Whatever Happened to Privatization? The World Bank and Divestiture: 1980–2020

John Nellis

Abstract

This is a review of the World Bank's use of privatization as a means to improve the performance of state-owned enterprises (SOEs) in its client countries. SOEs became matters of great concern to client governments of the World Bank in the 1970s and early 1980s, as their financial losses and poor quantity and quality of production mounted. The World Bank first approached the problem through policy, financial, and managerial reforms in SOEs and their supervising agencies. Most efforts were short of ownership change; privatization was only tentatively discussed. Positive results were modest and, more important, generally unsustainable. The World Bank—and indeed much of the world—turned to divestiture in the mid-1980s, and especially in the period 1990–2005. By the end of the 1990s, over half of World Bank SOE-related operations contained a privatization component. In the ensuing period, privatization lost its luster; the number and scope of World Bank-sponsored privatization actions declined greatly. The World Bank then employed, far more extensively than in the previous period, corporate governance actions, competition enhancement measures and SOE financing reforms.

This paper describes the course of the rise and fall of privatization in the World Bank. While acknowledging that privatization was far more difficult than anticipated to implement correctly, particularly in low-income and institutionally weak countries, the continuing difficulty of applying technical fixes to still large, still underperforming, and still capital-short SOE sectors justifies a renewed attempt at privatization.

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Whatever Happened to Privatization?
The World Bank and Divestiture: 1980–2020

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1. Prologue

Starting with the World Bank's first operations in developing countries, its projects usually contained institutional and/or managerial measures to strengthen the capacities of the infrastructure state-owned enterprises[1] (SOEs) and project management units involved. However: "The first World Bank-sponsored attempt to reform SOEs in a systemic, cross-sectoral manner was the Senegal Parapublic project, which became effective in 1978…" (Nellis, 1991, 109).

The focus on SOEs stemmed from a growing recognition of their poor financial and operational performance, and the increasing financial burden imposed on strained governments by this poor performance. SOE problems became evident in a wide range of Bank client countries in every region, including Jamaica, Philippines, Peru, Tunisia, Morocco, Turkey, Panama, Korea, Argentina, Egypt, Indonesia, and a number of sub-Saharan African countries.

Bank economic analyses made in preparation for structural adjustment lending revealed that infrastructure SOEs in particular—in electricity, water and sewerage, telecommunications, and transport—in many borrower countries failed to produce an adequate quantity and quality of service or product. Far too many SOE service providers failed to cover their variable, much less investment and debt repayment costs. Many SOE sectors "…moved from being a burden on the budget to….being a burden on the domestic banking system" (Nellis, 1994a, 15). Networks failed to expand to meet increasing demand. Supposedly purely commercial and manufacturing SOEs rarely competed successfully against domestic, much less international private sector operators. Many governments then skewed markets to favor their SOEs. Monopolies were granted; investment capital subsidized; input prices reduced; taxes, pension and social security obligations and other debts were forgiven, and environmental, safety and other regulations relaxed or ignored with impunity.

Despite the tilted playing fields, SOEs too rarely operated profitably or paid dividends to the state owner. For example, in 1982 the Government of Kenya estimated that the annual average rate of return on the $1.4 billion US (1981 dollars) invested since 1963 in the country's 176 SOEs was 0.2 percent (Nellis, 2005, 17). Moreover, the bulk of profitable actions was concentrated in a few SOE islands, operating in a sea of losses.

Client governments grew progressively concerned as consumers protested poor or non-existent supply of basic services—especially water and electricity—and commercial products. The international financial institutions (IFIs) warned of ever-more severe problems if the unsustainable financial burden of poor SOE performance was not resolved.

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[1] The name "state-owned enterprise" refers to government owned, semi-autonomous, self-accounting, commercial or semi-commercial entities required to raise a substantial part of their operating revenues from the sale of goods and services. At the limit, the distinction between commercial and non-commercial may be opaque; i.e., government-owned hospitals, research bodies that have a sellable product or two. But this definition has proven generally serviceable.

