Center for Global Development

Abstract

In Latin America, privatization started earlier and spread farther and more rapidly than in almost any other part of the world. More, and larger, firms were sold, and more proceeds were raised. Despite positive microeconomic results, privatization is highly and increasingly unpopular in the region. The core social criticism is that privatization contributes to growing poverty and inequality levels in Latin America—and circumstantial evidence supports the claim. But recent and rigorous studies dilute or counter the negative views, concluding that privatization has contributed only slightly to rising unemployment and inequality, and either reduces poverty or has no effect on it. Still, while privatization may be winning the economic battle it is losing the political war: The benefits are spread widely, small for each affected consumer or taxpayer, and occur (or accrue) in the medium-term. In contrast, the costs are large for those concerned, who tend to be visible, vocal, urban and organized, a potent political combination.

Privatization in Latin America*

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I — Introduction

Latin America's privatization experience illustrates the rapid rise, the recent relative fall, and the continuing puzzle of this contentious economic policy.

Privatization started early in this region. The first ownership changes in Mexico and Chile came in the mid-1980s, not long after Britain's pioneering sales. As elsewhere, Latin American privatizers—with the notable exception of Argentina—began with the sale of state firms operating in competitive markets before moving to involve the private sector in the management, financing and eventually the ownership of state firms in the infrastructure, or utility sectors. Outside the industrialized OECD countries, privatization spread faster and more extensively in Latin America than in any other region of the world;[1] and sales raised more revenues than elsewhere. In the 1990s, in 18 Latin American states, accumulated privatization revenues averaged a sizeable 6 % of GDP. (Inter-American Development Bank [IADB], 2002) By the end of the decade, in distinct contrast to other regions (again, outside the OECD states), more than half of all Latin American privatizations were of high value infrastructure or utility firms. From 1990 to 2001, private investment in infrastructure alone in Latin America totaled $360.5 billion USD, $150 billion more than the next most attractive East Asia-Pacific region. (Harris, 2003) Some of this was "greenfield" investment, but most was related to privatization[2] operations. Privatization has been very big business in Latin America.

At the same time, privatization has provoked more popular discontent and criticism in Latin America than in other parts of the world: More political opposition, more outrage, more—and more violent—demonstrations against the concept and its real or supposed effects.

Because of the large scope and swift pace of privatization in the region, its initial technical successes, and the growing negative social reaction, the process and results

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[1] With the exception, in terms of number of firms divested, of the post-communist transition states.

[2] In accord with popular usage, we term as "privatization" not simply the sales of controlling stakes of equity to private buyers, but also concession contracts that put infrastructure assets under the control of private operators—but leave the titular ownership in the hands of the state.

have been subjected to extensive analysis—economic, financial and social—by proponents and opponents, by internal and external observers alike. Thus, more has been published on Latin American privatization than in just about any other part of the world.

We review this rich story. Section II summarizes the pro- and anti-privatization views in the region. Section III assesses the criticism that privatization has contributed heavily to growing poverty and inequality in Latin America. Section IV examines the political economy of the "disconnect;" i.e., how to explain the fact that privatization has been generally successful in technical terms and so contentious socially and politically. Section V discusses the interplay between institutions and privatization, and speculates on what will happen next.

II — The good….

Almost all technical—what economists call "empirical"—studies of Latin American privatization conclude that it improves firm performance. Profits, operating efficiency, and output tend to rise. An early but rigorous privatization study (Galal *et al.* 1994) found increased performance *and* welfare gains in 5 of 6 Latin American cases reviewed. A more recent IADB study of six Latin American countries[3] found an average increase in profits (return on sales) of 29.8 % in a large sample of privatized firms. Efficiency gains, as measured by output per worker or ratio of costs to sales, averaged a remarkable 67 %. Output increases averaged 34 %, "regardless of the indicator used." (IADB, 2002, 3)

Because of the economic size and social importance of the firms involved, and the large number of utility sales or concessions in the region, infrastructure privatization in Latin America has received special attention: From the World Institute of Development Economics Research (WIDER) of the United Nations University, the World Bank, the

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

IADB, and from other interested scholars.[4] Overwhelmingly, these studies conclude that infrastructure privatization in Latin America improves financial and operating performance in (most) firms, relaxes the previously prevailing investment constraint, extends network coverage and access to it, and generally enhances the quality of services. This last can be of great social importance. One study from Argentina finds significantly lower levels of infant mortality from waterborne diseases in localities with privatized water services, versus towns retaining state water provision—and the poorer the locale, the greater the mortality decline. (Galiani, Gertler, Schargrodsky, 2003)

In addition, shifts toward more rational prices, the retirement of accumulated debt and cessation of subsidy flows, and the tendency of now profitable private firms to pay, or pay more, corporate taxes, leads to improvements in the selling government's fiscal position. With this record of accomplishments, small wonder that economists, finance ministers and investment bankers find privatization an impressive tool: "…there is no doubt that privatization was one of the key elements that helped to jump-start economic revival in the countries that were the most aggressive privatizers…" (Kuczynski, 2003, 40)

…and the bad.

