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PRIVATIZATION AND THE POOR

ISSUES AND EVIDENCE

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Issues

Does privatization harm the poor? More specifically, what is the distributional impact of privatization? The efficiency effects of privatization are well-known, substantial, and overwhelmingly positive, as shown by a survey in the *Journal of Economic Literature* (Megginson and Netter, 2001). The equity effects, however, are less well-understood and far less uniform. This is obviously unsatisfactory for those who care about equity, but it also matters to those concerned with generating further efficiency gains. The momentum of privatization, which accelerated through the 1990s, has recently slowed considerably in most, if not all, countries. In part, this is because the "easier" countries and companies have been "done." It is also because widespread public perception persists that privatization's benefits have not been shared equitably, with the rich gaining at the expense of the poor. The poor are said to suffer absolutely as consumers faced with increased prices and as workers who are laid off. In addition, they are said to be made relatively worse off as the benefits of efficiency gains go to corrupt officials, rich domestic businessmen, and foreigners.

To what extent are these charges substantiated by empirical findings? The impact on consumers, workers, and overall distribution are addressed below. Indirect effects (fiscal and macroeconomic activation) are then considered, followed by a section on the special problems of transition economies and consideration of the implications for future research and policy.

Consumer Impact

This discussion focuses on the utility sectors, because these sectors probably account for more than half the value of privatizations, and because privatizing tradable/competitive goods cannot harm consumers. Furthermore, the poor consume little of other privatized goods and services, such as air travel, banking, and steel. Most important, we focus on the utility sectors because they involve price increases, a popular concern. This is only natural, because fear that private monopolists would exploit consumers is a major reason these sectors were made public in the first place.

Post-privatization price regulation is not always done well (witness electricity in California and electricity and rail service in the United Kingdom). Even if regulators succeed in preventing exploitive pricing, consumers could still lose if a subsidized price changes to an efficient price that covers all costs. This could result, however, in a trade-off between a higher price and wider access, as higher revenues permit capacity expansion once constrained by a lack of funds under government operation. In this scenario, existing consumers lose but new consumers gain, as they are given, for the first time, access to water, electricity, or phone service.

Which effect dominates? Intuitively, one would expect that the gains to a household that obtains access would be much larger than the losses to a household that pays a little more. Yet how many households are there of each type? A balanced evaluation of the impact on consumers must ask questions such as this, but few do.

A notable exception is a set of recent studies done for Argentina (Ennis and Pinto, 2002), Bolivia (Barja, McKenzie, and Urquiola, 2002), Mexico (Lopez-Calva and Rosellon, 2002), and Nicaragua (Freije and Rivas, 2002) and summarized in McKenzie and Mookherjee (2003).[1] Using household-expenditure survey data and Engel curve theory, the authors econometrically estimate the welfare effects of changes in price and access for 10 expenditure deciles. Results vary widely by country, region, sector, and assumption, but some of the more interesting results follow:[2]

Did prices rise? Only in half the cases. The biggest rise was 48 percent; the biggest fall, 33 percent. No prices were unchanged.

Where prices rose, did the price or access effect dominate? In Bolivia, there were net gains for 9 of the 10 deciles in both electricity and telephone service; all deciles gained from water in La Paz and El Alto, but all lost in Cochabamba, where privatization failed after one year and there were zero access effects. In Nicaragua, half the deciles had a net gain in electricity.

Where results varied by decile, who won and who lost? It depends on who already had access and where the expansion margin falls in income distribution. In Nicaraguan electricity, the four richest deciles lost because they already had access, and the poorest decile lost because either its take-up rate was low or service was not extended to where residents live. The winners were the poor, but not the poorest of the poor. In both Bolivian telephone service and electricity, the single losing decile was the richest, because it already had access and had nothing to gain.

While these results are preliminary, they at minimum call into question the validity of popular wisdom once access effects are taken into account. This is reinforced by the fact that similar conclusions were reached in the one other set of studies that have looked at both price and access effects (Galal et al., 1994, which is discussed later). Given the small country samples involved, what might similar studies reveal elsewhere? An important factor to consider is that many of the world's poor, in Sub-Saharan Africa or South Asia, currently have no electricity, telephone service, or clean water service, so access effects could be even more important there.

