the process. Guinea Bissau, Syria, Libya, Cuba, North Korea and perhaps Sudan[1] are among the few states that have not tried privatization——and even in these countries some thought is being devoted to the prospect.

The forms of privatization are many, ranging from outright sale of government's entire stake, to partial sale, to concessions, leases, and management contracts, to the hiving off and sale of non-core business activities, to the opening of previously restricted sectors to new private entrants and competitors. Each one of these approaches has been carried out in a variety of ways; the forms of privatization are numerous.[2]

Despite its prevalence, and its popularity with finance ministers, the international financial institutions, and many economists who have analyzed the subject, privatization is viewed with suspicion and alarm by the general public, especially in developing countries. The many surveys touching on the subject reveal, across all regions of the developing world, a fluctuating but steady majority of voices opposed to the concept, or at least holding the view that privatization has not been beneficial. For example, the polling firm ***Latinobarometro*** annually surveys reactions to economic programs and policies among 19,000 people in 18 Latin American countries (with a combined population of more than 400 million). The percentage of respondents viewing privatization *negatively* rose from 55 percent in 2001 to 80 percent in 2003, and then fell back to about 70 percent in the most recent, 2005 poll.[3] Surveys from other regions, including sub-Saharan Africa, the post-communist transition states, and South Asia, also show high levels of public opposition. (Kikeri and Kolo, 2005, 22-24)

To the suspicion and hostility of the general public one must add the strident anti-privatization voices of most labor leaders, NGO activists and anti-globalization intellectuals,

---

[1] At least, no privatizations are recorded for these countries in the World Bank Privatization Database (2005), which can be accessed at http://rru.worldbank.org/Privatization/

[2] The many forms of privatization are not dealt with in detail in this study. They are briefly described in the "Options for Privatization" section in World Bank, 1995b, 1. The relationship between forms of privatization and outcomes is complex. For one survey of this issue in post-communist, transition economies see Djankov and Murrell, 2002.

[3] Source: ***The Economist's*** on-line reporting of ***Latinobarometro*** results, at http://www.economist.com/World/la/displayStory.cfm?story_id=5093522

and many journalists, academics, politicians and more than a few maverick economists.[4] The policy has many opponents, and they are active and vocal.

We shall examine below the political economy of privatization and try to explain privatization's unpopularity. The immediate point is that because privatization has been the most contentious item in the liberalization agenda it has also been the most studied of reforms: There are evaluations of privatization's impact on a firm's financial and operational performance and returns to shareholders (Megginson and Netter, 2001), its macroeconomic effects, (International Monetary Fund, 2000), its consequences for economic welfare both in the aggregate and in terms of groups of the most affected actors in societies (Galal et al., 1994), and its social and distributional impact (Nellis and Birdsall, 2005). In addition, there are dozens of case, sectoral, country and regional studies, and detailed analyses of just about every technical aspect of the issue.[5]

However, all this analysis has not produced a settled body of opinion on the costs and benefits of the process. The debate over privatization's impact and utility continues to rage; and the number of polemical statements for and especially against privatization (e.g., Kahn and Minnich, 2005) continues to mount. The purpose of this paper is to take stock of this process as it has been applied in developing and post-communist countries; to summarize, in a reasonably accessible manner, what is known, both pro and con, and what is not known about privatization in these parts of the world.

The approach is as follows. The first part of Section II presents reasons why privatization has been employed. The second part sums up the amount of privatization carried out in developing and transition countries in the last 15 years——but notes the surprisingly large amount and high value of assets that remain in the hands of states in less developed countries. The third portion of Section II discusses privatization's impact on a firm's financial and operational performance, the efficiency of resources employed, and returns to shareholders; that is, the microeconomic issues. The final part of Section II reviews the broader fiscal, macroeconomic and welfare impacts of privatization.

Section III looks at caveats to and concerns about the perceived impacts, noting the economic sectors (e.g., infrastructure) and geographical regions (e.g., low income areas and some transition states) where the findings are less positive in favor of privatization. It then reviews the complex relationship between economic institutions and privatization processes and outcomes.

Section IV looks at privatization's impact on income distribution and poverty. Section V discusses the political economy of privatization, in particular, the "disconnect" between the generally positive technical/economist assessments and the public's hostility to privatization. Section VI concludes.

---

[4] And some not so maverick: Nobel laureate Joseph Stiglitz, for example, has criticized the concept and practice of privatization, in both developed and developing economies, as hastily conceived and poorly implemented.

[5] A handy bibliographical source on privatization is "papers and links" section in the privatization portion of the World Bank's Rapid Response Unit: http://rru.worldbank.org/PapersLinks/

II. What has happened?

a. Why Privatize?

Why did privatization rise (or, more accurately, return) to prominence?

The trend of the first three-quarters of 20th century was state intervention in productive aspects of the economy, not withdrawal. From 1900 to 1975 the world witnessed: The spread of the socialist ideology and then the imposition of communism in the Soviet Union (and later China and a number of other states); enormous social and economic burdens imposed by repeated, protracted and worldwide wars; the near-breakdown of the capitalist system during the great depression; and the post-WW II disintegration of European colonial empires and their replacement by regimes, few of which initially had ties to private economic actors. These summary factors led many governments, overtly socialist and otherwise, to adopt interventionist economic programs. A prime operational principle of these programs was the public ownership and management of productive entities, especially in infrastructure.

Through the first two-thirds of the century, these “public enterprises” grew in number, size and significance, accounting, on worldwide average, for over 10 percent of GDP by the 1970s. Average percentages in developing countries surpassed 15 percent, with much higher figures in overtly socialist and communist economies.

A number of public enterprises performed well—but not enough. They generally failed to live up to the expectations of creators and financiers. Numerous studies and reports from the 1970s through the 1990s documented their shortcomings.[6] Rather than contribute to state budgets, public enterprises drained them. A high percentage failed to produce a sufficient quantity or a high quality of service or product. Particularly troublesome was a widespread failure to charge cost-covering tariffs in infrastructure/utility public enterprises; subsidies from government and soft budgets kept them afloat. These flows eventually posed large financial burdens on government budgets—and attracted the attention of the international financial institutions and donors.

The fundamental problem of public firms was multiple, ambiguous and conflicting objectives. To illustrate: Government owners decreed that public enterprises operate in a commercial, efficient and profitable manner. At the same time they insisted that they finance their actions with debt rather than equity, provide goods and services at prices less than cost, generate employment, receive their inputs from state-sanctioned suppliers, choose plant location on political rather than commercial criteria, hire their staff on the basis of who rather than what they knew, etc. The mixing of social and political with economic objectives weakened managerial autonomy, commercial performance, and efficiency.

[6] A summation of the nature and causes of public enterprise performance problems was found in the World Bank’s ***Bureaucrats in Business*** (1995a).

Repeated efforts to solve these problems by means other than changing ownership produced good results in a few settings (e.g., Chile, Korea, Mexico, New Zealand), modest results in many (e.g., Egypt, the Philippines, Ghana), and little or none in far too many others.[7]

Even when results were positive, they tended not to last. Repeatedly it was demonstrated that proper information and monitoring systems, incentives and financial discipline could be introduced in public enterprises. But too often, as the precipitating financial crisis eased, as another, more socio-political crisis replaced it, as the dynamic reformers who had brought about the improvements moved on to other areas and interests, then the capacity and will to impose painful reforms faded. Political interference resurfaced, poor performance reemerged, and the gains from reforming policies and leaders dissipated.

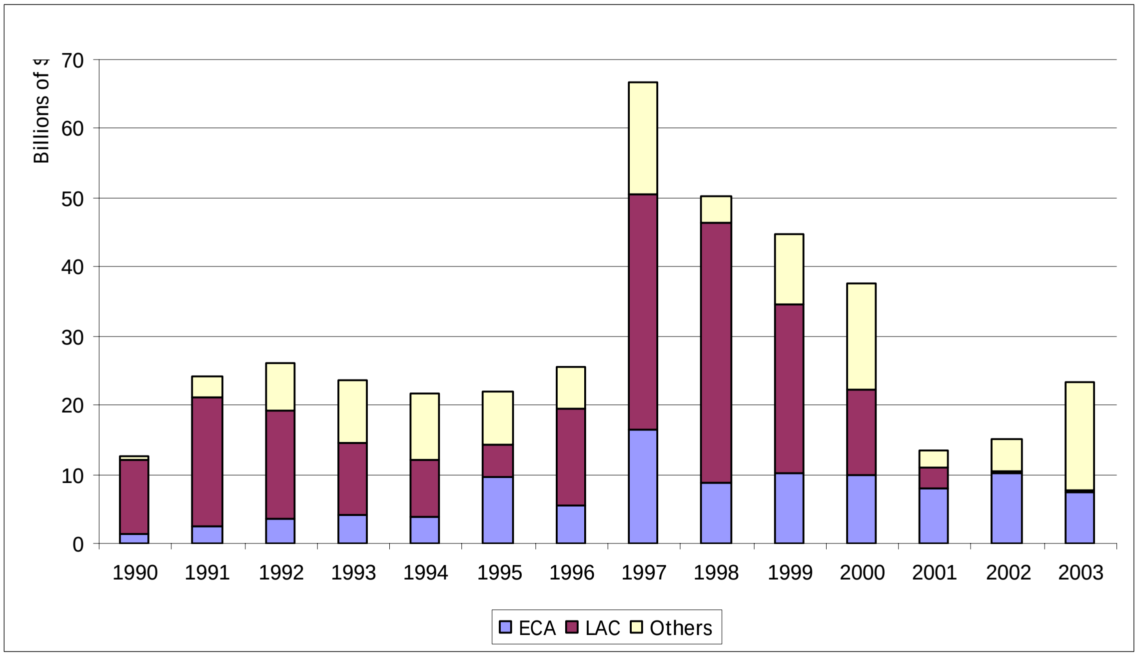
As disappointment with enterprise reform mounted, government and donor enthusiasm grew concerning privatization. In retrospect, this enthusiasm was generated as much or more by the modest results of performance improvement approaches other than divestiture, by the privatization examples of Britain and a few other OECD countries, and by expectations based on hope and theory, rather than on hard empirical evidence of the superiority of private participation and ownership in non-industrial economies. Thus, the shift to privatization was something of a leap of faith——but it was carried out.[8]

b. How much privatization has taken place, and where?

