

## Privatization -- A Decade Of Lessons Learned?

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### 1990: Privatization is fraught with formidable obstacles<sup>1</sup>

Privatization advocates identified the following major obstacles to privatization:

- Delays in implementing privatization transactions that could be traced to elaborate organizational structures and rigid rules which impede government decision-making
- 'Adversaries' of privatization -- ranging from the ideologues to 'self-serving' interest groups
- Love/hate attraction to privatization by most governments; and
- 'Unfailing tendency' to underestimate the time required to execute each privatization transaction.

### 1992: Eight key lessons in privatizing SOEs<sup>2</sup>

The World Bank's Private Sector Development (PSD) group identified key lessons in privatization:

- Privatization works best when it is part of a larger program of reforms promoting efficiency, as in New Zealand, the U.K., Mexico, and Chile that are all 'successful privatizers'.
- Regulation is critical to the successful privatization of monopolies.
- Countries can benefit from privatizing management without privatizing the ownership of assets through management contracts, leases, and concessions.
- The sale of large enterprises requires considerable preparation, including breaking them into competitive and marketable units, bringing in dynamic private sector managers (as in many telecom and airline sales around the world), settling past liabilities, and 'shedding excess labor'. Successful privatizing governments also avoided large new investments for plant modernization and equipment since getting the private sector to finance and manage these

investments was itself a major reason for privatization.

- Transparency is critical for economic and political success.
- Governments must pay special attention to developing a social safety net, including generous severance packages, employee ownership schemes, unemployment benefits, and retraining-redeployment programs.
- The former socialist economies should privatize in all possible ways that encourage competition and experiment with all available methods, including share give-aways (or mass privatization schemes), state-assisted financing methods, free or low-cost shares to employees in privatized firms, and new types of investment-management companies to run groups of companies and diversify risk.
- In changing the public-private mix in any type of economy, privatization will sometimes be less important than the emergence of new private business.

### 1992/95/97: Privatization is not a cure-all

Privatization in itself -- or the ownership of an enterprise -- is not the key towards its improved performance; privatization does not in itself guarantee that an enterprise will perform better. In 1992, World Bank staff<sup>3</sup> pointed out that although privatization when done right worked well, it was not a 'blanket solution' for the problems of poorly performing state-owned enterprises (SOEs). In its 1995 review of privatizations globally, the World Bank's Operations Evaluation Department (OED) further cautioned that the transfer of ownership from public to private should be under conditions that promote competition, discourage monopolies and where a strong regulatory sector exists.<sup>4</sup>

More recent ILO studies<sup>5</sup> have argued that privatization should not be an end in itself. In many

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cases, it is the 'exposure to competitive forces rather than the nature of the ownership by itself' that creates the greatest pressure for improved efficiency itself. The studies further dispel two widespread basic images in privatizing public utilities worldwide: '*One is that public companies necessarily perform better, or worse, than private ones... and that privatization is a panacea, a cure for all the difficulties faced by a given public enterprise, or the reverse.*' It is essential to complement the deregulation aimed at dismantling the monopolistic privileges of public companies with a new regulatory set-up. This should include a legal agreement between the public authorities and the new company, setting price ceilings for customers and basic standards of quality, full access to and global coverage of services, and environmental protection.

### 1995: Making privatization work<sup>6</sup>

The International Finance Corporation (IFC) -- the World Bank's private sector arm -- had the following advice to make privatization work:

- Keynote is political transparency.
- Appropriate institutional framework and approach depends largely on government strength and commitment.
- Privatize the easy candidates first for early sales to succeed in order to gain momentum.
- How many shares are sold to whom is politically determined.
- Privatizations are often the ideal vehicle to achieve capital market broadening and deepening.
- Governments should often absorb debts to sell an enterprise.
- Government should almost never invest before sale.
- Valuation is best left to the market.
- Reorganization is best left to the new buyer.