Alas, most Latinos who are neither economists nor investors nor government financial officials hold a much less positive picture of privatization. In 2001, a clear majority of people surveyed by *Latinobarométro* in 17 Latin American countries felt that privatization had not been beneficial, and by higher percentages than in previous surveys. A follow-up survey in 2002 showed a decline in anti-privatization sentiment in a few important countries—Colombia, Peru, Brazil and Ecuador—but increasingly negative views in Paraguay, Uruguay, Bolivia, Chile, Mexico, Venezuela and, not surprisingly, Argentina. In every country surveyed in 2002, the percentage of respondents who agreed

[4] For WIDER, see: Barja and Urquiola, 2001 (Bolivia); Delfino and Casarin, 2001 (Argentina); Parades, 2001 (Chile); Torero and Pasco-Font, 2001 (Peru). For the World Bank, see Chisari, Estache and Romero, 1999 (Argentina); Shaikh *et al.*, 1995 (Argentina); Galal *et al.*, 1994 (Chile and Mexico); Estache, Foster and Wodon, 2002 (entire region). For the IADB see the summary study by McKenzie and Mookherjee, 2003 (Argentina, Bolivia, Mexico, and Nicaragua); and the IADB summary of its research, 2002. Other notable studies of the impact of privatization in the region include Macedo, 2000 (Brazil), and La Porta and Lopez-de-Silanes, 1999 (Mexico); the latter concentrates on the effects of privatization in firms in competitive sectors, not infrastructure.

that "the state should leave economic activity to the private sector" was less than it had been in 1998.

Caution is required in interpreting such survey results. The questions posed are general, vague and unspecific. Asking people if they favor privatization is like asking if they favor "globalization" or "structural adjustment;" these terms have become demonized, almost automatically producing a negative reaction. Changing the wording or details of a question can produce dramatically different results: In another poll, most Peruvians surveyed said "yes" when asked if they would favor a privatization transparently conducted, where the private operator had firm performance targets, and a regulator was in place to enforce the rules. While the wording of the question is hardly impartial, the response nonetheless suggests that the Peruvian public, at least, objects more to poor implementation of the process and not ownership change *per se*. But despite the caveats, one cannot and should not discount to zero the generally negative public perceptions of privatization in Latin America. As shall be shown below, the unpopularity of the concept limits its use and its effects.

The greatest and most intense criticism is leveled against infrastructure privatization, particularly in the electricity, water and passenger rail sectors, less in telecommunications, freight rail, ports, airports and gas transmission. (Note that the very large amount of privatization carried out in competitive sectors has not come in for sustained or detailed criticism, an important fact that we return to in the conclusion.) The problem in infrastructure is partly the perceived loss of sovereignty; i.e., the turning-over of what is seen as valuable national assets to multinational firms (or worse, to firms based in neighboring countries with which there exists historical rivalry; e.g., the sale of Bolivian railways to a Chilean company, which promptly closed a popular, but loss-making line). A second part of the problem is a widespread belief that privatization inevitably results in steep increases in utility prices post-sale—leading to the claim that the poor cannot or can no longer afford essential services. Third, there is widespread suspicion that many of these large privatization and concession transactions have been tainted by collusion, fraud and incompetence; i.e., that the private bidders have colluded to reduce the price paid for a firm or concession;[5] that politicians have taken bribes to favor one particular bidder or to rig the regulatory rules in favor of a private firm or owner; or more broadly (if less sinister), that many governments in Latin America simply lack the skills and acumen to negotiate well with multinational or even domestic private firms in such a way as to protect the public interest during the sale, or to create and sustain competent, independent regulatory institutions post-sale.[6] (The fact that in the past there were numerous and large financial scandals in hiring, firing, procurement and contracting in state-owned firms is largely forgotten or downplayed.)