Tables 1 through 4, below, indicate the scope of divestitures in developing and transition countries since 1990. In these regions total revenues from privatization topped $400 billion U.S. The number is impressively large. Even so, the use of cash transactions and sales proceeds as indicators greatly underestimates the scope of privatization: Recall that in transition countries, literally thousands of firms—15,000 in Russia; 4,500 in Mongolia alone—were divested for vouchers, meaning no revenues were raised by the seller. These privatizations are not accounted for in the tables.

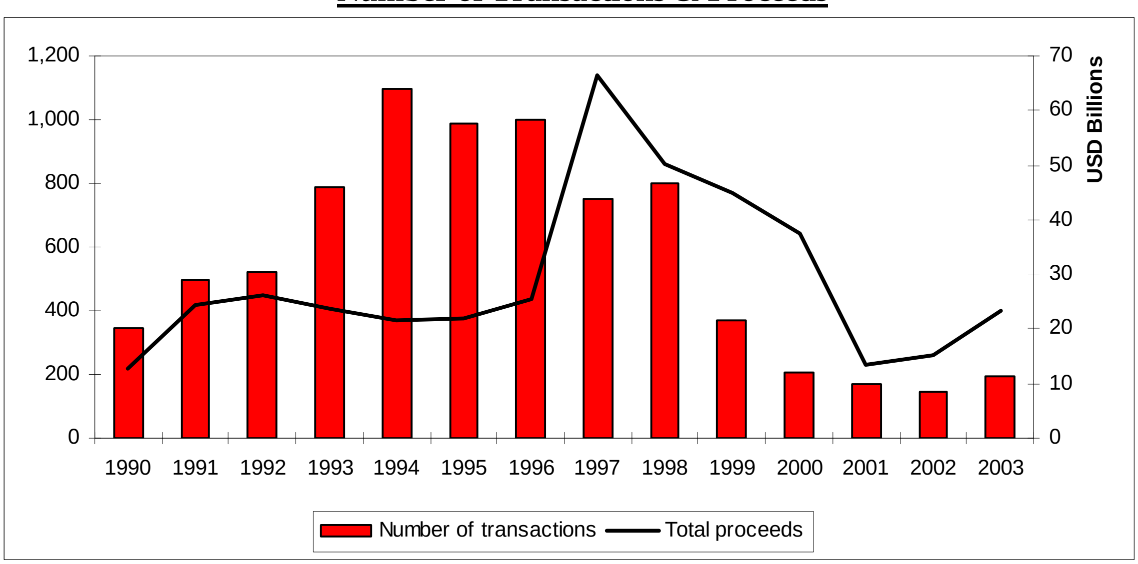
[7] For a review of public enterprise reforms other than privatization, see Shirley and Nellis, 1991.
[8] We shall not in this exercise show precisely how this was done.

Table 1
Privatization Proceeds: Developing & Transition Countries



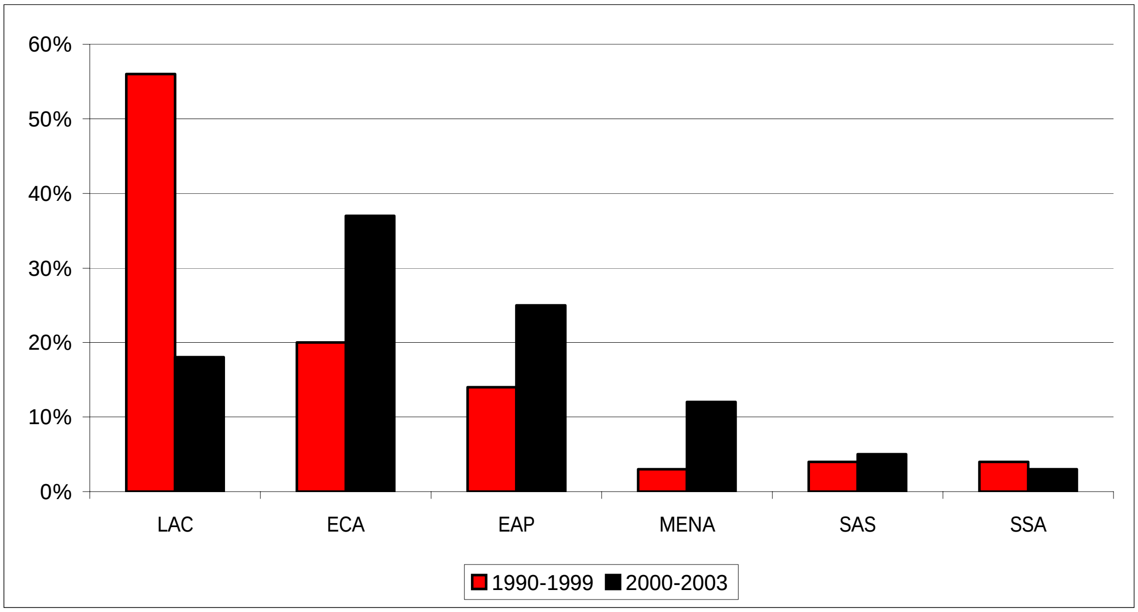
Source: World Bank Privatization Database, compiled by Kikeri and Kolo, 2005, p. 5.

Table 2
Number of Transactions & Proceeds



Source: Kikeri and Kolo, 2005, p.6. Again, note that the transaction numbers refer to the firms sold for cash.

Table 3
Regional distribution of privatization proceeds: 1990-1999 and 2000-2003



Source: World Bank, 2005. LAC = Latin America/Caribbean; ECA = Europe/Central Asia; EAP = East Asia/Pacific; MENA = Middle East/North Africa; SAS = South Asia; SSA = Sub-Saharan Africa.

Table 4
Privatization Numbers & Proceeds, by Region, 1990-2003

REGION	# TRANSACTIONS	PROCEEDS (US $ BNS.)
Middle East, North Africa	302	$18.9
South Asia	399	$15.4
East Asia/Pacific	417	$65.8
Sub-Saharan Africa	981	$11.5
Latin America, Caribbean	1,265	$195.1
East & Central Europe, Central Asia	5,634	$104.1
Totals	8,998	$410.8

Compiled by the author from the World Bank Privatization Database, 2005.

c. Is anything left to privatize?

Given the extent to which privatization has been advanced by indigenous reformers and the international financial institutions, one might think the process is substantially completed; that most governments around the world have just about finished divesting everything they had to sell or transfer. This is not the case. True, in some states the percentage of economic activity accounted for by public enterprises has fallen dramatically; e.g., in Russia and many other post-socialist countries; in Argentina, Mexico, Brazil and a few other Latin American nations; and, more surprisingly, in China. Nonetheless, a very large number of productive entities, including many of the larger and more valuable firms in energy, infrastructure and finance, remain in the hands of the state. The World Bank estimates that, on average, as much as 50 percent of these important sectors remain publicly owned and operated in its client countries.

As Table 4 (above) shows, this retention of control by the state is more prevalent in the Middle East and North Africa and South Asia than in other regions. In Algeria, for example, 65 percent of all value-added is still produced by public enterprises, and 90 percent of all banking is state owned and operated. In Algeria, Syria and Iran, up to 80 percent of the industrial sector is state-owned and operated. Across the region, energy exploration and exploitation firms remain firmly in state hands.

So what?

Does it make any difference that some developing countries have lagged the leading privatizers? Given the recent shift away from dogmatic promotion of ownership change, perhaps caution was the correct course of action, particularly regarding infrastructure. Possibly, the slow pace and limited scope of privatization allowed these more cautious states to avoid the mistakes that followed in the wake of wholesale ownership transformation in the absence of legal safeguards (Russia), or infrastructure privatizations elsewhere in the absence of effective regulatory institutions. Perhaps keeping the largest firms in state hands until the institutional framework is more solid will lead to the attraction of better buyers, higher sales prices, and better, more socially palatable outcomes?