LABOR

State-owned enterprises (SOEs) are typically overstaffed. The best available survey of the impact of privatization on labor (Kikeri, 1998) cites worldwide redundancy rates of 20 to 50 percent and corresponding layoffs of up to 50 percent of the preprivatization labor force (in Argentina). There is high variance, however. In Malaysia, for example, in an effort to disarm labor opposition, the government forced bidders to agree to keep the entire work force for three years, and there were few, if any, firings. How much of the world is like Argentina and

[1] For more information on this subject, one may download this paper from www.bu.edu/econ/ied/dp/papers/dp128.pdf.

[2] Mexican results are not included in their current, interim draft.

how much like Malaysia? We do not know. Studies for individual companies and countries abound, but no one seems to have assembled statistics for more than a handful.

For someone who is laid off, the impact depends on the magnitude of severance payments and the length of time the individual remains unemployed. Here again, experience is all over the map, but no broad survey exists. What is the poverty impact of someone losing his or her job and not finding another? This seems like a silly question, but in Zambia, a study found that despite losses in income, laid-off workers were less likely to be poor than the average for the country (London Economics, 1996). The explanation is that poverty is a function of household income, and SOE workers often come from politically well-connected households that can absorb the loss of one wage without falling into poverty. Finally, one needs to assess the impact not just on the individual, but on the labor market as a whole. Such an assessment reveals good news and bad news. The bad news is that whether or not a particular individual finds a new job, the person who would have otherwise gotten the job is worse off; what matters for distribution purposes is the loss of the job. The good news is that privatized enterprises often grow and create jobs, with a lag. Some workers lose now, others gain later, and the net present value of the latter can outweigh that of the former.

INDIRECT EFFECTS

Indirect effects are difficult to measure, and only one study has seriously attempted to do so in this area; therefore, this section is brief. The first indirect effect is fiscal. Data on government sale revenue are widely available, but one must also take into account the decrease in subsidies and increase in taxes. Sheshinski and Lopez-Calva provide considerable data on the magnitude of this effect. One of their studies (1999) that combines all effects finds that the subsidy/tax effects usually exceed the sale effect. Even if these data were available, however, it would be difficult to estimate the distributional impact, which depends on the use to which the fiscal gains are put. If they are used for rural roads, schools, or health-care services, the poor benefit. If they are used to reduce taxes, the poor do not benefit. Some suggest that when sale proceeds are earmarked appropriately (such as Bolivia's contributing 45 percent to a pension plan), the poor can benefit. If, however, funds are fungible and the pension plan might have been done anyway, then while this might be an excellent public relations ploy, it does not necessarily measure the true economic impact of privatization.

A second indirect effect of privatization is the macroeconomic activation effect. How many jobs for the poor are created elsewhere in the economy because electricity is now reliably available without brownouts and blackouts or because some of the gains to government and domestic buyers result in greater investment? A third set of indirect effects involves externalities. Of these, probably the most significant is the health impact of improved access to water. A study in Argentina estimates that privatization of water caused a 5- to 7-percent fall in child mortality rates (Galiani et al., 2002).

The one notable attempt to incorporate indirect effects is a computable general equilibrium model for Argentina (Chisary et al., 1997). Of primary interest here is that the model showed that all elements of the income distribution gained.

RELATIVE IMPACT

Thus far, we have focused on absolute gains and losses by particular groups. Here, we look at the relative impact across groups as revealed in two sets of studies. First, the studies summarized in McKenzie and Mookherjee (2003) calculated the impact of price and access on the Gini coefficient and several other measures of inequality and poverty. Their first conclusion was that with the single exception of Cochabamba, privatization either improved income distribution and reduced poverty or had no significant effect. Their second conclusion was that because of the small budget shares of the goods and services, and because price and access worked in opposite directions, the net effect was quite small. For example, improvements in the Gini were all less than .02.