### 1995/97: Bureaucrats in Business<sup>7</sup>

The World Bank's *Bureaucrats in Business* examined the economic problems that arise when governments own and operate enterprises that could be run as private firms. This sparked a debate on the theoretical and empirical basis of the Bank's obsession with public sector reform and privatization. Some critics<sup>8</sup> found its conclusions and underlying assumptions -- that seek economic and political explanations for the superiority of private over public ownership' -- to be poorly grounded in economic theory and empirical evidence. In its 1997 World Development Report, the WB stated that the first job of states was to 'get the fundamentals right... going beyond the basics, the

state need not be the sole provider'; privatization provided an 'obvious solution' to poorly-performing SOEs that are often a 'big drain' on national coffers.

### 1996/97: Privatizing social services

The World Bank's PSD group identified successful privatization experiences in the politically sensitive social sectors:<sup>9</sup>

- Chile's higher education reforms provide a prototype model for developing countries of how private resources could be mobilized through 'cost recovery' and result in the rapid growth of private institutions;
- Columbia's health sector reform seeks to transform both the financing and the provision of health care while simultaneously extending universal coverage through greater private sector participation; and
- Argentina's reform of the pension system has led to a multi-pillar system involving both the public and private sectors as providers of complementary services.

In Nicaragua, however, the institution of privatized health services disenfranchised citizens, resulting in the reversal to a biomedical emphasis rather than a 'broad-based, intersectoral and integral concept' of primary health care.<sup>10</sup> In the Philippines, various citizens' groups opposed the privatization of health services due to core issues of people's right to quality health care that is appropriate, affordable, and accessible to the majority, especially poor women and children whose nutritional and health status were more dismal than most. How would the privatized health institutions balance social responsibility and profitability? There were no guarantees that poor and charity patients will be given free and special treatment.

In the privatized health care system of the US, consumers felt powerless against the monolith of profit-seeking doctors, hospitals and insurers.<sup>11</sup> 'Perverse incentives' have been created -- e.g., unnecessary surgical procedures, including caesarians, hysterectomies and tonsillectomies. Moreover, the US private health insurance is a prime example of the inefficiency of the private sector; it is now an 'uncoordinated mosaic' of some 1,500 for-profit companies with its own sales staff, forms to fill up and different types of policies, with almost a quarter of every dollar spent on medical insurance goes to paperwork.

Privatizing health services in Europe revealed the following trends vis employment statistics, pay and conditions of health sector workers:<sup>12</sup>

- Health care support services (cleaning, catering, and computing) are being contracted out to some extent in most countries of the European Union.
- There are a large number of local private for profit, private not for profit and voluntary organizations already operating within the sector.
- There are a growing number of transnational companies who are already providing support services such as cleaning and catering in a number of countries.
- Two of Europe's largest support service providers -- ISS and Sodexo -- have the largest number of cleaning and catering contracts with healthcare institutions. Both ISS and Sodexo have expanded through acquisitions into the owning and operation of nursing homes and are winning contracts for the management of public sector care homes.
- Private medical insurance are entering the private hospital market.

The Chilean model of pension reform, on the other hand, was adjudged to be 'an extreme case of privatization'.<sup>13</sup> Chile's pension system is based on individual accounts (also called 'defined contribution' system) administered by private fund managers. It favors the individual and not the social group; the principle of solidarity is absent since the gains or earnings from individual contributions are strictly for the individual. The Chilean system contrasts with a 'defined benefit system' that is guided by the principle of social equity and solidarity; benefits are shared by all as individual contributions are also being used to subsidize the poor, the sick, the disabled and the old.