Perhaps——but just as likely not. Many obstacles stand in the way of the fulfillment of this strategy. First, it will take a long time, during which public enterprise performance may, indeed is likely to, deteriorate further. Second, it will thus be expensive. Most governments are finding it more difficult than ever to provide their infrastructure firms with the capital needed for long-delayed maintenance, much less expansion. Much of the improvement resulting from privatization has come from the ability of new private owners to tap private capital markets. Strained public and/or official funding will not be sufficient to meet repair and expansion needs. Private operators are more able to raise investment capital, both from private markets and from official sources.[9]

---

[9] That is, as the IFIs revive lending to infrastructure reform, they will be looking for, or actively putting in place, private operators if not owners.

Third, some of those advocating slow reform and continued state involvement do so not out of a desire to minimize pain and build institutions, but rather as a pretext to protect their ideological positions, political prerogatives and economic rents. They push for slow privatization; they intend no privatization. This may not be sensible from an economic perspective; unfortunately, it often makes good political sense (see Section V).

d. Impact: Microeconomic

The best-studied aspects of privatization are its effects at the level of the firm. The vast majority of studies report post-privatization increases in profitability, efficiency[10] and returns to shareholders.[11] In their extensive survey, Megginson and Netter (2001) estimate that these positive effects occur in from two-thirds to three-quarters of privatizations assessed, a remarkably high rate of success. With the qualifications discussed below, this finding is robust across regions, countries and economic sectors. The microeconomic studies show improved post-privatization performance in both industrialized and developing countries, and in most manufacturing, commercial, industrial and service sectors. For example, an Inter-American Development Bank review of privatization in six Latin American countries[12] found an average increase in profits (return on sales) of 29.8 percent in a large sample of privatized firms. Efficiency gains, as measured by output per worker or ratio of costs to sales, increased on average by 67 percent. Output increases averaged 34 percent, "regardless of the indicator used." (IADB, 2002, 3)

Note that it is not fully understood just why privatization produces, or is associated with, these improvements. Economic theory, either in its neo-classical or amended forms, offers "no clear picture…of a definite advantage of private ownership." (Roland, 2004, 21) Analysts point to improved information to and incentives for managers, greater access to capital market resources and pressures, increased isolation from political interference, and increased flexibility to deal with labor and other cost concerns, as likely sources of the improvements. Doubtless, all are at times of great import.

The problem is that privatization is almost never introduced as a stand-alone reform. It is usually part of a package of liberalizing policy changes that increase openness and competition at the same time that private ownership is introduced. This makes it hard to determine the extent to which ownership change in and of itself accounts for the improvements seen; it may be that increased competitive pressures are an equal or better explanation for the altered behavior. (Tandon, 1995) Whatever the underlying cause, the fact remains that firm performance most often does improve.

[10] Usually measured in terms of labor productivity, but sometimes by total factor productivity tests.

[11] What economists call "selection bias" may be at work in these findings. The term has two meaning: First is the possibility that it is not privatization that improves firm performance, it is, rather, that the highest potential firms are selected to be privatized—thus skewing the findings in favor of divestiture. The second possibility is that the analyst consciously or unconsciously selects for study the better performing privatized firms. This concern rose most acutely in privatization in the transition states. For discussions of selection bias and ways to test for and overcome it, see Marcincein and Van Wijnbergen, 1997; and Frydman *et al.*, 1999.

[12] Argentina, Brazil, Chile, Colombia, Mexico and Peru.

e . Impact: Macroeconomic and Welfare

Concerning the fiscal and macroeconomic impacts of privatization, the IMF found that in a set of 18 developing and transition economies[13] privatization proceeds were large, that the net[14] receipts were saved (generally meaning that they were used to retire debt) rather than quickly spent, and that governments' fiscal positions benefited from privatization: Gross budgetary transfers to the firms and sectors undergoing privatization declined, as did general deficits and quasi-fiscal operations. Though they found a "strong correlation….between privatization and growth," (Davis *et al.*, 2000, p. 2) the authors noted that privatization

> ….is not the suggested cause of the large increases in growth rates (in the sample countries)….Rather, it is likely that privatization is serving as a proxy in these regressions for a range of structural measures that may be characterized as a change in economic regime. (Davis *et al.*, 2000, p. 23)

More simply put, there is an association between privatization and increased growth, but whether—or the extent to which—privatization causes growth is not known. In a similar vein, for transition states the European Bank for Reconstruction and Development detects a strong correlation between the total amount of privatization and the rapidity and strength of the return to growth. (EBRD, 2004)

Other regional and particularly country case studies paint a more nuanced picture. For Latin America as a whole, Campos *et al.* (2003, p. 165) find that the effects of privatization of infrastructure on regional GDP *per capita* are "…neutral at worst and most probably positive.." However, it may produce a decline in public sector accounts, thus casting doubt on the argument that privatization generates "fiscal space" for selling governments. For example, in Brazil in the 1990s, huge resources were generated by privatizations. Post-sale, firm financial performance improved. But Macedo (2000 and 2005) argues that the Brazilian government used the proceeds on current expenditure rather than debt relief, thus increasing the fiscal deficits. It then compounded the problem by adopting high interest rates, in a fruitless effort to defend the Brazilian *real*. Macedo concludes that government misused the privatization revenues to soften its public and external debt constraints, thus weakening the economy. A good part of the close to $80 billion in privatization inflows in Brazil in the 1990s "…went down the drain in the disarray of public finances." (Macedo, 2000) Knight-John and Athukorala (2005) make a similar argument in the case of Sri Lanka's use of privatization proceeds, though they note that after 1995 government began using privatization revenues to retire debt rather than add to current consumption.

A number of other studies demonstrate that privatization has put substantial resources in the hands of divesting governments. They conclude that it provides an opportunity for

[13] Argentina, Bolivia, Cote d'Ivoire, Czech Republic, Egypt, Estonia, Hungary, Kazakhstan, Mexico, Mongolia, Morocco, Mozambique, Peru, Philippines, Russia, Uganda, Ukraine and Vietnam. For additional assessment of the IMF' in privatization, see Brune *et al.*, 2004.

[14] Net proceeds average about half of gross proceeds, reflecting the high costs of sales; that is, debt and environmental clean ups, generous severance, retraining and sometimes settlement packages, and high fees charged by transaction facilitators and advisors.

governments to put their fiscal houses in order, and redirect expenditure from non-productive subsidization to more socially beneficial uses. As noted, advocates speak of the fiscal space that privatization will or should create.

But privatization does not guarantee that the opportunities will be seized, that the funds will be wisely applied. A key question is, what uses do governments actually make of the generally large, but one-time or short-term gains? The IMF concluded the funds were not generally wasted, but it did not specify the revised allocations of expenditures. Mckenzie and Mookherjee note that government spending on health and education in Mexico increased by 50 percent in the period of peak privatization revenues; that similar social spending in Argentina also increased following privatization (and the reduction of spending on debt servicing); and that Bolivia earmarked a portion of privatization revenues to capitalize a national pension fund and make special payments to all citizens over 65. (Mckenzie and Mookherjee, 2005, p. 72) These are but scattered impressions; the subject requires wider, much more detailed investigation.

Welfare Effects

Improved performance in firms does not sufficiently measure privatization's utility. A privatized firm may be doing better while the economy is doing worse. This may occur due to the firm's exploitation of a monopoly position, or to government policies, protections, special arrangements or even illegal actions that give the firm an advantage. Its superior performance (and even its greater contribution to government revenues through increased tax payments) might be coming about at the expense of competitors or taxpayers. In short, firm and/or government financial performance might be improved only because of costs imposed elsewhere in the broader economy.

This notion is straight-forward, but determining whether and to what extent there is agreement or deviation between the narrow and broad impacts of a privatization is complex. To address this issue, economists use concepts derived from welfare economics, combined with techniques drawn from social cost-benefit analysis. They ask not simply whether the position of the firm or the government or any single actor has improved or worsened due to privatization, but rather: What was the privatization's impact on the economy as a whole; what significant economic variables have changed as a result of the privatization, and only as a result of the privatization? They then ask, do the changes brought about by privatization result in gains or losses for relevant actors in the economy—the divesting government, consumers, workers, the buyers, competitors—and, if so, how are they distributed among them; i.e., who are the winners and the losers from the process? After estimating the total loss or gain, and the distribution of the loss or gain, one can calculate the overall economic impact of a privatization.

The seminal work employing this approach is that of Galal *et al.* (1994) Later works in this vein include those of Newbery and Pollitt (1997), Jones, Jamal and Gökgür (1998), Domah and Pollitt (2000), and a number of works in progress on African cases by Gökgür, Jammal and Jones (2005).

To answer the question of what changes were brought about by privatization (and, to repeat, only by privatization), all of these works construct a "counterfactual." This is an estimate of what would have happened if privatization had not taken place, and the publicly owned firm had continued in operation. Analysts readily admit that counterfactual construction is demanding and difficult. Even the most careful estimate of what would likely have happened requires a bit of "crystal ball gazing."[15] For the counterfactual to be transparent and persuasive, the assumptions used in its construction must be plausible; for example, that technology coming on line after the privatization would (or would not) have been adopted by the public firm. Small or seemingly innocuous assumptions can make a large difference in projected outcomes. One is in effect constructing hypothetical history.

