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Privatization's bad name isn't totally deserved

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WASHINGTON – Outside last month's UN Conference on Sustainable Development in Johannesburg, privatization was a dirty word. Outside the annual meetings of the World Bank and the International Monetary Fund here this weekend, the tirade will continue. That's too bad.

Protesters and antiglobalizers say privatization of state-run businesses has hurt the poor. And the common assessment in developing and transition countries – from Argentina to Russia to Sri Lanka – is that privatization has enriched the few at the expense of the many, increased consumer prices, and reduced jobs – and hasn't delivered on the promise to boost production and growth.

Influential thinkers concur with the negative popular perception. Joseph Stiglitz, the former World Bank chief economist, excoriates the IMF across the board, but reserves particular scorn for the way it and other international financial institutions pushed for massive and speedy privatization of state-owned industries and utilities, especially in Russia. Mr. Stiglitz argues that privatization in the absence of institutional safeguards – coherent laws; competent, impartial courts, the decisions of which are enforced; a civil service that is at least basically civil and that actually serves rather than extracts – is a recipe for enriching the privileged via corruption.

Certainly, privatization was oversold as the solution. A number of corrupt and incompetent governments made a hash of the process; and international financial institutions and some advisers pushed mechanically for privatization long after they should have known better.

Nonetheless, this is a case where the baby ought not be thrown out with the bath water. Our study of the effects of privatization suggests that ending – or worse, reversing – privatization would hurt the world's poor.

In the short-run, privatization worsens wealth and income distribution. Assets formerly held (in theory) for the public at large are now held by a small number of owners – in the worst cases, a tiny group, such as the Russian oligarchs. Jobs are usually lost. In most countries the losses are small, but it's the older and women workers who end up worse off. Prices go up for electricity and water. Aggressive collection of fees hits the poor and middle class. And often the windfall from sales revenue is eaten up by the rising cost of public debt.

Benefits to new private owners are large and immediate. Benefits to consumers and citizens are smaller and uncertain, sometimes never emerging at all – as in privatized toll roads in Mexico, and water in Bolivia and Argentina. In the end, general benefits depend heavily on the quality of policy, the enforcement of contracts, and the competence of regulators.

But privatization usually improves the operating and financial performance of a business – clearly good for buyers and shareholders, but also for others.

Privatization increases the financial resources available to governments. Revenue from the sale itself is a bonus, but the big payoff to the public purse comes from the elimination of subsidies to cover the losses of state-run firms, and the increased taxes paid by now-profitable private companies. These increased resources provide an opportunity for good governments to help the poor. In Chile and Mexico, for example, privatizing governments have increased spending on social services.

And privatization usually leads to expansion of utility coverage: In Chile, Peru, Bolivia and, Argentina, the percentage of people with electricity and telephone service rose dramatically after privatization, with the poor benefiting most.

Yes, privatization is very good for rich insiders. But where governments are clean and reasonably competent, it is still a pretty good deal for the poor.

Is that good enough? Not quite.

Inequality matters, and not just in a moral sense. First, large increases in inequality and long waits for modest widespread benefits spur opposition among the disaffected. For a government to carry out good policy, it has to stay in power. Second, when insiders grab the firms, they then lobby against subsequent reforms, like policy promoting meaningful competition. Then privatization entrenches opposition to progress. Ignoring the risk of insider grabs is neither just nor shrewd.

Opportunities have been missed in privatization, opportunities to minimize equity losses while securing efficiency gains. There are lessons to apply:

• Deal with regulation before, not after sale of state property.

• Concentrate on the quality, not just the quantity, of new owners.

• Use the proceeds in ways that are socially astute and financially sound.

The bottom line: Do privatize. But do it cautiously – and do it right.

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