#### **1997: Privatizing public utilities**

An ILO sectoral review of the experiences in Africa, the Americas, Asia and Europe in privatizing public utilities (water, gas, electricity)<sup>14</sup> concluded that:

- There are no best practices but a variety of good practices;
- The preferred options are partnerships between the public and private sector, rather than fully public or fully private public utility enterprises;
- A thorough, in-depth assessment of each option should follow;
- Criteria need to be set for monitoring rigorously performance and achievement of goals;
- The process of privatization and regulation is at least as important as the option chosen;

- From the empirical evidence available on effectiveness and cost-efficiency, it is not possible to draw a straightforward, firm conclusion as to the advantage of private or public firms.

Potential impacts on consumers were observed:

- Privatization can mean improvements in the quality of service offered, although this does not occur systematically.
- On coverage of service - the outcome is mixed; in some cases, poorer families and regions and the countryside were marginalized; and
- On prices - water tariffs of privatized companies in Europe are at least as high as those of public utility firms; for electricity and gas, there is little difference between public and private management. In general, utility prices do increase under private management; typically, large industrial clients experience slight increases or even cuts in tariffs, while residential and small business consumers often suffer sharp increases. Some companies could even go further and raise household tariffs disproportionately to deter small clients and be able to concentrate on the more profitable, large ones.<sup>15</sup>

The consequences on public sector workers and unionism were assessed:

- In the public utilities, employment losses almost always accompany adjustments both under restructuring and under privatization schemes worldwide; the substantial costs may be passed on ultimately to governments and society.
- There is an increasing trend towards more flexible and individualized remuneration systems, as the 'public sector value' of solidarity shifts towards the 'merit-based private corporate culture' based on what the employee contributes to profit.
- In the area of industrial relations, privatization generally affects unionization, bargaining patterns, and collective agreements, but the results have been 'fairly mixed;' in many cases, however, unionization and industrial relations come out weakened from privatization and restructuring processes.
- There should be greater efforts to understand the impact of multinationals taking over public utilities; their transnational nature is reflected in their economic behavior and human resource strategy, including bargaining and labor relations.

### **1999: Time to rethink privatization**

In 1999, the World Bank's privatization advocates argued that countries which improved SOE performance the most followed a comprehensive strategy of reforms, including a combination of privatization and corporatization.<sup>16</sup> An earlier study<sup>17</sup> found that 'despite an increase in privatization, SOEs shares in GDP and employment had not declined in developing countries; ' those which improved SOE performance in 'reforming' countries followed a 'comprehensive strategy of divestiture, competition, hard budgets, financial sector reform and changes in the institutional relationship between SOEs and governments.'

Where in the early 1990s the World Bank's PSD head, John Nellis, vigorously advocated for privatization -- *Privatization is necessary, and ownership matters, not simply to improve the performance of public enterprises but also to lock in the gains achieved earlier in reforming public ownership*<sup>18</sup> -- by the late 1990s, the PSD head seemed to be singing a different tune. Now it was 'time to rethink privatization' in transition economies of the former Soviet Union (FSU) and Central and Eastern Europe (CEE),<sup>19</sup> due to what happens when the *'shift to private ownership gets far out in front of the effort to build the institutional underpinnings of a capitalist economy.'* This change of heart was seemingly influenced by 'disastrous results of massive and speedy privatization programs' in countries like Russia and the Czech Republic. Nellis' proposals included re-nationalization and/or postponement of further privatization, both to be accompanied by measures to strengthen the managerial capacities of the state.

### **1999: 'Public-private partnerships' in the social sector**<sup>20</sup>

In recent years, some 'consensus' has emerged on the financing and provision of social services:

- *Health* - The public sector is 'most naturally suited' to addressing issues involving communicable diseases, availability and quality of information about health and health care, creation of viable health insurance programs, safety nets for the poor, and equity in distribution of health resources. The private sector is believed to control costs and promote efficiency.
- *Education* - The public sector is 'bound to provide primary education' as it impacts so deeply on all areas of the country's well-being;

government should oversee private sector provision. Tertiary education is more suitable for private partnerships, either in financing and provision or both, as education becomes more specialized; the public sector must ensure that quality and equity are maintained.