Perhaps because of these difficulties, welfare analysis based on elaborate and systematic counterfactuals has been applied in only a limited number of cases. However, note that almost all of the studies so carried out report substantial aggregate welfare gains from privatization for the economies in question.[16] The same positive conclusion is reached by the larger number of other studies calculating welfare consequences with less elaborate counterfactuals or by totally different methods.[17] Thus, empirical analysts answer "yes" to the question, does privatization contribute positively to the overall economy? How these aggregate gains are distributed among relevant actors and income groups is discussed below in Section IV.

III. Caveats and Institutions

So, in the main and on average, privatization produces positive microeconomic results. But not always. Where and when does privatization *not* work, or work less well? Experience reveals two major caveats, and one corollary. First, privatization is less likely to succeed in low-income countries, or in settings where markets are embryonic, due either to their never having been established or having been suppressed; i.e., some post-communist countries.[18] Second, privatization is harder to carry out and is more likely to produce questionable or negative effects in the natural monopoly segments of utilities/infrastructure services (and in

---

[15] The phrase is David Newbery's; other analysts agree: "In a study of this sort, innumerable choices of parameter values and other assumptions are made on the basis of judgments or educated guesses. This obviously leaves a lot of room for subjectivity." (Galal *et al.*, 1994, p. 536)

[16] Galal *et al.* found substantial welfare increases in 11 of 12 privatizations examined, from Great Britain, Mexico, Malaysia and Chile. Newbery and Pollitt found the same for the case of Britain's electricity industry, and Dommah and Pollitt confirmed the British results, and expanded them to Wales. Jones, Jammal and Gökgür found welfare increases from Cote d'Ivoire's privatization program as a whole.

[17] See for example, Arocena (2001; Spain), Barja, Mckenzie and Urquiola (2005; Bolivia), Chisari, Estache and Romero (1999; Argentina), Delfino and Casarin (2001; Argentina), Ennis and Pinto (2005; Argentina), Fischer *et al.* (2003; Chile), Rodriguez and Rivas (2005; Nicaragua), Galiani *et al.* (2003: Argentina), Mckenzie and Mookherjee (2005; summation), Paredes (2001; Chile), Toba (2003; Philippines); Torero and Pasco-Font (2001; Peru), and Torero, Schroth and Pasco-Font (2005; Peru).

[18] This statement does not contradict the EBRD findings, above, of the positive impact of privatization in the transition region. The transition countries that have done privatization well are those in the western section of the region; i.e., those that historically been part of capitalist markets and traditions. The farther east one moves in the region, the more difficult and problematic privatization becomes.

banks and insurance companies, where some aspects of the firms' functioning require government rule-setting and monitoring to protect consumers and depositors).
The evident corollary is that difficulties are most likely to surface when these two situations are combined; i.e., when privatizing an infrastructure or financial public enterprise in a low-income or post-communist country. Common difficulties include:

- Private operators and investors often find that records and accounts of the firm, on which they based their offer, are inaccurate or completely false, particularly with regard to the state of assets and the collection of tariffs;
- that some liabilities were not disclosed;
- that government will not or cannot accede to tariff increases called for in a formula agreed to in the contract;
- that local courts will not or cannot assist in enforcing agreements, or assist in maintaining shareholders' rights; or, on the other hand,
- that the private provider makes a low bid to get a foot in the door and then, pointing to informational and institutional deficiencies, claims an inability to meet terms, and demands renegotiation of the contract.

Institutional Requirements

The underlying reason for both the sectoral and the geographical problems is the same: For markets to function in an efficient, productive and socially acceptable manner, a set of legal, policy and behavioral underpinnings—referred to as "economic institutions"—must be present and operating. These institutions promote, monitor, and render transparent market operations. They include:

- The definition and protection of property rights;
- Contract enforcement and commercial dispute settlement through credible, predictable, peaceful means (more broadly, court decisions that are timely and based on law, not payments or social precedence);
- Independent, well-staffed agencies to regulate the natural monopoly elements of private utilities (that deliver timely, law-based decisions, predictable and credible for both investors and consumers);
- Functioning bankruptcy/insolvency regimes for firms operating in competitive markets; and, in general,
- A public administration that meets modicum standards of predictability, competence and probity and promotes and enforces rules enhancing competition.

These institutions stabilize and render predictable market operations; they thus lower transaction costs. Where they are absent or weak, privatization is more likely to result in poor outcomes—particularly in the case of infrastructure/network industries, and particularly with regard to distributional concerns. Thus, the more extensive the institutional underpinnings, the better the privatization results, in both efficiency and equity terms (e.g., Chile versus Argentina, Hungary versus Russia).

The idea that institutions heavily influence economic vitality has rapidly risen to the status of conventional wisdom. The association between the existence and performance of economic institutions and good results from privatization is widely predicated. (Stiglitz, 1999a and

1999b) Rodrik, Subramanian and Trebbi (2002) go further; they argue that "the quality of institutions 'trumps' everything else" in explaining all economic development outcomes—while admitting that the finding is at such a high level of generality that it provides little specific guidance to policymakers.

The lack of operational precision is the problem: The list of needed institutions is very long, and the concepts very general. Explanations of how these institutions come into being and attain a state of effectiveness are lacking or vague. Research is just beginning on which institutions are crucial in what particular circumstances, or in what sequence they should and can be introduced. And while most of these policies/institutions function under at least the partial control of the public sector, and while many donor-supported efforts are underway to create and strengthen institutions in developing and transition countries,[19] it is, again, unclear as to what governments can do to aid their emergence and enhance their capacity. As Shirley (2003, 1) notes, "…over time the development paradigm has shifted from 'get your prices right' to 'get your institutions right;' the latter instruction has proved as useless as the former."

So: One cannot simply state that institutions are required, note their presence or absence, and legislate them into existence and competence. This leads to the key dilemma: The countries that stand to benefit most from liberalizing reform and privatization are those with the lowest incomes, the weakest institutions and the worst public sectors. In such settings, the efficiency and financial gains from private operation are potentially very great. At the same time, the risks are high that the reform processes will be mismanaged or captured, and produce suboptimal or errant results.[20]

Up until the late 1990s, the extent to which institutions influenced privatization processes and outcomes was underestimated by most (though not all) of those involved. Placing ownership change before institution-building proved costly in low-income developing states, and even more so in the post-communist transition states. There, speedy privatization had been recommended by the bulk of analysts and insisted upon by the IFIs. The idea was that capitalism required capitalists; many of them, and fast. Ownership change was seen as "…not just a necessary condition of capitalism, but a sufficient one." (Kornai, 2000, p. 15)

This led to the belief that the required legal/institutional frameworks would arise from demand by the new owners of private property. In the transition states, privatization's proponents failed to realize that in the absence of a supporting legal framework, it was more rational, in the short run, for individual property owners to buy a private police force rather than to band together to help build a law enforcement regime supporting free and fair business operations. In a number of low-income countries, infrastructure firms were leased

[19] Especially in the creation and reinforcement of legal/judicial systems.

[20] This conclusion is statistical rather than comprehensive; one is talking about tendencies. That is, privatizing an infrastructure monopoly in a low income, institutionally weak country is certainly much more dangerous than doing so in a high income industrialized state, and one can cite a number of cases where such privatizations have gone badly wrong——for recent example, in the failed concessions of water companies in Tanzania, Uganda and Mozambique. However, in Tanzania, the quite similar concession of the container terminal is an outstanding success. Low income levels and weak institutions hinder good outcomes, but do not guarantee bad ones.

or given in concession to private operators on the assumption that private operation could not help but be superior to public management. But the public sector mechanisms needed (i) to attract to the bidding process a good number of reputable and competent private operators and (ii) to construct, and especially monitor and enforce their performance contracts, were absent, weak or easily corrupted.

By the end of the 1990s, dissatisfaction grew over corrupt transactions in transition countries (mainly in commercial firms), and ineffective ones in developing countries (centered on infrastructure cases). This led to considerable rethinking about the pace and techniques employed in privatization.[21] Many previously known for their strong support of privatization admitted to errors and doubts. The IMF and World Bank, that for a decade had pushed privatization vigorously, became more cautious and less dogmatic about the need for speedy transformation.[22]

The importance of economic institutions, the limitations of ownership change as a stand-alone reform, and the need to modify the excessive optimism of the 1990s regarding privatization, are now well and widely recognized. The proposed solution is "public-private partnerships," but the term is vaguely defined; it is quite unclear as to how workable partnerships will emerge, what they will look like, and in what precise ways they will differ from what has already been tried. Specificity is lacking on how future reforms will avoid the errors of the past, with regard to both public enterprise reform *and* privatization.

IV. Privatization's Social Impact

Some critics may concede that privatization is of economic benefit, but all question its social utility. They argue that privatization's rewards go to the agile, the rich, the foreign and the corrupt, at the expense of poor and honest nationals. They claim that privatization negatively affects the mass of citizens——that it harms workers because of lost jobs, consumers because of higher prices, and taxpayers in general, because of government under pricing of assets, the collusion of crooked bureaucrats with buyers, or the inability of ill-trained and underpaid public servants to see through the stratagems of clever private investors. The overall claim is that privatization contributes to inequality and poverty.