In response, in the 1980s, the World Bank constructed a large number of public enterprise operations, either as stand-alone technical assistance/institutional development projects, or as major technical assistance components of the then widespread structural or sectoral adjustment loans. By 1988, loans in which SOEs featured prominently numbered 101. And more limited SOE-related actions were widespread in many operations not labelled as SOE specific.

Initial SOE reform actions stressed improving operational and financial performance through means other than ownership change. Borrowers were encouraged and assisted to:

- **Create a rational policy framework** laying out the proper role of the state; that is, defining the border between actions that should and could be carried out by government-owned and operated SOEs, and those to be handled by firms with private management, or partial or full private ownership;
- **Map the state's current portfolio of SOEs,** aimed at placing enterprises into the categories of retain and restructure, prepare for sale, divest partially or fully, or liquidate;
- **Reduce the flow of funds from the state to SOEs** and increase the flow from the enterprises to the treasury, through increases in tariffs and improved collection of fees for service;
- **Assist selected SOEs to improve their financial and operational performance** through:
  - Reducing multiple, conflicting and non-commercial objectives, ideally by identifying non-commercial actions deemed socially crucial (e.g.; maintaining employment, obtaining inputs from domestic sources), quantifying their cost and subsidizing the firm for these and only for these;
  - Improving their pricing, billing and collection capacity (especially for infrastructure SOEs);
  - Rationalizing SOE financing, ideally by requiring them to seek funding on private commercial terms;
  - Reforming the supervisory capacity and role of SOE monitoring agencies by updating management information, accounting and auditing systems;[2]
  - Improving the quality and roles of SOE Boards of Directors and managers, and, in general;
  - Minimizing political interference in purely commercial decisions.

Some few actions or components of these loans met with success; many, too many, did not. And even where there were initial successes, a fair number did not endure past the

[2] In this period the Bank devoted considerable effort to introducing negotiated performance agreements between government owners/supervisors and managers of SOEs. The idea was to specify the obligations and responsibilities of the two parties, and then hold both to the agreements. These agreements ranged from "contract-plans" (used in Senegal and other francophone countries; see Nellis, 1988) to "memoranda of understanding" (in India), to the Korean and Pakistani attempts to use "signaling systems" to monitor their SOEs (see Song, 1988). Results were meager (See Shirley, 1998).

departure of the technical assistance furnished to implement the first steps of a reform, or the end date of the project with its flow of special resources and project management unit assistance. From the outset, reform efforts calling for reductions in staff, stepping up prices and collection of fees (for water and electricity in particular), requiring governments to name qualified SOE managers and board members, or—especially—liquidating a firm, met with stonewalling or outright resistance.

2. Enter privatization

By the mid-1980s, the recognition grew among many World Bank staff, management, and a number of reforming leaders and officials in client countries, that Bank-assisted SOE reforms were not producing the needed results. A more drastic approach was required. It seemed obvious that that approach should center on increased private involvement in SOEs, as partners, managers, lessors or partial to full owners and operators.

Note that even earlier, the Bank had called for such actions, but in a modest and tentative manner. Only five 1980s adjustment operations, out of over 100 surveyed, called for the sale of a particular SOE; liquidation was a condition in seven. Nine of these twelve operations were in sub-Saharan Africa. They were the exceptions. Much more often, private involvement conditionality was phrased in general terms: Twenty-five 1980s adjustment loan agreements contained statements that the borrowing government "will initiate a divestiture program;" "will accelerate its program on divestiture;" "will agree with the IDA on a strategy for rationalization and disengagement of the state-enterprise sector;" or "that the program of divestiture shall be satisfactory to the Bank" (Nellis, 1991, 114). The bulk of efforts continued to stress SOE reforms short of ownership change.

