DISTRIBUTIONAL EFFECTS OF PRIVATIZATION

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MOST STUDIES
JUDGE
PRIVATIZATION AN
OPERATIONAL &
FINANCIAL SUCCESS
PROFITABILITY, EFFICIENCY & RETURNS TO SHAREHOLDERS INCREASE....
....IN 2/3 TO 4/5 OF CASES, DEPENDING ON INDICATOR MEASURED
MACROECONOMIC IMPACT POSITIVE (IMF)

- Net proceeds = 1 % GDP; generally not wasted
- Growth impact positive (?)
- Good proxy for liberalizing reform
- Financial flows to govt. increase post-privatization
CAVEATS:
1st:

WIDE REGIONAL VARIATION IN OUTCOMES;
e.g. FSU vs. CEE; OECD vs. SSA
OUTCOMES LESS POSITIVE IN LOWER INCOME COUNTRIES & REGIONS
2nd: OUTCOMES VARY BY SECTOR (infrastructure & bank privatization harder than manufacturing/commercial)
3rd:

MANY STUDIES REPORTING POSITIVE FINDINGS DATE FROM PERIOD OF GENERAL BOOM --- 1992-1998
& 4\textsuperscript{th}:

\textbf{EXTENT TO WHICH OWNERSHIP EXPLAINS PERFORMANCE IMPROVEMENTS STILL UNDER DEBATE}
WHICH IS THE MAJOR FACTOR: COMPETITION OR OWNERSHIP?
DESPITE IMPROVED FINANCIAL & OPERATING PERFORMANCE & RETURNS TO OWNERS....
PRIVATIZATION HIGHLY & INCREASINGLY UNPOPULAR---- IN LATIN AMERICA, SOUTH ASIA, AFRICA & MANY TRANSITION COUNTRIES
AVOIDING THE NAME...

- Bolivia  "capitalization"
- India    "disinvestment"
- Vietnam  "equitization"
- Sri Lanka "peopleization"
- China    "ownership reform"
- Mexico   "disincorporation"
% agreeing: “privatization has benefited the country”

Source: Latinobarometro surveys, 1998-2002
IN RUSSIA, 2/3 INTERVIEWED: “LOST MORE THAN GAINED FROM PRIVATIZATION”

2001; 1600 respondents; only 5 % said opposite
LABOR: PRIVATIZATION IS UNFAIR----

- ASSISTS RICH & AGILE, LEAVES POOR BEHIND
- HARMS WORKERS
- RAISES PRICES
- INCREASES CORRUPTION
- IMPOSED BY IFIs; ERODES SOVEREIGNITY

(Indian trade union view)
TRUTH OF THE
ALLEGATIONS?

- IS PRIVATIZATION INCREASING
  INEQUALITY?

- IF SO, HOW & TO WHAT
  EXTENT? &

- WHAT, IF ANYTHING, CAN &
  SHOULD BE DONE ABOUT IT?
HOW CAN PRIVATIZATION AFFECT EQUITY?

1. ASSET DISTRIBUTION
2. EMPLOYMENT
3. ACCESS TO & PRICES, ESP. IN INFRASTRUCTURE
4. GOVT.’s FISCAL POSITION & RESOURCE ALLOCATION
SUBJECT BEST STUDIED IN LATIN AMERICA

- LARGE AMOUNT OF INFRASTRUCTURE PRIVATIZATION
- HOUSEHOLD EXP. & CONSUMP. SURVEYS AVAILABLE (LSMS)
- LARGE # OF LOCAL RESEARCHERS
D. McKenzie & D. Mookherjee:

STUDIES
MEASURE PRIV.’s….