Even the prospect of privatization in utility sectors has been enough to generate widespread opposition and street demonstrations. Violent protests against water privatization and price hikes erupted in Cochabamba, Bolivia—where the concession was cancelled—and against electricity privatization in Arequipa, Peru—where the government decided to abandon the sale. The combination of popular protests and poor performance led to the cancellation, after two years, of a 30 year private concession for water provision in the Argentine province of Tucuman. Street demonstrations and burgeoning opposition have led to government rethinking of plans to privatize utilities in Panama, Lima, Rio de Janeiro, and elsewhere in the region. (Finnegan, 2002)

Moreover, fifteen toll road projects in Mexico, a telecommunications operation in Costa Rica, along with a port project and a water concession in Argentina (in addition to that in Tucuman) have been cancelled.[7] (Harris *et al.* 2003) And dozens more privatization or partial privatization contracts have been called into question and

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[5] For example: The ***Financial Times*** of May 21, 2003, carried a story alleging collusion and rigging between two bidders in the 1998 sale of *Electropaulo Metropolitana*, an electricity utility in Sao Paulo, Brazil. The allegation is that, in return for not bidding for the concession, one of the parties 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 stipulated price for the utility. The ***FT*** reports that the winning bidder had come to the final meeting prepared to offer $500 million USD more than the $1.78 billion it eventually did, but submitted the lower offer at the last second, once it was clear the 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. (See "Secret deal that kept Brazil in the dark," ***FT***, May 21, 2003, p. 32.)

[6] The reputation of Bolivia's privatization program was not helped in 2001 when ENRON, one of the co-concessionaires in its gas pipeline project, collapsed. However, the remaining private partner continued to function and operate the line.

[7] In the case of the Mexican private toll road projects, cancellation was not due to public protest but rather to loan repayment schedules that required levels of traffic far in excess of what appeared.

renegotiated, due to unanticipated shifts in market conditions, opportunistic behavior by private providers seeking to improve the terms originally agreed to, and governmental inability or unwillingness to comply with the contract, particularly regarding tariff increases, an issue that is technically complex and inevitably politicized. (Guasch, Laffont and Straub, 2002) All this, in conjunction with the worldwide economic slowdown, means that private investors previously eager to bid on infrastructure privatizations in Latin America no longer are so interested; and a number of investors and providers have made it clear they would like to withdraw or divest from present undertakings.

The upshot has been, since 1998, a strengthening of the critics, weakening governmental and investor resolve and support for existing, much less future privatizations, and a calling into question of privatization's utility by former advocates—including some in the World Bank, where direct lending to state-owned infrastructure companies, more or less taboo through the 1990s, is about to re-emerge.

III — Privatization's Effect on Inequality and Poverty

The principal economic objective of privatization is to increase efficiency in the affected firms. In Latin America, the evidence is that, on average, this objective has been achieved. But from the outset the proponents and implementers of privatization have had more than efficiency enhancement in mind. The widespread hope, often translated into assertions and promises by beleaguered reformers and political authorities, was that the efficiency gains from privatization would rapidly produce substantial macroeconomic benefits: improvements in the selling government's fiscal position, increased job creation, and higher rates of overall economic growth.[8] The enlargement of the scope of anticipated or promised privatization benefits from the micro to the macro level opened the door to debate and dissension.

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[8] One of the very few studies to examine the fiscal and macroeconomic effects of privatization argues that the results, worldwide, have generally been moderately positive. (Davis, Ossowski, Richardson and Barnett, 2000) But the authors note that in the 18 countries they surveyed, net proceeds from privatization averaged a modest 1 % of GDP (because of the high costs of sales); and they admit that the statistical association between privatization and improved growth is weak.

The core social criticism of privatization is that it is unfair, that it is a primary contributor to the rising poverty levels and income inequality seen in Latin America in the past decade. The claim is that privatization increases inequality and poverty in three main ways: through negative effects on employment levels and returns to labor; negative effects on access to and affordability of privatized infrastructure services; and negative effects on government's revenue generation and allocation processes.[9]

Jobs and Wages

The first claim is that privatization throws people out of work. And indeed, it is incontestable that a number of Latin American privatizations and privatization programs have resulted in the dismissal of many workers: 150,000 in Argentina between 1987 and 1997; roughly 50 % of all employees in firms privatized in Mexico; a reduction of more than 90,000 from peak employment levels in privatized Brazilian railways alone; the dismissal through privatization of 15 % of the total labor force in Nicaragua. (McKenzie and Mookherjee, 2003, and Frieje and Rivas, 2003) Chong and Lopez-de-Silanes (2002) 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, argue the critics, this amount of job loss, falling on those whose main source of income is wages, must result in increased inequality of incomes?[10]

Access and Prices

The second claim is that privatization, or private sector involvement through concessioning, raises the prices for essential goods and services, especially water, sewerage, electricity and transport. Few dispute that under state ownership many Latin American governments set utility prices at less than cost-covering levels. This produced scarcity, rationing, and starved state firms of investment and expansion capital. Thus, price increases are often necessary if the firm is to modernize, expand to meet demand, and operate without—or with smaller—subsidies. But critics claim that the size and speed of the price adjustment is excessive, and they decry the supposed harsh impact on low-income consumers. For example, in the short-lived Cochabamba concession in

[9] Privatization may also affect the distribution of assets and the return on assets; little is known about this in Latin America. Macedo (2000) discusses this issue.

