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The Decision to Privatize: Finance, Politics, and Patronage

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Privatization Barometer

Paper Overview

- **Empirically investigate how financial and political factors impact decision to privatize Indian SOEs**
  – Study population of federal SOEs, sales 1991-2004
- **Explicitly models impact of relative political strength and patronage variables on decision**
  – Find size, profitability positively related to sale decision; wage expense negatively related
- **Documents that privatization "works" but selection is endogeneous**
  – Partially divested firms' sales, profits rise significantly

Study Strengths, Unique Contributions 1

- **Rare study to explicitly model privatization *decision***
  - Motivated by IPO, empirical privatization literature
  - Study why govts privatize some firms, but not others
- **Uniquely (?) also includes realistic political variables**
  - Excellent database on relative political strength of alliances, based on actual election outcomes
  - Document “home state SOEs” for parties, ministers
  - *No SOE is ever privatized if located in a minister’s home state!*
- **Examines initial sale of stock, not majority sale**

Study Strengths, Unique Contributions 2

- **Documents that Indian state sector very large, intrusive, and loss-making**
  - 25% of GDP, ~40% of capital stock, half losing money
- **Points out privatization yields large but diffuse benefits, highly concentrated costs**
  - Also major patronage benefits for politicians
  - Coalition politics yields instability, contestability
- **Comprehensive database of SOEs, elections**
  - Tie individual SOEs to specific states, ministers

Study Strengths, Unique Contributions 3

- **Appropriately use Cox proportional-hazard model to estimate sale decision**
  - Yields intuitive, yet robust results
  - Larger, profitable, capital intensive SOEs sold first
  - Contestable state elections deter sales
- **Clearly documents that even partial privatization significantly improves firm performance**
  - Hardly unique result, but stronger for explicitly accounting for endogeneity of selection

Study Shortcomings, Ways To Improve

- **Costs of privatization are obvious, but why would a governing alliance *ever* choose to privatize?**
  - Must have some compensating benefits, but unstated
  - Punish opponents, raise revenue, reward supporters?
- **Role of budget deficit not modeled or acknowledged**
  - Large fiscal deficit, need to subsidize losses
- **Why is federal government so unimaginative in designing sale terms?**
  - Other govts use share allocations, underpricing to buy off opposition (especially workers); target proceeds
  - Control restrictions to diffuse nationalist hostility

General Comments on Privatization

- **Study highlights role of external forces in promoting privatization**
  - Promise of EU entry critical for CEE transition states
  - EU rules constrain state aid, ownership in Europe
  - World Bank, IMF, Washington Consensus in Africa, Latin America; WTO in China
  - External pressure lacking in India
- **Highlights difference between privatization in OECD and Emerging Markets**
  - SOEs more important, patronage more blatant in EM

Overall Study Assessment:

- **Very Solid Paper That Should Publish Well And Have Significant Policy Impact**

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