### **1999: Policy issues in privatization**<sup>21</sup>

The Tokyo-based ADB Institute highlighted the following policy issues at a capacity-building seminar on privatization that it organized in November 1999:

- Privatization is grounded on the changing role of governments in the economic development process.
- Privatization is vital for long-term development of the private sector, development of local capital markets and financing institutions, fostering an enabling environment that facilitates private initiatives and rewards risk-taking, improving fiscal balances, and may promote democratization through the devolution of power.
- The driving force for privatization and economic policy reforms must come from within developing countries.
- Privatization may result in increased efficiency gains due to less political interference in decision-making, among others.
- Three major pre-conditions are required -- irreversible political commitment; legal and regulatory reforms; structural reforms across all economic sectors.
- Privatization is a political process.
- Building capacity in government institutions is necessary.
- Menus of privatization programs are recommended according to objectives.
- An emerging 'core lesson' is privatization to a capable strategic investor.

### **1999: Privatizing to strategic investor works best**<sup>22</sup>

Citing diverse regional experiences, IFC Lead Economist Frank Lysy recommended that privatization to a 'capable strategic investor' generally works best, rather than to 'insiders' or 'dispersed ownership', although it is important to 'ensure minority shareholder rights.' These were largely influenced by instances of 'privatization disasters' in the former Soviet bloc-- e.g. the so-called loans-for-shares scheme in Russia that became 'hopelessly corrupt' and the 'controversial' voucher privatization in the Czech Republic.

### WHAT HAPPENS TO WOMEN IN A PRIVATIZATION REGIME?

There are very few empirical studies on women and privatization. In their 'private' or reproductive sphere, women as unpaid family labor subsidize the market economy by reproducing and nurturing the next generation of workers. Women's reproductive work remains largely invisible, is not included in GNP tallies and is absent in official labor statistics. Women perform such tasks as child-bearing, child-rearing and care-giving deemed part of the processes of social reproduction. These traditional roles limit women's opportunities in obtaining paid work outside the home. In their 'public' lives, or when women get the chance to leave home and join the formal workforce, women are usually discriminated against and take on low-paying, low-skilled or auxiliary jobs. Within the government bureaucracy, women are dominant as lower-rung members of the rank-and-file (e.g., clerks, typists, secretaries) who perform most of the much-maligned bureaucratic 'red-tape'. Women are also mostly employed in jobs that reflect their traditional roles as nurturers and care-givers in the home, reflecting again the limited career choices made available to women. Among public sector workers, women are dominant in the teaching and health professions, hence the privatization of the social sectors will have the most effect on women as providers of these services in the public and private sphere.

HUNGARY<sup>23</sup> Gender-related questions that need to be asked during privatization, especially in the transition economies: What happens to women when released from the public sector? How is the new private sector being evolved? Are there discriminatory hiring policies? The public sector is an important employer of women; in Hungary, a protective labor policy has evolved out of the state's perceived need to harness the potential of women. Women are slow to enter modern-sector sources of employment, and when they do, they usually enter out of dire economic need; they left as soon as economic conditions allowed them to. Major issues at the workplace concern: child care facilities, wages linked to seniority, wage differential between the private and public sector, the public sector as the only major source of technical jobs for women, the public sector as not being feminized, and women entering non-traditional jobs in the public sector. Four methods in which workers are released from the workforce through privatization, and all affect women differentially: (a) enterprises selling their own assets (e.g. canteen, child care, etc); (b) closure of peripheral plants (affecting unskilled workers); (c) employer-initiated soft measures -- e.g. retirement; and (d) lay-offs.