Certainly, privatization does generally result in job losses: 150,000 in Argentina between 1987 and 1997; roughly 50 percent of all employees in firms privatized in Mexico in the 1990s; a reduction of more than 90,000 from peak employment levels in privatized Brazilian railways alone; the dismissal through privatization of 15 percent of the total labor force in Nicaragua, to cite just a few Latin American cases. Chong and Lopez-de-Silanes (2002)

[21]Nellis discusses this rethinking in transition countries (2002) and sub-Saharan Africa (2005). Note that in the transition region, some analysts justify privatization, warts and all. They argue that the unjust initial distribution of assets was a regrettable but unavoidable price that had to be paid to get these economies into, or back into, the market system; that Russian privatization in particular, though morally deplorable, was better than leaving the firms in state control. (Shleifer and Treisman, 2000)

[22] A July, 2005, World Bank paper, *Infrastructure development: The roles of the private and the public sector*, describes the Bank's shift to a more pragmatic position, away from its 1990s view that the state has little role to play in infrastructure industries.

show that employee numbers are reduced in many firms prior to sale, and that, worldwide, on average, 4 of 5 surveyed firms decrease employees further after sale. Surely, this amount of job loss, falling on those whose main source of income is wages, must result in increased poverty and increased inequality of incomes?

The second claim is that privatization and private sector involvement raise the prices for essential goods and services, especially water, sewerage, electricity and transport. There is no dispute that under state ownership many governments set utility prices at less than cost-covering levels. The frequent result was scarcity, rationing, and state firms starved of investment and expansion capital. Thus, price increases are often unavoidable if the firm is to modernize, expand to meet demand, and operate without—or with smaller—subsidies. But critics argue that the size and speed of price adjustments imposed following privatization are often excessive and unjustified, and they decry the supposed harsh impact on low-income consumers. For example, in the short-lived Cochabamba concession in Bolivia, water prices for poorer consumers rose after privatization by 43 percent on average, and doubled for a small segment of poor consumers. (McKenzie and Mookherjee, 2005, p. 49) What is a bearable annoyance for upper income people might be an insurmountable, inequality enhancing financial burden for the poor.

Third, it is evident that some of the investors willing to bid on privatizations in situations of poor information and worse governance are entrepreneurs more of the buccaneer than the Fortune 500 type. And, of course, even the most reputable investors will take all legally available steps to reduce risks and ensure and maximize profits.

Efforts of investors to influence bid outcomes, obtain costly and sometimes illegal concessions and terms (pre- and post-bid), or collude to reduce the price offered, are often alleged. For a rare example that found its way into print: The ***Financial Times*** (May 21, 2003, p. 32) reported an alleged collusion and rigging between two bidders in the 1998 sale of *Electropaulo Metropolitana*, an electricity utility in Sao Paulo, Brazil. The accusation was that, in return for not bidding for the concession, the non-bidder would be given a major contract to build a generation plant for the winning bidder—who, in the absence of a competitor, could and did offer the minimum price for the utility stipulated in the bidding documents. The ***FT*** cited reports that the winning bidder had come to the final meeting prepared to offer $500 million USD more than the $1.78 billion bid it eventually submitted; but put in the lower offer at the last second, once it was clear the only competitor was not going to bid. All parties that could be contacted by the ***FT*** denied any illegality; the Brazilian government was reported to be considering legal action.

Even where no illegalities appear to be involved, it can be difficult for beleaguered civil servants to strike a fair deal with canny and powerful investors. As a Tanzanian official put it, “they (the private bidders) came to negotiate with 10 lawyers from London; we had me.” *Prima facie*, there are reasons to worry about the social impact of these three elements of privatization.

Counterargument

But the latest empirical research dilutes many of the claims that privatization adds to inequality and poverty. Several recent studies examine the effects of privatization on income groups. They move beyond assessments of privatization's impact on a neighborhood, a city, or the employees of a particular firm being privatized. They quantitatively estimate the direct and indirect, short and medium term, distributional effects of ownership change.[23]

For example, McKenzie and Mookherjee (2005) summarize the distributional impact of 10 infrastructure privatizations in Argentina, Bolivia, Mexico and Nicaragua. They calculate that these privatizations:

- Contributed only slightly to rising general unemployment levels (except in Nicaragua, which went through a transition akin to those in formerly communist states);
- Increased access to services, and that this access was disproportionately concentrated in the lower income groups.

Looking specifically at the impact of privatization on income equality and poverty levels, they conclude that:

- "….privatization has a very small effect on inequality" (on average privatization is responsible for increases in Gini coefficients in the four countries of 0.02 or less); and that
- "privatization either reduced poverty or has no effect on it."

The reasons behind these findings are: (i) the direct unemployment effects of privatization are small in relation to the total workforce, and tend to be offset in the medium term by increased job creation produced in part by privatization; and (ii) increased access offsets any negative effects of higher prices.[24] The numbers of workers laid off due to privatization are small, even in Argentina or Mexico, relative to the entire workforce. In the cases reviewed the number of new private sector jobs created by the general reform program, of which privatization was a part, soon exceeded the number dismissed. General and enduring increases in overall unemployment levels in these countries are real and troublesome; but they came some time after privatization and were caused by external shocks, labor market

[23] They do this by examining differences in household expenditure and consumption for a service—such as water—by income group, before and after privatization. This approach requires survey data from before and after the sale. There are limitations to the approach: Most countries possess only a few surveys; most survey only urban, not rural residents; these surveys usually show amounts spent on a service and not amounts consumed; the questions in and coverage of some surveys vary over time within the same country. There are also problems in calculating price shifts over time; different studies reach different conclusions. The methodological issues, and the techniques devised to overcome shortcomings, are discussed in McKenzie and Mookherjee (2005). The detailed country cases for Argentina, Bolivia and Nicaragua, on which Mckenzie and Mookherjee draw, are also found (along with Mckenzie and Mookherjee) in Nellis and Birdsall, 2005.

[24] That is, the positive distributional impact of increased access to privatized utility services far outweighs any negative impact of increased tariffs—where indeed the tariffs did actually increase, which was only half the time in the cases reviewed. Note, however, that a separate study of the impact of private provision of water on access, in Argentina, Bolivia and Brazil, concluded that while access rose under private provision, it increased by just about the same amount in areas that maintained public provision. In addition, this study could not find any differences in increased coverage among the poor between the public and private providers. (Clarke *et al.*, 2004)

rigidities, and financial indiscipline—not privatization. It has even been argued that, in Latin America, privatization may have mitigated unemployment; that is, absent privatization, unemployment levels would be higher. (Behrman, Birdsall, Szekely, 2000)

All this calls into question the portrayal of privatization as a prime cause of growing inequality and poverty. But perhaps these findings only apply to Latin America; perhaps the economic environments and privatization processes adopted in other countries and regions have produced more negative results? Given the discussion on institutions above, this seems plausible. The fact is, we do not know for sure, because almost no similar studies have yet been carried out in these other regions.[25] This author's guess is that the distributional impact in other regions would resemble that found in Latin America, except in the countries that were once in the Soviet Union, and perhaps in the institutionally weakest African states.

However, even if a dozen studies confirming the McKenzie and Mookherjee conclusions in other regions were to shortly appear, it is unlikely that this would alter greatly the public's negative perception of privatization. The problem is that the argument is not being fought strictly or even mainly on empirical economic and financial grounds; the reasons for the unpopularity of privatization are fundamentally political in nature.

V: The Political Economy of Privatization: Explaining the "Disconnect"

So: Privatization usually results in improved performance in the affected firm. Its macroeconomic impact is generally assessed as positive, at the very least in the sense of providing governments with opportunities, and being correlated closely with increased growth and aggregate welfare. Data from the best-studied cases show that privatization's impact on poverty and income distribution is, in many instances, negligible, and far less negative than popular perception would have it.

Why then is the policy so widely, so vehemently, so persistently disliked? As with many economic issues, a good part of the explanation is that privatization's benefits are dispersed, while its costs are concentrated.

That is, privatization's benefits for consumers at large tend to be dispersed among amorphous, unorganized segments of the public. The average benefits are small for each affected consumer. Mass benefits occur in the medium term, or at least they accrue to a significant size in the medium term.

To illustrate: In several Latin American cases, post-privatization average real electricity tariffs declined by 5—10 percent, and there are numerous cases, worldwide, of even larger reductions in average real telephone bills. In the aggregate, these savings are substantial and worthwhile gains for any economy. And increased disposable income by a few dollars a

[25] For three reasons: (1) Regions other than LAC have fewer infrastructure privatizations, and those they have are relatively recent. (2) Other regions have fewer and less sophisticated household expenditure and consumption surveys to draw on; their existence is crucial to this form of analysis. (3) Other regions have less dense networks of local economists at ease with the complex measurement techniques required.

billing period (along with service quality improvements, lowered pollution, and a number of other social gains that often come in the wake of privatization) is no doubt welcome by the great mass of consumers. But gains of this nature rarely if ever move masses of consumers to mobilize politically in favor of the policy, much less the reforming regime. Moreover, many of the beneficiaries of coverage increases resulting from infrastructure privatization are the poor, who are both less organized, and less organizable. In addition, some consumers, particularly poor ones, probably do not associate any gains from reduced tariffs (to the extent they even perceive them[26]) as having anything to do with privatization of the service. The upshot: Modest average price declines thrill economists, but not the broader public.