[10] Some critics admit (others ignore) that SOEs tended to be overstaffed, but they rarely discuss the harmful effects of maintaining at public expense unproductive jobs.

Bolivia, water prices for poorer consumers went up at once by 43 % on average, and doubled for a small segment of poor consumers. (McKenzie and Mookherjee, 2003) What would be a bearable annoyance for upper income people might be an insurmountable, inequality enhancing financial burden for the poor.

Given the essential nature of water, provision is often made—in Chile, and many other Latin American countries—to offset the effects of price increases on the poor. One such device is a "lifeline tariff." On the assumption that everyone should receive some minimal amount of water at an affordable price, some set daily or monthly amount of initial use is billed at a special low rate. This addresses the affordability issue for the "connected poor." But for the many poor not previously connected, there are more obstacles than consumption prices to overcome. For example, new subscribers to water service are often required to pay a connection fee (for pipes, meter, etc.), and it can be large. To illustrate, the Buenos Aires water and sewerage concession contract allowed the private operator to charge connection fees of between $1,100 to $1,500 USD (with payments spread over 24 months) in areas where the average monthly income was $245 USD per month. Charges this high could cause some poorer consumers not to connect to the water network, even though they would pay a much lower unit cost than they presently do to small informal water providers, and be better off in the longer run.[11]

In other infrastructure sectors: The price of privatized electricity rises in only half of reviewed Latin American cases—in itself a noteworthy finding. But even when average electricity prices fall post-sale, as they did in Argentina, Chile and parts of Peru, the benefits may not be felt, or felt as much, by lower income consumers, depending on the extent to which rates vary by locality served, or are adjusted for amount of use with large users receiving a lower rate, or require a connection fee. (Lifeline tariffs seem to be less commonly applied in electricity than in water.) Moreover, private operators usually move swiftly to eliminate illegal connections to electricity networks. Indeed, the ending of theft and improved collections contribute greatly to the improved financial health of

[11] Estache, Wodon and Foster (2002) review mechanisms Latin American governments can employ—and have employed—to enhance access and affordability for poor consumers of privatized infrastructure services. A key recommendation is more attention to connection subsidies rather than price subsidies.

privatized infrastructure firms. In Argentina, for example, 436,000 of the first 481,000 additional subscribers to the privatized electricity system had had illegal hook-ups. (Delfino and Casarin, 2001) Assuming that most of these were lower-income people, and that they are now spending a higher percentage of their income on these services than do the wealthy, the result would be increased inequality. Obviously, these consumers had been stealing the product, and obviously, someone has to pay—either the consumer or the taxpayer or a combination of the two. Nonetheless, from a strictly economic point of view, those now required to pay have suffered a welfare loss.

Mass transport services, particularly bus services, are used disproportionately by poorer people. The topic has not received the study it deserves, but some privatization of these services has taken place, and some price increases have accompanied the change of ownership. Again, the hypothesis is that poorer people are spending larger portions of their disposable incomes on these services, and this may be adding to inequality.

"Negative concessions"—auctioning a service to a private provider not on the basis of how much is paid to obtain the firm, but rather how little the private operator will demand from government as a subsidy to run a stipulated level of service with a stipulated fare structure—has been used in some Latin American transportation reforms. The fear here is not that of affordability. The concern, rather, is with the ability of governments to conceive, manage and monitor correctly the auctioning process by which the concession is awarded. Critics fear that a negative concession gives the private operator a strong incentive to skimp on service and safety in order to maximize returns. They question whether Latin American states have adequate regulatory legislation and institutions to monitor and enforce compliance with such contracts. It is sometimes acknowledged that governments often poorly maintained service and safety standards in transport SOEs prior to privatization, but the assertion is that private providers possess the incentives and the skills to be even more successful at avoiding and evading regulatory standards.

