

## Sri Lanka's Experience with Privatization<sup>1</sup>

John Williamson  
Senior Fellow, Institute for International Economics

The big mystery that appears to have inspired this conference is: Why is privatization so unpopular? It indeed appears to be unpopular in Sri Lanka, as in so many other countries: the paper reports that no less than 80 percent of the population of Sri Lanka believe that further privatization would have a negative impact on poverty and living standards. Yet most economic assessments have concluded that privatization has had a positive impact, most conspicuously on access to basic utilities that have been privatized. Indeed our theory leads us to expect a positive impact:

- The asset transfers that take place when an enterprise is privatized will have no first-order effect on the distribution of wealth if they take place at fair values.
- The termination of subsidies to an enterprise that is privatized typically results in a price increase to relatively affluent consumers, but it yields a fiscal bonus<sup>2</sup> that one would expect will typically benefit the poor disproportionately.
- Private enterprises have a stronger incentive structure that makes one expect efficiency to increase. Given a competitive environment or, in its absence, an effective system of regulation, the benefits of this should spill over to society at large (in lower prices or better access) rather than all being appropriated by the owners.

If the people of Sri Lanka have the acute perception of self-interest that economists would normally attribute to them, presumably some of those standard presumptions were not fulfilled. Why didn't things work out as theory would have led one to expect?

First, it is quite clear that many asset transfers were not at fair value. On the contrary, we read of sales that were deliberately under-priced in order to attract particular classes of buyers, and of non-transparent tender procedures and the suspicion that the friends of the powerful were able to profit from insider information. The result was frequently non-negligible and inegalitarian wealth transfers from the public sector to either foreigners or the rich.

Second, fiscal benefits. These were present but the privatization receipts were quite small, an average of less than 1 percent of GDP gross and only around 0.4 percent

---

<sup>1</sup> Discussant's comments on Malathy Knight-John, "Distributional Impact of Privatization: The Sri Lankan Experience", a paper presented to the CGD conference on The Distributional Impact of Privatization on February 25, 2003.

<sup>2</sup> Privatization may also benefit the fisc by the initial receipts from privatization (although one expects that to be largely offset by smaller future revenues from the enterprises that no longer pay their profits to the government), as well as by yielding tax revenue on profits made by the privatized enterprise.

of GDP net, after deducting the costs of privatization. We are given no estimate for any saving there may have been on subsidies that were withdrawn post-privatization, or of tax revenue on the newly-privatized enterprises. Malathy volunteers the judgment that fiscal benefits were squandered pre-1995 by increased current government spending of little value to the poor, but that after 1995 they were applied to debt reduction. This was in fact a period when the government ran fiscal deficits that swamped privatization receipts, and it is not clear on what basis she is judging that revenue and spending were uninfluenced by the availability of receipts from privatization.

Third, there is a certain amount of evidence that efficiency increased post-privatization. It is reported that productivity increased. Higher efficiency might also explain the report that investment often decreased: rather than reflecting lessened efforts to increase output, this could be the result of less waste. And there are also reports of improved access, especially in telecoms. Thus there indeed appear to have been benefits from improvements in efficiency, despite the extraordinary government edict that no worker should lose his or her job after privatization. However, except for the case of improved access, the benefits of improved efficiency appear not to have been widely dispersed, either through effective competition in the affected sectors or, failing that, through strong and effective regulation. (Despite that, the profits data that are recorded show no evidence of price-gouging.)

The impression left by these facts is that the benefits of privatization were probably positive, but that they were certainly disappointingly small. The public perception was, as noted earlier, even more negative. There are three ways one might react to this negative perception.

- One could dismiss the public as ignorant and incapable of understanding its own self-interest. The solution is to hire better public relations managers.
- One can rejoice at the failure of privatization. The solution is to go back to nationalizing enterprises, or at least to stop the process of privatization.
- One can conclude that the process of privatization needs to be done better. In particular, the process of actually selling the enterprise needs to be more transparent so as to provide greater assurance that the public will receive something close to fair value for what is being sold. But this does not mean that the government should seek to maximize privatization receipts: on the contrary, the enterprise should be subject to effective competitive pressures or, failing that, it should be subjected to strong and effective regulation.

Both Malathy and I believe the third reaction to be the appropriate one.