The costs of privatization, in contrast, are concentrated. They affect a visible, vocal and urbanized few—dismissed workers, represented by powerful public sector unions; bureaucrats in supervisory ministries that lose their authority, perks and perhaps even *raison d'etre;* managers and board members of public enterprises removed pre- or post-sale, middle- and upper-income consumers about to lose a service long-furnished at a subsidized price. Though the sum of their welfare losses may be, presumably often are, much less than the aggregate gain, these actors possess "voice" and access to power; they can and do make their needs and views known.

They are motivated to do so because the loss for each affected individual is comparatively large and intensely felt, and it occurs in the very short term; indeed, in the case of affected workers, often before the completion of the transaction. Losses of comparatively large magnitude, among stakeholders of this nature, typically result in protest, direct political action, or equally (if not more) effective bureaucratic delay and misdirection. It is easier to mobilize protest against losses, and generate sympathy for the losers, than to engender gratitude for gains. And the gratitude created by the awarding of any gain is far less politically potent than the protest generated by the imposition of an equivalent loss.

This situation is hardly unique to privatization. A number of liberal economic policy reforms—reducing barriers to trade, increasing labor market flexibility, reducing or eliminating rent controls, and rationalizing tax regimes are but the first four that come to mind—can be shown to generate medium-term economy-wide benefits. But when they are implemented they impose costs on some previously benefiting segment or segments of society. The affected take steps to protect their interests. They portray the loss as a threat to society, not simply to their or their group's utility: They are taking away our jobs, and you are next; we workers are asked to pay for management's and politicians' mistakes; foreigners are controlling and misusing our most valuable national resources; national security is being weakened, etc. All this is expected and predictable, the warp and woof of normal political life. The function of the political system is to reconcile the conflicting demands;[27] some manage to do so, many do not, at least, not often or for long.

[26] Sometimes price reductions (where they occur) are not expressed in consumers' bills for a year or two. If inflation has remained at even a moderately high level, the average consumer could end up paying more in current terms, and the gain would only be seen when a constant currency value is used.

[27] Leroy Jones of Boston University once offered an excellent definition of "political Pareto optimality:" A shift in resources in the system such that one actor is made better off without any other actor *realizing* that someone had been made better off. For a discussion of the techniques used by governments that have succeeded in cutting back on long-established public subsidies and entitlements, see Pierson (1994). Four main tools have been

But privatization is a particularly easy target to hit. The pain that privatization imposes on limited groups arouses sympathy, and is readily described as a cost, or potential cost, to society at large. Pro-privatization arguments are dry, technical and abstract. Foes of liberal reform find in privatization a simple, visible, comprehensible summation of all they oppose. Privatization has become a lightning rod and handy scapegoat for all discontent related to liberalization and globalization.

Thus, anti-privatization leagues (and forums, workshops, toolkits, strategies, etc.) are numerous and popular, and receive strong support from trade unions. Many journalists, academics and other opinion-makers in developing countries share an anti-market perspective; they often perceive and portray privatization as imposed, unnecessary, unproductive and unfair. While the negative results of other liberal reforms are sometimes too indirect and unclear to spur active opposition, privatization's costs appear evident.

In addition, supporters of privatization have often misplayed their hand. Many governments (and donors) oversimplified the economic situations faced, and vastly oversold privatization as the key to rapid and sustained growth and social progress. For example, Anatoli Chubias famously stated that the Russian privatization voucher would quickly attain the value of a Lada car; most Russians found that their vouchers, and the shares for which they could exchange them, were valueless.[28] Thus, when the rosy financial claims, and growth and job creation predictions were not fulfilled, the backlash was strong. Many governments have been unable to manage the high expectations of consumers and the electorate.

Even in cases where privatization is a clear economic/financial success, and there is no issue of price increases for essential infrastructure services, political problems still arise. For example, in several sub-Saharan African states, privatization of commercial firms has produced generally good results. Most are now making profits, they are providing goods and services of higher quality and in a more reliable manner. Job losses were relatively small, and the privatized firms are paying better salaries to those fortunate enough to have retained their positions.[29] Governments no longer have to subsidize their losses or carry their debts. All should be content—but they are not.

In both Zambia and Tanzania, for example, many of the commercial public enterprises, in banking, mining, brewing and transport, were purchased by South Africans. The nationality of purchasers is an issue in privatizations around the world; every country is concerned with this question, including OECD states. It is a particularly salient issue in Africa, however——especially when the buyers are South Africans, nationals of a country that a decade ago was

employed: informing the public of the costs of past policies and the costs of inaction; informing the public of the nature and spread of benefits; dialoguing with and compensating the losers, and—in line with political Pareto optimality—"lowering the visibility of costs," or, more bluntly, "obfuscation."

[28] Similar problems arose in almost all countries that employed vouchers in privatization programs; e.g., the Czech Republic, Slovakia, Romania, Lithuania, etc.

[29] Salaries and general job satisfaction tend to be higher in privatized firms than in public enterprises. Job security tends to be lower. Those likely to be retained post-sale, or obtain work elsewhere if dismissed, are the younger, better educated, and male workers.

black Africa's greatest enemy. Allegations abound that these buyers often act in an irresponsible, illegal or inefficient manner. The objections have some basis in fact—for example, the buyer of one Zambian mine fired many workers, despite having promised to retain them all, and then failed to pay the legally required severance awards. While the proven cases of misbehavior are few fewer than the claims, they are the ones that catch the public's eye and memory. These events always count among electorates.[30]

Yet another major political problem is that of post-privatization firm closures. A certain number of mainly commercial (seldom infrastructure) firms fail post-sale. That is, that are cases where no amount of new and clever management, fresh capital, or labor and other cost reductions can save the venture. Demand is overestimated, the availability or cost of capital underestimated, key personnel depart or cannot be found, cost and business forecasts are faulty; new, lower-cost competitors arise, and the upshot is firm failure and closure. No quantitative estimates are available on the number of privatized firms that fail to make it,[31] but it is likely to be as high or higher[32] than the normally prevailing rate of business failure in the private sector in the economy in question.

Bankruptcy is a regrettable but normal aspect of business life. Economists readily justify such failure as part of the "creative destruction" of capitalism. Failure and disappearance of firms are seen as productive, necessary processes that take misapplied resources out of the hands of the less competent or unlucky, and offer them up again, in the hope and expectation that the next user will possess what is needed to put them to more productive and profitable work. In this calculation, society is much better off, in welfare terms, by liquidating a persistent loss-maker rather than endlessly subsidizing it. The economic argument is impeccable.

[30] Another example: The non-privatized Tanzanian electricity public enterprise, TANESCO, has long provided a poor quality and inadequate quality of service. Brown- and black-outs are very common, and at present, its debts to government exceed $800 million US. After repeated failed attempts in the 1990s to improve performance, liberalize the sector and privatize the firm, the Tanzanian Government, under pressure from donors, decided on the interim solution of a Management Contract. An experienced South African firm won the competition. Under private management since 2002, the technical and financial performance of the firm has improved greatly (though the debt overhang remains to be resolved), in good part because TANESCO has reduced its internal operating costs and is for the first time cutting service to non-payers, including government offices. Tanzanians in and outside TANESCO interviewed in June of 2005, including workers in the firm, acknowledge the performance improvements. Still, there is some bitterness and dismay that a handful of white South African managers has been able to do in three years what Tanzanian managers could not accomplish in 40. The fact that the expatriate managers are very well rewarded for their services (in addition to base pay, they receive a portion of the financial savings attributable to performance improvements) is a compounding matter. The level of public grumbling is such that, despite the much improved electricity situation, the Government is under some pressure to terminate the contract and reinstate Tanzanian management.

[31] Megginson and Netter (2001) state that privatization improves performance in between two-thirds and three-quarters of cases. Presumably, performance either remains the same or deteriorates in between one-quarter to one-third of privatizations. This provides something of an "upper bound" estimate of the percentage of privatized firms that fail.

[32] Higher because privatized firms often inherit conditions that impede rapid transition to "lean, clean and mean" performance in competitive markets. Many studies from transition countries contrasting the performance of different types of firms rank new entry or "*de novo*" firms as the most productive and dynamic; then privatized companies, and last, state-owned firms. The gap between the *de novo* set and the privatized is often larger than between privatized and state-owned.

But as another economist (Oliver Williamson) has said, “politics usually trumps economics.” No political system will welcome, and few have been able to manage well, the popular discontent stemming from a wholesale closure of firms and hemorrhage of jobs. A few closures may be tolerated; a flood of shut-downs will almost certainly result in government efforts to try to soften the blow. This is particularly true when alternative jobs are scarce, and even if found, may entail longer hours, less security of tenure, and fewer fringe benefits.[33] So the political economy conundrum of privatization is this: When privatization goes well, it is close to invisible and taken for granted; when it goes wrong—as it frequently does for some—few politicians want anything to do with it.[34]

VII. Conclusions

Privatization is a widely applied economic policy. It has, incontestably, produced substantial economic benefits by raising profitability and efficiency in firms, by providing financial resources to strapped governments, and by signaling to creditors, investors and donors the seriousness and credibility of a government’s shift in economic regime.