Macroeconomic concerns

A third concern is the macroeconomic and fiscal effects of privatization. If governments, through corruption or incompetence, sell state firms for much less than their market value (see footnote 5, above), or if they squander the proceeds on economically unproductive operations (which includes simple theft), then privatization could have a negative impact on government finances, on the provision of state-supplied social services, and in turn on growth—and thus, eventually, contribute to poverty and perhaps inequality. One of the few studies to examine this complex question concludes that the close to $80 billion USD in privatization inflows in Brazil in the 1990s substantially "…went down the drain in the disarray of public finances," and that inequality was increased. (Macedo, 2000) A somewhat similar accusation is made about Argentina. (Mussa, 2002) Of course, the focus of the criticism is governmental incompetence and mismanagement of available proceeds, not privatization in and of itself (neither author claims that these states should be deprived of resources because they will inevitably mis-use them).

Overall, and despite a tendency to overlook the distributional shortcomings of pre-privatization arrangements, the argument that privatization adds to inequality lands some punches.

The empirical counterargument

But the latest empirical research questions, dilutes or counters many of the claims that privatization adds to inequality and poverty. A number of recent studies examine the effects of privatization on income groups; that is, they move beyond illustrations of privatization's negative short-term impact on a neighborhood, a city, or the employees of a particular firm being privatized, and quantitatively estimate the direct and indirect, short and medium term, distributional effects of ownership change.[12]

[12] As is shown below, they do this, in part, 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. Interpreting the results always involves speculation and simplifying assumptions, since many countries possess only a few surveys—most of which survey only urban, not rural residents—; and since these surveys usually show amounts spent on a service and not amounts consumed; and since the questions in and coverage of some surveys vary over time within the

The most rigorous and recent of these analyses (McKenzie and Mookherjee, 2003) summarizes detailed privatization case studies from Argentina, Bolivia, Mexico and Nicaragua.[13] It concludes that privatization in these countries:

- Contributed only slightly to rising general unemployment levels (except in Nicaragua, which went through a transition akin to those in formerly planned European states); 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." (McKenzie and Mookherjee, 2003, 195)

The reasons for the lack of negative 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 is more important than higher prices. (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.) The numbers of workers laid off due to privatization are small, even in Argentina or Mexico, relative to the entire workforce. In most cases reviewed the number of new private sector jobs created by liberalization and privatization soon exceeded the number dismissed. General increases in the overall unemployment level are real; but they came later and were caused by external shocks, labor market rigidities, and financial indiscipline—not privatization. It has even been argued that privatization may have mitigated unemployment; that is, absent privatization, unemployment levels would be higher! (McKenzie and Mookherjee,

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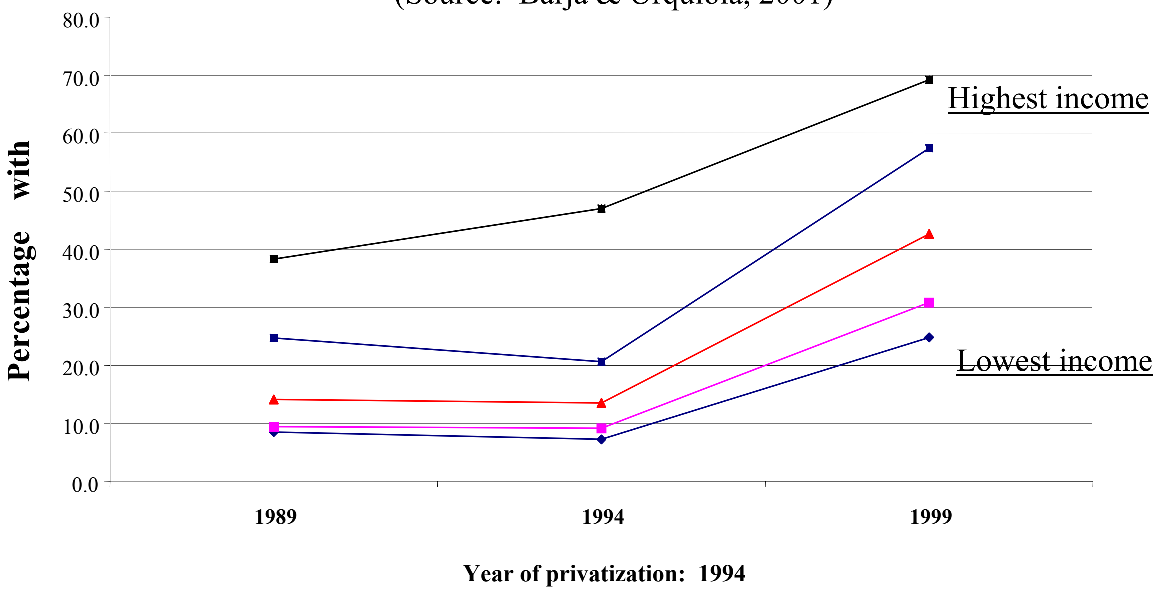
same country. There are also problems in calculating price shifts over time; different studies reach different conclusions. The methodological issues, and the techniques devised to overcome shortcomings, are discussed in McKenzie and Mookherjee (2003), Price and Hancock (1998), Delfino and Casarin (2001) and Torero and Pasco-Font (2001), among others.