VIETNAM<sup>24</sup> The status and social gains made by women in Vietnam have begun to erode as the market economy evolves. Rapid changes to family life have occurred in which women bear more of the negative impacts than men -- e.g., there is an increase in the number of hours women work, which is a reflection of both the decrease in government-supplied social services and increased emphasis on production activities. The privatization of SOEs and downsizing of public service has sharply increased unemployment since reforms were introduced in 1986, with female workers bearing the brunt. A 1990 Vietnam Women's Union survey of workers released from public sector jobs in Ho Chi Minh City indicated that 69% of those laid off were women.

LAOS<sup>25</sup> Social structure adjustments in Laos have not matched economic ones, leaving gaping holes in social services and human resource development, especially for the 80% of women and girls living in rural Laos. As the economy opens up, women are diversifying their roles and entering into sectors other than agriculture. Private sector participation in the burgeoning garment industry, the sector with the second largest export earnings, has also enticed the participation of women in the workforce; it has become the largest employer of female urban labor (95% of the labor force). Violations of the 1994 Labor Law, however, are frequent in most of the small to medium-size foreign-Lao joint ventures. The surge in hotels, restaurants and nightclubs is drawing rural women into the cities to look for employment opportunities, some of which involve risk behavior and introduce social problems. As markets begin to reach the rural areas, women are operating as the majority of the farm-to-market traders and petty business entrepreneurs. Women are also breaking numerous cultural barriers against their participation in public life by emerging as innovative agents of rural development. Retrenchment in the civil service has reduced employment possibilities; outside of agriculture, government service is the second largest employment avenue for women in Laos. In 1988 and 1991, civil service retrenchments reduced women's employment more than that of men, as the former disproportionately held lower staff positions than the latter.

CAMBODIA<sup>26</sup> Women in Cambodia do more of the work in virtually every field -- agriculture, industry, the government bureaucracy, and in marketing (more men than women died during the Khmer Rouge period). Given the 'surplus' of women, it has been argued that women's status has declined in recent years. Furthermore, some of the protections and benefits of the social system for women have been lost in the transition to capitalism, though it is unclear just how well some of these protections actually functioned in the 1980s; women who worked for state enterprises which have been privatized have been displaced.

CANADA Privatization hurts women -- 'first they cut good jobs for women; then they cut the services women need, leaving women to pick up the pieces', according to the Canadian Union of Public Sector Employees (CUPE). The following set of questions should serve as a guide: (a) Are most of the affected workers women? (b) Are most of the jobs traditionally women's jobs? (c) Are most of the clients/consumers women? (d) Are women affected differently than men? (e) Are some women affected more than others? (f) Will the workload of the remaining women increase? (g) Will women's work in the community increase? (h) Will women's ability to participate in the union be affected? (i) Do women have the same protection in the contract? (j) Do women have the same access to alternatives? (k) Do women have the same resources to fight back?

**WHAT IS NEEDED --**

**Rigorous social, environmental impacts/ post-privatization assessments needed**

No systematic studies have been carried out to monitor the efficiency of divested enterprises over a longer period.<sup>27</sup> There appears to be a lack of clear assessment of the benefits and costs of the various privatization processes, and insufficient efforts to seek alternatives or a full-options approach. Most World Bank studies, for instance, that show 'superiority' of privatized SOEs are limited to narrow efficiency criteria such as: increased sales, increased earnings, increased average salary per worker, and decline in both short-term and long-term debts. Moreover, the budgetary implications of privatization -- which tend to be based on gross, incomplete figures -- should take into account: transition costs, monitoring costs, costs arising from unemployment, losses for assets sold below market value, losses of future streams of dividends, and various financial and other support lent by governments to the new entities.

More in-depth and strategic assessments of privatization should address fundamental issues related to, among others, the social function of the state, accountability and profit motives of private enterprises, impact on prices and poor consumers, opening of strategic sectors (e.g. power, telecoms) to foreign multinational interests, further re-concentration of wealth, contractualization of labor, hidden private sector subsidies and/or guarantees, so-called 'fiscal space', retention of public sector debts, environmental protection and privatizing control and management over natural resource assets (e.g. water, geothermal power).

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