In developing countries, privatization has most successfully been applied in commercial, industrial, manufacturing and service firms operating in competitive markets. This form of privatization has generally proven its worth: Consumers appreciate improvements in terms of quality and quantity of good or services produced—even when prices increase, which is far from the general case. In most countries, complaints about this sort of privatization have been relatively muted and short-lived. Citizenries may not like the job losses or the foreign ownership of breweries, banks, mines and hotels, but the matter rarely reaches the level of street demonstrations. The more important issue, economically and politically, is that of infrastructure privatization.

On this issue, the first point to note is that privatization has also produced improvements in infrastructure sectors in many developing countries, most often and obviously in telecommunications (where technological change has made competition relatively easy to introduce and maintain, and private provision has become the norm) and transport, less sweepingly but steadily in electricity, and more problematically in water. What is often overlooked is that, even in the more difficult sectors and settings, private involvement in infrastructure generally produces results superior to those previously attained by the public

---

[33] The question of what happens to workers laid off because of privatization needs more study. In Mexico and Brazil, follow up surveys show that about half of persons laid off found other formal sector employment within 12 months of dismissal. In both cases, wages were about the same. In Brazil, the new jobs required longer hours and entailed fewer benefits. In contrast, in Mexico, 45 to 50 percent of those dismissed found jobs in the same sector and obtained about the same level of benefits and health coverage. (Mckenzie and Mookherjee, 2005, p. 68)

[34] And those politicians who have stood by privatization until the bitter end—Anatoli Chubias in Russia, Roger Douglas in New Zealand, Carlos Menem in Argentina, for example—have paid a high political price for their tenacity.

provider.[35] For example, a review of seven "private participation in infrastructure" cases in sub-Saharan Africa concluded that none of these privatizations produced levels of service and cost recovery comparable to best practice in industrialized countries. All suffered from financial or political problems (or both). Still, all the results were "better compared to what outcomes would have been without private sector contracts." (Castilla Strategic Advisors, 2005, 1) A second set of African case studies, by Gökgür, Jammal and Jones (2005), reaches much the same conclusion. The financial and operational improvements made under private provision need to be better disseminated.

Despite the comparative success, infrastructure privatization remains a problem, especially in low-income countries, and most acutely in the electricity and water and sewerage sectors. There, because of the essential nature of the goods produced, because of the level of decrepitude of the businesses being privatized, because of the unwillingness or inability of governments to impose costs on elites, and because of the relative power of the private investors vis-à-vis the civil servants they deal with before and after the transaction, it has proven hard to construct credible and enduring transactions. A number of renegotiations, non-renewals, and outright cancellations of contracts have occurred. (Harris, 2003) Because of the problems, it has proven easy to cast privatization—not just in infrastructure but across the board—in the role of a (or even the) social villain; the tool of the rich, the foreign, the corrupt. In sum, privatization has everywhere and inevitably proven to be an intensely political event, even more than most other economic reform measures.

What next?

Many public policies move in and out of fashion, but few have shifted in pendulum-like manner to the extent of privatization. More than a decade ago, Gomez-Ibañez and Meyer (1993) wrote of the cyclical process of privatization and nationalization. (see also Klein and Roger, 1994) The idea is that private provision of utility services eventually, inevitably, leads to conflicts over what price the provider may charge to cover costs, and what is a "reasonable" return on investment. A common response is more and more strenuous government intervention and regulation. This decreases returns and causes the private operators to quit the market, and/or to the government takeover of the service. But this solution too is short-lived. Populist pricing, insufficient investment, and a failure to sustain reform short of ownership change lead to problems of both quantity and quality of service—provoking once more the increasing involvement of the private sector, first as managers and financiers, sometimes as owners of the utility. And the cycle begins anew.

Privatization events roughly approximate this model in many developing countries. Are we then at the stage where a wave of renationalizations might occur? The answer is, no. The past never simply reoccurs; the next cycle will encounter a changed political-economic landscape. For prime example, the preceding wave of nationalization in developing countries involved many firms producing tradable goods as well as infrastructure services. As noted, few sustained anti-

[35] The most shocking aspect of the cancelled lease contract in urban water in Tanzania, mentioned above, was that this was a rare case where the private operator did worse, by a variety of technical and financial measures, than its public enterprise predecessor. Far more often the problem is that a financially exhausted government allows a private operator to charge a cost-covering tariff, or contracts to allow tariffs to rise in line with input prices, and this at once or eventually provokes a public outcry, protests, and a political crisis.

privatization protests have centered on the divestiture of manufacturing, industrial or non-infrastructure services. No leader, either in left-leaning Argentina, Brazil or even Venezuela (or Russia, for a non-Latin example), has yet seriously suggested the renationalization of privatized commercial or industrial concerns (with the possible exception of banks and the energy/petroleum sector; e.g., in Bolivia—and even here the outcome is, at time of writing, unclear). The likelihood is high that all these divestitures will be allowed to stand; the legitimate arena for private action has been expanded.[36]

Utilities, as usual, present a more complex story. First, outside of telecommunications, declining investor interest has made it difficult to launch any new concession, much less outright purchases. Few private operators are presently willing to invest equity and take major and long term risks in emerging market utilities. Investors that remain are looking for management contracts or carefully hedged leases with most if not all of the commercial risk being borne by governments. Second, a number of governments, shaken—and in a few cases removed from office—by public outcry centering on infrastructure privatizations, have become equally unwilling to undertake such ventures.

However, the underlying factors that led initially to private provision of infrastructure have not disappeared: Relentlessly increasing demand for infrastructure services, decaying networks and poor public enterprise performance, and exhausted state budgets leave many governments with little choice but to continue the search for private infrastructure partners. The constraints are revealed in time of crisis: In many (of the relatively few) instances of cancelled lease and concession contracts, governments have immediately sought to re-bid the contract to another private provider.

The point is that, despite problems and contract woes, most developing states are far more open and more integrated into world capital markets than they were a decade ago. Few will take drastic steps that would further alarm or threaten markets. Most are still financially strapped, and most will require the approval and involvement of the international financial institutions in further, still badly needed, infrastructure expansion and reform. While the IFIs will be much less insistent on ownership change as a *sine qua non* of infrastructure reform, they will (it is hoped) recall the extent to which their previous infrastructure reform efforts, without private sector involvement, were ineffectual and counterproductive. A major question is whether this time around the governments and IFIs can learn the lessons of the past and jointly devise—and sell to the public—reform mechanisms that give incentives and comfort to reputable private investors, that create and sustain the policy and regulatory institutions that make governments competent and honest partners with the private operators, while at the same time protecting consumers, particularly the most disadvantaged, from abuse.

---

[36] The test will come when (if) some of these privatized firms fail or otherwise go out of business. Particularly if they are large employers, or the only employment source in a region, governments will be greatly tempted to renationalize them simply to keep them alive and maintain jobs. Indeed, many commercial firms originally became state enterprises, in India, Mexico and elsewhere, because governments would not allow them to disappear the first time they failed.

References

Arocena, P. 2001. *The Reform of the Utilities Sector in Spain.* WIDER Discussion Paper 2001/13. Helsinki: United Nations University/World Institute of Development Research.

Barja, Gover, David McKenzie, and Miguel Urquiola. 2005. Bolivian Capitalization and Privatization: Aprroximation to an Evaluation, in John Nellis and Nancy Birdsall, editors, *Reality Check: The Distributional Impact of Privatization in Developing Countries, op. cit.*

Behrman, Jere, Nancy Birdsall, and M. Szekely. 2000. *Economic Reform and Wage Differentials in Latin America,* Working Paper No. 435. Washington: Inter-American Development Bank..

Brune, Nancy, Geoffrey Garrett, and Bruce Kogut. 2004. *The IMF and the Global Spread of Privatization,* IMF Staff Working Papers, 51, 2. Washington: International Monetary Fund.

Campos, Javier, Antonio Estache, Noelia Martin and Lourdes Trujillo. 2003. Macroeconomic Effects of Private Sector Participation in Infrastructure, in William Easterly and Luis Serven, eds. *The Limits of Stabilization: Infrastructure, Public Deficits and Growth in Latin America.* Washington: World Bank.

Castilla Strategic Advisors. 2005. *Experience with Private Participation in Sub-Saharan African Infrastructure.* Washington: Unpublished report submitted to the Africa Energy Department of the World Bank.

Chong, Alberto, and Florencio Lopez-de-Silanes. 2002. *Privatization and Labor Force Restructuing Around the World* World Bank Policy Research Working Paper No. 2884. Washington: World Bank.

Chisari, Omar, Antonio Estache, and Carlos Romero. 1999. Winners and Losers from the Privatization and Regulation of Utilities: Lessons from a General Equilibrium Model of Argentina. *World Bank Research Observer*, 13, 2.

Clarke, George, Katrina Kosec, and Scott Wallsten. 2004. Has Private Participation in Water and Sewerage Improved Coverage? Empirical Evidence from Latin America, *World Bank Policy Research Working Paper No. 3445.* Washington: World Bank.

Davis, Jeffrey, Rolando Ossowski, Thomas Richardson and Steven Barnett. 2000. Fiscal and Macroeconomic Impact of Privatization, *Occasional Paper no. 194*. Washington: International Monetary Fund.