[13] Drawing on detailed case studies by Ennis and Pinto (2003), Barja, McKenzie and Urquiola (2003), Frieje and Rivas (2003), and Lopez-Calva and Rosellon (2001).

2003, for the general argument; Behrman, Birdsall, Szekely (2000), for the mitigation calculation)

To illustrate how infrastructure privatization can produce positive distributional results, Figure 1 shows that access to telephone services increased dramatically, following privatization, in Bolivian secondary towns and cities, and that the additional connections were concentrated among lower income consumers. Ownership change may not have been the only cause of the pro-poor network expansion, but it is hard to ignore the clear break points in rates of growth that occur in 1994, the year of privatization.

FIGURE 1
BOLIVIAN SECONDARY CITIES: HOUSEHOLDS' ACCESS TO TELEPHONE SERVICES, BY INCOME QUINTILE: 1989-1999
(Source: Barja & Urquiola, 2001)



McKenzie and Mookherjee summarize findings from four quite different Latin American countries, with four quite different approaches to, and scope and pace of privatization.[14] Though the estimation methods employed are more rigorous than in almost all previous studies, they are—as the authors are the first to admit—imperfect and tentative (see footnote 12). Still, if the findings hold up, and are shown to apply to many other countries in the region, then the criticisms of privatization's negative impact on income equality are incorrect, or at least considerably exaggerated.

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

IV — Explaining the "disconnect"

The political conundrum of privatization is as follows: Privatization's benefits for consumers at large[15] tend to be dispersed among amorphous, unorganized segments of the public. In the main, the 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. A sustained decline by 5—10 % in average electricity tariffs, for example, is in aggregate a substantial and worthwhile gain for any economy. And increased disposable income by a few dollars a billing period 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, as shown above, many of the beneficiaries of coverage increases resulting from infrastructure privatization are the poor, who are both less organized, and less organizable. In any case, some consumers, particularly poor ones, probably do not associate any gains from reduced tariffs (to the

[14] Note that Torero and Pasco-Font reached roughly similar conclusions in their study of Peru (2001), as did Paredes in his study of Chile (2001).

[15] Of course, managers and shareholders in privatized firms may reap comparatively large and immediate benefits, which may be justified by their investment and assumption of risk (though the picture can be severely complicated by governmental interference or corrupt behavior on the part of the investors to reduce these risks). Thus, some may obtain large and immediate gains, and others will doubtless complain of this—but normally these numbers, of either beneficiaries or the size of gains, will be small in relation to societal totals.

extent they even perceive them[16]) as having anything to do with privatization of the service. The sad fact is that modest average price declines thrill economists, but not voters.

The costs of privatization, in contrast, are concentrated among 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 SOEs 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 losses for each affected individual are comparatively large, and they occur 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. The reality is that it is easier to mobilize protest against losses 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. Most liberal economic policy reforms—expanding free trade, rendering labor markets more flexible, 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 implemented, impose costs on some previously benefiting segment or segments of society. The affected then take steps to protect their interests, often by portraying the threat as one to society, not simply to their or their group's utility. This is expected and

[16] If, as sometimes happens, the price reduction is not expressed in consumers' bills for a year or two, and inflation has remained at even a moderately high level, the average consumer could end up paying more in current terms, and the gain is only seen when a constant currency value is used.

predictable, the warp and woof of normal political life. The function of the political system is to reconcile the conflicting demands;[17] some manage to do so, others do not.

However, a second, somewhat less common factor adds greatly to privatization's political problems: The simplicity of the concept, the ease with which it can be attacked by a variety of stakeholders, the ease with which the costs it imposes on limited groups can be described as costs to society at large, the comparative complexity of pro-privatization arguments—all these make privatization a convenient target, a lightening rod and scapegoat for all discontent related to liberalization/globalization in general. Foes of liberal reform find in privatization a simple, visible, comprehensible summation of all they oppose. The claims fall on fertile political ground. 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 Latin America, share an anti-market perspective; they often perceive and portray privatization as imposed, unnecessary, unproductive and unfair. The point is that while the negative results of some liberal reforms are too indirect and unclear to spur active opposition, privatization's costs appear evident. It is too obvious and easy a target to miss.

