PRIVATIZATION

Successes and Failures

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FOREWORD

Joseph E. Stiglitz

This book brings together a set of essays on recent experiences and current thinking in the debate over privatization, the conversion of state-owned assets into privately managed assets. Especially after Ronald Reagan and Margaret Thatcher assumed office in the United States and the United Kingdom, a conventional wisdom developed that private management and ownership was better, in some sense, than public ownership and management: enterprises would be run more efficiently and there would be less opportunity for corruption. The World Bank and the International Monetary Fund (IMF) pushed countries to privatize as much as they could and as fast as they could. Privatization became not only one of the pillars of the "Washington Consensus" but also a condition imposed on countries seeking assistance.

The experiences of the last 15 years have cast a pallor over this unbridled enthusiasm for privatization. As these essays illustrate, a new, more pragmatic consensus is developing—more consistent with economists' normal two-handed stance, "it depends." Privatization has had some successes, but it has also been marked by dramatic failures and disappointments. There are dramatic successes, and failures, in state ownership. The questions being posed today are: When will privatization be successful? And how can the privatization process be managed to maximize the likelihood of success?

Perhaps no subject in development arouses more passions—on both sides—than privatization. The privatization process has been marked by enormous abuses: in many countries a few individuals managed to grab hold of previously state-owned resources for a pittance and become millionaires—or billionaires. In a few years, Russia became a country marked by great inequality, with a Gini coefficient as bad as many in Latin

America. By some estimates, $1.5 trillion in assets were stolen. While Russian became a language commonly spoken in the most fashionable resorts around the world, Russia's pensioners were becoming increasingly impoverished, its educational system, once one of the finest in the world, was decaying, and the Russian economy was declining. Life expectancy was decreasing, while elsewhere (outside of those African countries afflicted with AIDS) it was on the rise.[1]

Elsewhere, I have explained why these results should not have been unexpected.[2] Critics of state-owned enterprises (SOEs) argued that they were subject to corruption; that is, that government officials responsible for managing them often did not act in the interests of those they were supposed to be serving (i.e., the public). This is an example of a classic principal-agent problem. But there is an even more serious principal-agent problem in the privatization process itself. What is at stake is not just the current flow of profits (rents), but the present discounted value of these rents, which is much larger. It follows that incentives for abuse are all the greater. Moreover, there are a variety of ways by which the extent of abuse in the running of SOEs can be monitored and controlled (e.g., by benchmarking), but experience suggests that it may be more difficult to control abuses within the privatization process. Standard remedies have focused on the use of auction processes, but in Russia and elsewhere it became clear that there is ample scope for auctions to be rigged by setting the rules (including "qualifying" bidders).

Other failures of privatization arose when monopolies (especially natural monopolies) were privatized before regulatory and antitrust systems were put into place. The private sector was better at exploiting monopoly power than the government: overall economic efficiency was not enhanced. Monopoly in Mexico's telecommunications sector, the result of a poorly designed privatization, has helped create one of the richest men in the world. High telephone prices, however—a multiple of those in India—have not helped Mexico's development.

But while privatization has deservedly had its critics, so have SOEs. Many have not been run efficiently, and many have created losses that have been a burden on the state—money that could have been used for education or to pursue other developmental objectives. There are instances of corruption. Even advocates of state ownership, like Greece's socialist prime minister, Andrea Papandreou, talked of the challenges of "socializing" the SOEs,[3] making them act in ways that were consistent with social objectives, not just the interests of their managers and workers.