Delfino, Jose A. and Ariel A. Casarin. 2001. *The Reform of the Utilities Sector in Argentina.* WIDER Discussion Paper No. 2001/74. Helsinki: United Nations University/ World Institute of Development Research.

Djankov, Simeon, and Peter Murrell. 2002. Enterprise Restructuring in Transition: A Quantitative Survey. *Journal of Economic Literature,* 40, no. 3: 739-92.

Domah, P., and M. G. Pollitt. 2000. *The Restructuring and Privatisation of Electricity Distribution and Supply Businesses in England and Wales: A Social Cost-Benefit Analysis.* Working Paper No. 7. Cambridge, UK: University of Cambridge. Department of Applied Economics.

Ennis, Humberto, and Santiago Pinto. 2005. Argentina's Privatization: Effects on Income Distribution. In John Nellis and Nancy Birdsall, *Reality Check: The Distributional Impact of Privatization in Developing Countries, op. cit.*

European Bank for Reconstruction and Development. 2004. *Fifteen Years On….* London: European Bank for Reconstruction and Development. http://www.ebrd.com/pubs/tr/04/15yearsinsert.pdf

Fischer, Ronald, Rodrigo Gutierrez, and Pablo Serra. 2003. *The Effects of Privatization on Firms and on Social Welfare: The Chilean Case.* Research Network Working Paper #R-456. Washington: Inter-American Development Bank.

Frydman, Roman, Cheryl Gray, Marek Hessel, and Andrejz Rapaczynski. 1999. When Does Privatization Work? The Impact of Private Ownership on Corporate Performance in the Transition Economies. *Quarterly Journal of Economics,* 114, 4, pp. 1153-1191.

Galal, Ahmed, Leroy Jones, Pankaj Tandon and Ingo Vogelsang. 1994. *Welfare Consequences of Selling Public Enterprises.* Washington: World Bank.

Galiani, Sebastian, Paul Gertler, Ernesto Schargrodsky, and Frederico Sturzenegger. 2003. *The Costs and Benefits of Privatization in Argentina: A Microeconomic Analysis.* Research Network Working Paper #R-454. Washington: Inter-American Development Bank.

Gökgür, Nilgün, Yahya Jammal, Leroy Jones. 2005. *Assessing the Impact of Infrastructure Privatization in Africa,* Interim Report for Conference on the Way Forward to Private Participation in Infrastructure in Sub-Saharan Africa. Washington: World Bank.

Gomez-Ibañez, Jose A. and John R. Meyer. 1993. *Going Private: The International Experience with Transport Privatization.* Washington: The Brookings Institution.

Harris Clive. 2003. Private Participation in Infrastructure in Developing Countries: Trends, Impacts and Policy Lessons. *World Bank Working Paper No. 5*. Washington: The World Bank.

Inter-American Development Bank. 2002. The Privatization Paradox. *Latin American Economic Policies,* 18, Second Quarter.

Jones, Leroy, Y. Jammal and Nilgün Gökgür. 1998. Impact of Privatization in Cote d'Ivoire. Unpublished report to the World Bank. Boston: Boston Institute of Development Economics.

Kahn, Si, and Elizabeth Minnich. 2005. *The Fox in the Henhouse: How Privatization Threatens Democracy*. San Francisco: Berrett-Koehler Publishers, Inc.

Kikeri, Sunita, and Ashetu Fatima Kolo. 2005. Privatization: Trends and Recent Developments. Washington: World Bank.
http://rru.Worldbank.org/Documents/Privatization/Privatization_paper.pdf

Klein, Michael and Neil Roger. 1994. *Back to the Future: The Potential in Infrastructure Privatization.* New York: Oxford University Press.

Knight-John, Malathy, and P. P. A. Wasantha Athukorala. 2005. Rethinking Privatization in Sri Lanka: Distribution and Governance. In John Nellis and Nancy Birdsall, editors, *Reality Check: The Distributional Impact of Privatization in Developing Countries, op. cit.*

Kornai, Janos. 2000. *Ten Years After 'The Road to a Free Economy:" The Author's Self-Evaluation.* Washington: World Bank.

Macedo, Roberto. 2005. Distribution of Assets and Income in Brazil: New Evidence. In John Nellis and Nancy Birdsall, editors, *Reality Check: The Distributional Impact of Privatization in Developing Countries, op. cit.*

Macedo, Roberto. 2000. *Privatization and the Distribution of Assets in Brazil.* Working Paper No. 14. Washington: Carnegie Endowment for International Peace.

Marcincein, Anton, and Sweder J. G. Van Wijnbergen. 1997. *The Impact of Czech Privatization Methodson Enterprise Performance Incorporating Selection Bias Correction,* Working Paper, Centre for Economic Reform and Transformation. Edinburgh: Heriot-Watts University.

Megginson, William L. and J. M. Netter. 2001. From State to Market: A Survey of Empirical Studies on Privatization. *Journal of Economic Literature,* 39, no. 2: 321-89.

Mckenzie, David, and Dilip Mookherjee. 2005. Paradox and Perception: Evidence from Four Latin American Countries. In John Nellis and Nancy Birdsall, editors, *Reality Check: The Distributional Impact of Privatization in Developing Countries, op. cit.*

Nellis, John. 2005a. *Enterprise Reform in Sub-Saharan Africa.* ESMAP Technical Paper 084. Washington: World Bank.

Nellis, John. 2003. *Privatization in Latin America.* Washington: Working Paper No. 31, Center for Global Development.

Nellis, John. 2005b. *Privatization in Transition.* Milan: Privatization Barometer Newsletter, No. 2, Fondazione Eni Enrico Mattei/Fondazione IRI.

Nellis, John, and Nancy Birdsall, editors. 2005. *Reality Check: The Distributional Impact of Privatization in Developing Countries.* Washington: Center for Global Development.

Nellis, John. 2002. *The World Bank, Privatization and Enterprise Reform in Transition Economies,* Washington: World Bank: Operations Evaluation Department.

Newbery, David M., and M. G. Pollitt. 1997. The Restructuring and Privatisation of Britain's CEGB: Was It Worth It? *Journal of Industrial Economics,* 45, no. 3: 269-303.

Paredes, Ricardo. 2001. *Redistributive Impact of Privatization and the Regulation of Utilities in Chile.* WIDER Discussion Paper No. 2001/19. Helsinki: United Nations University/World Institute of Development Research.

Pierson, Paul. 1994. *Dismantling the Welfare State? Reagan, Thatcher and the Politics of Retrenchment.* Cambridge, U.K. Cambridge University Press.

Rodrick, Dani, Arvind Subramaniam and Francesco Trebbi. 2002. "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development." Cambridge: Unpublished paper, Harvard University.

Rodriguez, Samuel Freije, and Luis Rivas. 2005. Inequality and Welfare Changes: Evidence from Nicaragua, in John Nellis and Nancy Birdsall, editors, *Reality Check: The Distributional Impact of Privatization in Developing Countries, op. cit.*

Roland, Gerard. 2004. Economic Theory and Privatization. Berkeley: unpublished paper, Department of Economics, U. C. Berkeley.

Shirley, Mary. 2003. Institutions and Development: A Statement of the Problem. Unpublished paper, The Ronald Coase Institute, Chevy Chase, MD, pp. 7.

Shirley, Mary, and John Nellis. 1991. *Public Enterprise Reform: The Lessons of Experience.* Washington: World Bank.

Shleifer, Andrei, and Daniel Treisman. 2000. *Without A Map: Political Tactics and Economic Reform in Russia.* Cambridge: MIT Press.

Stiglitz, Joseph. 1999a. *Quis Custodiet Ipsos Custodes? Corporate Governance Failures in the Transition.* Paris: World Bank.

Stiglitz, Joseph. 1999b. *Whither Reform? Ten Years of Transition.* Washington: World Bank.

Tandon, Pankaj. 1995. Welfare Effects of Privatization: Some Evidence from Mexico. *Boston University International Law Journal,* 13, 2: 329-49.

Toba, Natsuko. 2003. Welfare Impacts of Electricity Generation Sector Reform in the Philippines. ERD Working Paper Series No. 44. Manila: Asian Development Bank.

Torero, Maximo, and Alberto Pasco-Font. 2001. *The Social Impact of Privatization and the Regulation of Utilities in Peru.* WIDER Discussion Paper 2001/17. Helsinki: United Nations University, World Institute for Economic Development Research.

Torero, Maximo, Enrique Schroth and Alberto Pasco-Font. 2005. Peru After Privatization: Are Telephone Consumers Better Off? In John Nellis and Nancy Birdsall, editors, *Reality Check: The Distributional Impact of Privatization in Developing Countries, op. cit.*

World Bank. 1995a. *Bureaucrats in Business: The Economics and Politics of Government Ownership.* Washington: World Bank.

World Bank. 1995b. *Concessions: The Way to Privatize Infrastructure Sector Monopolies.* Public Policy for the Private Sector. Note No. 59. Washington: World Bank.

World Bank. 2005. *Infrastructure development: The roles of the public and the private sectors.* Washington: Infrastructure Vice-Presidency, World Bank.