To make matters worse, supporters of privatization have often misplayed their hand. Many Latin American (and other) governments oversimplified the economic situations they faced, oversold privatization as a key to rapid and sustained growth and social progress, and—when the rosy growth and job creation predictions were not fulfilled or sustained—have been unable to manage the high expectations of consumers and the electorate.

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[17] 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 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."

V — Conclusions

Institutions and privatization[18]

Our argument is that reformers expected and promised too much of ownership change. A prime lesson of the 1990s experience, and not only from Latin America, is that privatization is but one aspect of liberalizing reform. If it is to work well, and to be perceived by the public as working well, it should be embedded in a set of well-functioning legal and economic institutions that promote, monitor, and render transparent market operations. These include:

- The definition and protection of property rights;
- contract enforcement and commercial dispute settlement through lawful, peaceful means, or, more broadly, court decisions that are timely and based on the 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 that are reasonable 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.

These institutions provide stability and predictability to market operations, and thus lower transactions costs. If these institutions are not in place and working at some modicum level, privatization may produce sub-optimal, perhaps negative outcomes—particularly in the case of infrastructure/network industries, and particularly with regard to distributional concerns. Thus, the more careful and extensive the preparation devoted to the institutional underpinnings of privatization, the better the results, in both efficiency and equity terms (e.g., Chile versus Argentina).

[18] This section benefited greatly from points offered by Carol Graham and Michael Klein. (Personal communications; July and September 2003)

The idea that institutions are critical to economic vitality has rapidly risen to the status of conventional wisdom. The association between the existence and competent performance of this set of institutions and good results from privatization is widely predicated. (see 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 association, while strongly significant, is at such a high level of abstraction as to provide little or no specific guidance to policymakers.

The lack of operational precision is the problem: The list of needed institutions is very long, but there is no explanation of how they come into being and attain a state of effectiveness. 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 the control of the public sector, and while many donor-supported efforts are underway to create and strengthen these institutions, it is, again, not clear as to exactly what governments, and those that assist them, can and should 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."

The point is that one cannot simply state that this set of institutions is required, note its presence or absence, and legislate it into existence and competence as needed. This leads to the key dilemma: The countries that stand to benefit most from liberalizing reform and privatization, in Latin America and elsewhere, are those with the weakest institutions and the worst public sectors. In such settings, the gains are potentially very great. At the same time, the risks are high that in institutionally weak countries the reform processes will be mismanaged or captured, and produce suboptimal or errant results.

The discouraging upshot is that those countries that most desperately need liberalizing reforms are those in which it will be most difficult to launch and sustain the reforms. Some thus argue that in the near-total absence of governance institutions or state capacity to provide a service (e.g., Haiti or Somalia), infrastructure provision by an unregulated private monopoly, even at an extremely high price, is superior to absolutely no provision whatsoever. That may well be, but the issue is surely more open to debate in situations where institutions are present but weak, or captured by particular elements in the political system; and where a public agency is providing some level of service, deficient though it may be—the case (at least in the past) in a number of Latin American settings.

This complicates greatly the choice: Between provision of an infrastructure service by a poorly regulated private provider, operating in a deficient legal-political environment; or provision by an inefficient, capital-starved publicly managed provider.[19] The practical policy question is, is it better to place efforts on the creation and reinforcement of regulatory bodies to oversee a private provider; or should efforts be devoted to reforming the SOE without going so far as to change ownership? (The latter can be done either as an end in itself, or as preparatory steps for more extensive private participation, when the institutional and political conditions are in place and functioning at some minimal level of competence.)

The evidence reviewed above leads me to conclude that part of the anti-privatization sentiment in Latin America stems from a lack of understanding or appreciation of what it has accomplished, combined with a pronounced tendency to forget both the poor past performance of state-owned infrastructure firms, and the very poor track record of performance improvement attempts that did not involve the private sector. I thus would opt for the continuation of private involvement and ownership,

[19] This poses a dichotomy that seldom exists in reality: There are few 100% privately-owned infrastructure firms in Latin America; the state, or some public body, usually retains some share of the equity. On the other hand, management contracts, leases and even concessions are among the ways governments can retain full ownership, but involve the private sector in the management and financing of the assets. Larger efficiency gains are associated with a greater degree of ownership transfer, but the correlation is far from perfect.

accompanied by expanded efforts to put in place the needed institutional framework. This crucial question of just how to strengthen the institutional underpinnings of private participation has recently received a fair amount of attention, emphasising how to attack the problem in the least-developed countries, and how to protect or enlarge poor consumers' access to affordable insfrastructure services. (see Cowen, 1997a; Cowen, 1997b; Cowen and Tynan, 1999; Brook and Smith, 2001; Estache, Foster and Wodon, 2002)