- IMPACT ON EMPLOYMENT, ACCESS, PRICE & QUALITY
- EFFECTS ON CONSUMERS ACROSS INCOME GROUPS
- CONSEQUENCES FOR INEQUALITY & POVERTY
MANY CONSTRUCT A “COUNTERFACTUAL”

ESTIMATING WHAT WOULD HAVE HAPPENED IN ABSENCE OF PRIVATIZATION
FINDINGS:

- ACCESS UP (infrastructure)
- PARTICULARLY BENEFICIAL TO POOR
- PRICES UP IN HALF OF CASES, DOWN IN OTHER HALF
- SERVICE QUALITY IMPROVES MARKEDLY
QUALITY SHIFT CAN BE VERY IMPORTANT

Argentina: infant mortality down 6 to 8 % in areas where water privatized

Poorer the area, greater the decline (up to 24%)

(Galiani, Gertler, Schargrodsky, 2003)
STILL, & OFTEN, OWNERSHIP BECOMES:

MUCH MORE CONCENTRATED, DESPITE VOUCHERS; SHARES TO WORKERS; “CAPITALIZATION,” RESERVING TRANCHES FOR WORKERS, LOCALS, ETC.
Ownership effects unlikely to effect bottom end of income distribution:
Employment/consumer effects more important
In some cases privatization can contribute significantly to seriously worsened asset distribution (e.g., Russia)
EMPLOYMENT:

EMPLOYEE #s DECLINE BEFORE & AFTER SALE

E.g.: 50% loss rate in Argentine & Mexican firms; 15% of total employment Nicaragua
SURVEY OF 308 PRIVATIZED FIRMS:

POST-SALE EMPLOYMENT LOSS IN 79 %
EMPLOYMENT NEUTRAL OR GAIN IN 21 %

(Chong & Lopez-de-Silanes, 2002)
HOWEVER....

- # DISMISSED SMALL % OF TOTAL WORKFORCE
- PRIVATIZATION NOT PRIME CAUSE OF HIGH POST-REFORM UNEMPLOYMENT
EMPLOYMENT:

- RETAINED EARN ABOUT SAME
- WORK MORE HOURS; LESS SECURITY
- MEN, YOUTH, BETTER EDUCATED THE WINNERS; WOMEN, THOSE > 45 THE LOSERS
WAGE/BENEFIT EFFECTS

- Privatization causes downward effect on overall wage rate
- “...unlikely to be significant...”
- Hours worked increased, &
- Fringe benefits often reduced or lost
ACCESS & PRICES:

- ACCESS INCREASES, ESP. IN POORER DECILES
- QUALITY INDICATORS UP
- PRICE INCREASES IN ½ OF OBSERVED LAC CASES—OFTEN LARGE
- BUT LARGE PRICE DECREASES ALSO OBSERVED
IMPROVED ACCESS

- Peru telecom
  - electricity + 167 %
  - + 33 %

- Bolivia telecom
  - electricity + 123 %
  - water + 2.7 %
  - + 15 %

- Argentina telecom
  - electricity + 30 %
  - natural gas + 11 %
  - + 30 %
Figure 7
Department capitals: percentage of households that have access to telephone services, by income quintile: 1989-1999
PRICE SHIFTS IN INFRASTRUCTURE

- UP IN WATER & ELECTRICITY; DOWN IN TELECOM & GAS
- DISTRIBUTIONAL IMPACT DEPENDS ON REGULATORY COMPETENCE but......
- HOUSEHOLD BUDGET SHARES NOT LARGE ENOUGH TO PRODUCE SIGNIFICANT PRICE EFFECTS
EVEN WHEN WELFARE +, POOR CONSUMERS CAN & DO SUFFER

E.G., ENDING ILLEGAL HOOK-UPS (Argentina)
Does increased access offset price increases?

Answer: “yes” --- access effects + for all but top decile
In best-studied Latin American cases ......