The other set of studies looked at privatization of a sample of 17 firms in Chile, Malaysia, Mexico, and the United Kingdom (Galal et al., 1994) and Côte d'Ivoire (Jones et al., 1999). It first used traditional Harbergarian benefit–cost analysis to estimate the net gains of the difference between a constructed counterfactual (what would have happened without privatization) and what actually happened. An extension of the methodology then permitted decomposition of the total into net benefits accruing to consumers, workers, competitors, the government, and the new domestic owners and foreign owners. Key results were as follows:

- Consumers were made worse off in 5 cases and better off or neutral in 12 cases. Three of the negative cases were in Mexico and resulted from moving to something like international efficiency pricing from highly subsidized prices.

- Labor in no case lost as a class: workers who lost their jobs were worse off, but this was more than compensated for by the gains to the remainder through some combination of higher wages, eventually increased employment, and appreciating share values.

- The government gained in 14 cases, with the 3 cases of losses being small. In general, the biggest source of such gains was not from the initial sale price itself, but from increased tax revenues from (and reduced subsidies to) the newly profitable firms. In several cases, revenue from deferred tranches also exceeded that from the initial sale.

- Domestic buyers did well, suffering net losses in only a single case.

- Foreign buyers also did well, gaining in all cases where they existed.

- How big were the gains and losses of each group? There is high variance, but as measured (badly) by a simple average of the percentage gains, the biggest winners were the government and domestic buyers (about 20 percent lower than the government).[3] Worker and consumer gains were much smaller (at 20 or 30 percent of the government's). Finally, 80 percent of the benefits went to domestic groups and 20 percent to foreigners.

[3] Some unknown share of the new owners' gains often goes to corrupt officials, but both businessmen and bureaucrats are at the top of the income distribution, so this makes no difference for our present purposes.

If these results are seen as broadly positive, what explains them? There is a clear sample bias. The authors' methodology required access to detailed financial accounts of the firms involved for at least three years before and after privatization, plus extensive and intrusive interviewing to develop a believable counterfactual. Governments and companies cooperated only when they thought they had a very good tale to tell. So, the results can by no means be generalized to other cases. The results only say that, done well, privatization need not have a significantly deleterious distributional impact. A contrary example is electricity in Britain, where Newbery and Pollitt (1997) found small gains for consumers and government and large gains for owners.

IMPLICATIONS

This review suggests that popular opinions on the negative distributional impact of privatization are not broadly supported by the available empirical literature. However, the literature is sparse and spotty enough that very–well-informed observers can take the opposite view. Birdsall and Nellis (2002) know as much about privatization as anyone and "conclude that most privatization programs appear to have worsened the distribution of assets and income, at least in the short run."[4]

This review, then, has three implications. First, we need to know considerably more. Second, we might need to do a better job of informing the public of what actually happened. Third, we need to help future privatizations apply best-practice techniques to enhance equity without sacrificing efficiency. A good deal is already known in this area, as illustrated by the following. To benefit poor consumers, one must focus on access effects by requiring bidders to commit to extending service at some specified rate. Also, carefully targeted lifeline pricing schemes are needed to subsidize poor consumers. Both cases will yield a price in terms of government gains, but that will be a transfer and may often be worthwhile. To benefit poor workers, privatizers should consider banning layoffs of at least unskilled workers for three years, but with a clear provision that work rules can be reformed so efficiency gains will not be imperiled. Again, there will be a price in terms of government sale revenue, but where labor redundancy is not egregious (say, less than 20 percent), the price will often be small, because redundancies will be eliminated through natural attrition and the labor demands of an expanding enterprise. Finally, privatizers should enhance government returns by retaining some shares (in nonvoting shares, so as not to reduce efficiency gains) and earmark the proceeds for projects to help the poor.

[4] The difference is in part due to the authors' inclusion of the transition economies. To assess their evidence, go to www.cgdev.org/wp/cgd_wp006.pdf.

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