It must be acknowledged that some serious students of the question have reached the opposite conclusion. For example, Newbery (2001) surveys liberalization and privatization in electricity, focusing on OECD and Latin American cases. He specifies the conditions for successful electricity liberalization/privatization: excess generating capacity prior to reform, modest growth rates in demand, and the availability of generating technology that will allow a number of private power producers to enter the market and produce energy more cheaply than the existing suppliers, and thus exert a downward pressure on prices. (39) Where these conditions are present, the introduction of wholesale electricity markets has gone well. But many Latin American countries do not meet these conditions. The less the conditions are fulfilled, the less competition there will be in the wholesale market, and the more government will still be involved in the sector (for example, as a single buyer to force producers to sign long-term supply contracts)——and thus the greater the demands placed on independent regulation both to protect consumers from the possible abuses and opportunistic behavior of dominant private energy suppliers, and to protect the investors from government repudiation of pricing agreements when these threaten to cause political problems. If this kind of regulation cannot be designed, monitored, and above all, enforced, then

> …reform of the….state-owned ESI (electricity sector industry) to improve autonomy, accountability, and financial viability, may be the only option. The fact that such reforms have failed in the past does not make it wise to encourage irreversible reforms of unproven worth, and privatisation in unpropitious circumstances may be even more costly than the unsatisfactory status quo. (43-4)

Thus, strong caution on premature liberalization from an experienced and generally pro-reform observer of electricity reform.[20]

What next?

Many public policies move in and out of fashion, but few have shifted in pendulum-like manner to the extent of privatization. This has long been recognized and even predicted. A decade ago, basing their reasoning on Latin American experience, Gomez-Ibañez and Meyer (1993) wrote of the cyclical process of privatization and nationalization.[21] 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, finally as owners of the utility. And the cycle begins anew.

Privatization events in Latin America in the period 1980 to 2000 approximated this model. Are we then at the stage where renationalizations might occur? The answer is, no. The past never simply reoccurs in its entirety; the next cycle will encounter a changed political-economic landscape. First, the preceding wave of nationalization in Latin America involved firms producing tradable goods as well as infrastructure services. As noted, almost none of the anti-privatization protests have centered on the results of the extensive privatization of manufacturing, industrial or non-infrastructure services in the region. No leader, either in crisis-stricken Argentina or in increasingly populist Venezuela, has yet seriously suggested the renationalization of privatized commercial or

[20] The risks of delay are that: the wait for a minimally acceptable institutional framework could be interminable; it allows opponents of privatization time to mobilize; it demotivates workers and managers and leads to asset-stripping; and it dilutes investor interest and confidence and thus depresses prices. When privatization finally arrives, the assets may be worth much less. For example, La Porta and Lopez-de-Silanes (1999) argue that in Mexico, delays in privatization significantly reduced government proceeds.

[21] See also Klein and Roger, 1994.

industrial concerns (with the exception of banks). The likelihood is high that these divestitures will be allowed to stand; the legitimate arena for private action has been expanded.

Regarding utilities, it will be extremely difficult to launch any new, large-scale, traditionally structured privatization in Latin American infrastructure (or perhaps in banking as well) in the near term. At present, major equity investors are as scarce as government willingness. But, and second, while populist politicians, most recently in Brazil, Argentina and Venezuela, have hinted in electoral campaigns of their desire to renationalize some "misprivatized" or poorly performing utilities, few such actions will actually take place. And any that do would be described not in classic anti-capitalist terms, but rather along the lines of "a temporary measure in order to produce a renewed public-private partnership."[22]

The reason is that most Latin American states are 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. All 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 jointly devise—and sell to the public—reform mechanisms that give incentives and comfort to 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 from abuse.

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[22] *De facto* renationalization might occur in some Latin American countries if heavily-indebteded privatized firms fail, and their creditors are state-owned banks that have no option but to convert the debt to equity. This happened in Chile in the 1980s, and could conceivably take place in Brazil, where the state-owned BNDES is the principal creditor of a number of deeply troubled privatized firms. If this were to happen in Brazil or elsewhere, the authorities would do well to study how Chile handled the problem: slight and rapid financial restructuring of the firms and re-sale.

Third and finally, the experience of the 1990s suggests that the key infrastructure issue in most of Latin America has shifted from that of private versus public ownership to the politics of retail pricing for the socially sensitive products—water, energy and transport. This could be good news, illustrating the "graduation" of many countries in the region from an ideological to a supposedly more technical level of debate. On the other hand, as the 2001 energy debacle in California showed, this is one of the least tractable issues of public policy in any country, industrialized or developing. The issue will remain contentious.

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