- “...privatization has a very small effect on inequality...”
- changes to Ginis 0.02 or less
- “Privatization either reduces poverty or has no effect on it.....”
NO SIMILAR DEPTH OF ANALYSIS IN OTHER REGIONS; BUT MANY HINTS THAT FINDINGS ARE LESS POSITIVE
FISCAL EFFECTS

- Positive “flow of funds” (despite “underpricing”)
- More from end of subsidies & new corporate taxes than from sales proceeds
- Public debt down; social expenditures up in many cases
- Privatization a fiscal opportunity
CONCLUSION:

IN SHORT RUN, PRIVATIZATION SEEMS TO WORSEN ASSET & INCOME DISTRIBUTION
SO WHAT?
INCREASED INEQUITY A NECESSARY, TEMPORARY, COST OF PUTTING PREVIOUSLY WASTED ASSETS BACK TO WORK?
• Wealth effects mainly important in transition economies
• Income effects small & often temporary
• Increased access far outweighs price increases
Our conclusion:

Inequality & perceptions matter; privatizations can & should be structured to minimize trade-offs between efficiency & equity
NONETHELESS, REGARDING INCOME DISTRIBUTION:

SEVERELY NEGATIVE PUBLIC PERCEPTION NOT SUPPORTED BY EMPIRICAL ANALYSES
IMPACT ON THE POOR:

- Access increases—but…. 
- Rural lags urban 
- Net employment effect somewhat negative 
- Distributive schemes (e.g. vouchers) have not worked 
- Aiding poor requires good regulation, institutions & innovative implementation (inf.)
How can privatization harm the poor? Through...

- Job losses
- Price increases (to cover costs)
- More vigorous collection
- End of illegal connections
- High cost of connection & new equipment
Tariff rebalancing (e.g., local phone)
Reduced incentives to serve poor
Reduction in alternative services
Increased network costs due to quality improvements
PROTECTING THE POOR REQUIRES SPECIAL EFFORTS:

- PROMOTE ACCESS
- ENSURE AFFORDABILITY
- REGULATE WELL
- DEVISE & IMPLEMENT GOOD POLICY
PROMOTING ACCESS

- OBLIGATE CONTRACTORS (CONNECTION TARGETS)
- SELECT CHEAPER TECHNOLOGIES
- SPREAD C-COSTS OVER TIME
- SUBSIDIZE CONNECTION COSTS
- OPEN MARKET TO ALTERNATIVE SUPPLIERS
CONNECTION TARGETS

- Service obligations & expansion programs are effective when focused on poor communities, &
- When financial penalties for non-compliance specified in the contract
CHEAPER TECHNOLOGY

- Offer poorer households choice of lower quality, cheaper service
- Allow poor neighborhoods to contribute to local network in labor
- Good is not the enemy of the best
SPREAD COST OVER TIME

- Installments to pay for large connection costs (esp. water)
- Micro-credit lines to pay for connection, & interior plumbing & facilities
CONNECTION SUBSIDIES

- CHEAPER (in long run)
- EASIER TO TARGET
- EASIER TO MANAGE
ALTERNATIVE SUPPLIERS

- Oblige dominant utility to *allow* alternative, less formal suppliers
- Oblige dominant utility to *include*
- Provide incentives for suppliers to cooperate
  (most common in water)
MAKING IT AFFORDABLE

- SUBSIDIZE PRICE (cross-subsidies, certain households or regions, etc.)
- OFFER LOWER QUALITY
- LIMIT QUANTITY
- INCREASE FREQUENCY OF PAYMENT; USE PREPAYMENT
REDUCTIONS IN PRICE

- CROSS SUBSIDIES BACK IN VOGUE?
- TARGETED SUBSIDIES
  - “lifeline” subsidies (according to consumption level)
  - “means-testing” (according to socioeconomic characteristics)
- SHIFT MORE FIXED-COST BURDEN TO LARGER CONSUMERS
QUALITY & QUANTITY

- CHOOSE INTERIOR OR EXTERIOR CONNECTION (WATER)
- CONTRIBUTE LABOR TO NETWORK
- LIMIT QUANTITY---OR BILL FIRST PORTION AT LOWER RATES
- ACCEPT REDUCED TIMES OF SERVICE
PAYMENT METHODS

- Poor have cash-flow problems, frequent small payments a solution
- Use prepayment methods (cell phones)

(Adds costs; may increase unit price)
GOOD REGULATION

- Competition, competition, competition....
- Flexibility in service quality
- Flexibility in technical standards
- Promote innovative tariff structures
Staff perceptions: privatization

Source: FPSI Staff Survey, 2003