• Jomo Kwame Sundaram

Privatization, the problem or the solution?

Privatization is expected by many to promote competition and eliminate corruption. In practice, the converse has been true as privatization beneficiaries have successfully colluded and engaged in new types of corruption to maximize their own gains.

At the risk of reiterating what should be obvious, the question of private or public ownership is distinct from the issue of competition or market forces. Despite the misleading claim that privatization promotes competition, it is competition policy, not privatization, that promotes competition.

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Instead, privatization has typically been accompanied by collusion, which undermines competitive pricing. Formal and, more commonly, informal collusion is rife. Informal collusion is more likely among those involved in public or transparent bidding to provide privatized or contracted-out services.

Transparent institutions and arrangements, such as public auctions and open, competitive bidding for contracts, have often been compromised by secret, informal collusion. Typically, those with political connections and insider information are better able to secure lucrative contracts and such other business opportunities.

Greater public transparency and accountability were expected to promote greater efficiency in achieving the public interest while limiting waste and borrowing. But contrary to such claims, privatization itself does not ensure transparency and accountability, or address corruption. As it is rarely implemented on an arm's length basis, it may also contribute to other problems, including new types of corruption.

Hence, privatization does not enhance efficiency except to augment profits. The public sector can be more efficiently run, as in some economies. Hence, the challenge is to ensure that the public sector is better run. Greater public accountability and a more transparent public sector can help ensure greater efficiency in achieving the public and national interest while limiting public sector waste and borrowing.

Ascertain problems to determine solutions

Correlation does not imply causation. An enterprise may be better run after privatization due to managerial reforms, behavioural changes or organizational improvements. But if such improvements could have been achieved without privatization, then one cannot conclude that privatization is needed to bring about desired reforms.

It is important to consider the organizational and managerial reforms, including incentive changes, which might be desirable to achieve superior outcomes. One should not assume that privatization is the answer regardless of the question or the problem at hand.

After all, many SOEs were set up precisely because the private sector was believed to be unable or unwilling to provide certain services or goods. In many instances, the problems of an SOE are not due to ownership *per se*, but rather to the absence of explicit, feasible or achievable objectives, or the existence of too many, often contradictory goals.

In other cases, poor managerial and organizational systems, blocking flexibility, autonomy and needed reforms, as well as cultures supportive of them, may be the key problem. Such reforms may well achieve desired objectives and goals, or even do better, at lower cost, thus proving to be the superior option.

Many SOEs have undoubtedly proven to be problematic and inefficient. However, privatization has not proved to be the universal panacea for the myriad problems of the public sector it has been touted as. As such, the superior option cannot be presumed *a priori*, but should instead be the outcome of careful consideration of the nature and roots of an organization's malaise.

SOE reform or government procurement often superior

SOE reform is often a superior option for a variety of reasons although there are no 'one size fits all' solutions regardless of circumstances. Problems need to be analysed in context and solutions cannot be assumed *a priori*.

It would be erroneous to presume that public ownership is always a problem. There may be other problems which are not going to go away without properly identifying and resolving them.

Desirable changes, resulting in improved performance and outcomes, may take place following the privatization of a particular SOE. But even this does not mean that privatization *per se* is responsible for these improvements unless state ownership itself has blocked needed changes, in which case there may well be compelling cases for privatization in such situations.

Another alternative, of course, is government or public procurement. Generally, public-private partnerships (PPPs) are much costlier than government procurement. With a competent government, government procurement is generally more efficient and much cheaper.

Yet, international trade and investment agreements are eroding the rights of governments to pursue government procurement. With a competent government and an incorruptible civil service, and competent accountable consultants doing good work, efficient government procurement has generally proved far more cost-effective than PPP alternatives.

Monopolies of Status Quo

To ensure public acceptability, some benefits accrue to many in the early stages of privatization in order to minimize public resistance. However, in the longer term, privatization tends to enrich a few but typically fails to deliver on its ostensible aims.

Never is everyone better off. Rather, some are better off, while others are not, and typically, many are even worse off. The partial gains are typically high, or even negated by overall costs, which may be diffuse, and less directly felt by losers.

Since many SOEs are public monopolies, privatization has typically transformed them into private monopolies. In turn, abuse of such market monopoly power enables more rents and corporate profits.

As corporate profits are the private sector's yardstick of success, privatized monopolies are likely to abuse their market power to maximize rents for themselves. Thus, privatization tends to burden the public, e.g., if charges are raised.

In most cases, privatization has not closed the governments' fiscal deficits, and may even worsen budgetary problems. Privatization may worsen the fiscal situation due to loss of revenue from privatized SOEs, or tax evasion by the new privatized entity.

Options for cross-subsidization, e.g., to broaden coverage are reduced as the government is usually left with unprofitable activities while the potentially profitable is acquired by the private sector. Thus, governments are often forced to cut essential public services.

In most cases, profitable SOEs were privatized as prospective private owners are driven to maximize profits. Fiscal deficits have often been exacerbated as new private owners use creative accounting to avoid tax, secure tax credits and subsidies, and maximize retained earnings.

Meanwhile, governments lose vital revenue sources due to privatization if SOEs are profitable, and are often obliged to subsidize privatized monopolies to ensure the poor and underserved still have access to the privatized utilities or services.

Privatization burdens many

Privatization burdens the public when charges or fees are not reduced, or when the services provided are significantly reduced. Thus, privatization often burdens the public in different ways, depending on how market power is exercised or abused.

Often, instead of trying to provide a public good to all, many are excluded because it is not considered commercially viable or economic to serve them. Consequently, privatization may worsen overall enterprise performance. 'Value for money' may go down despite ostensible improvements used to justify higher user charges.

SOEs are widely presumed to be more likely to be inefficient. The most profitable and potentially profitable are typically the first and most likely to be privatized. This leaves the rest of the public sector even less profitable, and thus considered more inefficient, in turn justifying further privatizations.

Efficiency elusive

It is often argued that privatization is needed as the government is inherently inefficient and does not know how to run enterprises well. Incredibly, the government is expected to subsidize privatized SOEs, which are presumed to be more efficient, in order to fulfil its obligations to the citizenry.

Such obligations may not involve direct payments or transfers, but rather, lucrative concessions to the privatized SOE. Thus, they may well make far more from these additional concessions than the actual cost of fulfilling government obligations.

Thus, privatization of profitable enterprises or segments not only perpetuates exclusion of the deserving, but also worsens overall public sector performance now encumbered with remaining unprofitable obligations.

One consequence is poorer public sector performance, contributing to what appears to be a self-fulfilling prophecy. To make matters worse, the public sector is then stuck with financing the unprofitable, thus seemingly supporting to the privatization prophecy.

Benefits accrue to relatively few

Privatization typically enriches the politically connected few who secure lucrative rents by sacrificing the national or public interest for private profit, even when privatization may not seem to benefit them.

Privatization in many developing and transition economies has primarily enriched these few as the public interest is sacrificed to such powerful private business interests. This has, in turn, exacerbated corruption, patronage and other related problems.

For example, following Russian voucher privatization and other Western recommended reforms, for which there was a limited domestic constituency then, within three years (1992-1994), the Russian economy had collapsed by half, and adult male life expectancy fell by six years. It was the greatest such recorded catastrophe in the last six millennia of recorded human history.

Soon, a couple of dozen young Russian oligarchs had taken over the commanding heights of the Russian economy; many then monetized their gains and invested abroad, migrating to follow their new wealth. Much of this was celebrated by the Western media as economic progress.

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