At the end of the 1980s, however, the Bank dramatically increased the pace and scope of divesture support. Poor results of past operations were an important reason for the shift, but there were other contributing factors.

- Conservative leaders, in power in the UK and US in the late 1980s, were forcefully promoting the supposed superiority of a limited role for the state. The previously prevailing social democratic tone of political discourse was altered. The British program of privatization was widely touted.
- As deeper analysis revealed the breadth and depth of the problem,[3] the IFIs pushed ever harder, around the world, for performance improvements and the reduction of the financial burden imposed by weak SOE sectors.
- Before or at the start of the 1980s, as they ran out of means to finance their disappointing SOEs, a few developing countries launched privatization programs,

[3] For example, a 1985 World Bank study concluded that in twelve West African states, 62 percent of surveyed enterprises showed persistent net losses, and 36 percent were in a state of negative net worth. (Bovet, 1985) SOE portfolios in other regions were not faring much better.

with little if any assistance from the World Bank. For example, between 1975 and 1981, the Pinochet government in Chile divested most state-owned banks and a number of commercial SOEs dating from the Allende period and before.[4] Mexican, Togolese and Argentinian officials also initiated, at first without much IFI prodding or help, the divestiture of a number of poorly performing SOEs. Other governments began to take notice.

- A major spur to divestiture sentiment was the collapse of the European-Central Asian communist economies, and that of the USSR in particular—in good part caused by the failure of central planning to obtain the needed quantity and quality of production out of state-owned enterprises (see Nellis, 2016, for a detailed description of the disarray of Soviet enterprises in 1990). This raised the question of what was to be done with the tens of thousands of enterprises, entities, and masses of assets now being cast adrift? Options other than privatization seemed absent.
- The apparent end of the Cold War led many Western officials and scholars to believe in "the end of history," an assumed feature of which was that capitalism and democracy would, inevitably and fairly quickly, replace the failed socialist systems. Private enterprise, it was then widely believed, would become the dominant mode of production throughout a dramatically changed world.

The arguments for increased private involvement were based on more than the failures of public ownership reform, the political context and exhortation. Neo-classical economic theory was relatively agnostic on the question of public vs. private ownership, contending that market structure and the degree of competition were the critical determinants of outcomes. Public choice theorists, in contrast, argued that the selfless dedication to the public interest of bureaucrats managing and supervising SOEs could not be taken for granted. These bureaucrats, and their political masters, had personal interests that could be served by the promotion of SOEs, irrespective of their performance (Niskansen, 1971 & 1994).

In this view, private ownership would, supposedly, improve SOE performance because it:

- Creates *a market for managers*; an area of noted deficiency in SOEs; and that
- *Capital markets subject privately owned firms to greater financial scrutiny and discipline than governments do their SOEs;*
- *This would decrease if not eliminate a key SOE problem, that they operated under "a soft budget constraint" as governments persistently provided loss-makers with treasury financing or pushed state-owned banks to do the job;*
- *Private firms are subject to exit much more often than SOEs;*
- *Public officials interfere less in the workings of private firms than they do SOEs;*
- *Private firms are supervised by self-interested board members and shareholders rather than by (theoretically) disinterested bureaucrats* (Nellis, 1994, 1–4).

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[4] A financial crisis in 1981 led the Pinochet Government to re-nationalize most of the banks sold (critics derisively called this "The Chicago Road to Socialism") and recapitalize them. Under a subsequent democratically elected government, the banks were re-privatized after 1985.

3. Privatization takes center stage

Acceptance of this reasoning set the scene for the World Bank, the other multilateral development banks, the International Monetary Fund and many bilateral aid agencies to highlight and push harder for privatization.

The heyday of enthusiasm for privatization, in and outside the World Bank, was the period, 1990–2005. As noted, at the start of this period there had already been a substantial number of major SOEs privatized, without external agency involvement, in OECD countries. For more examples, thirty-some large SOEs were sold off in the UK in the period 1979–86; 29 major SOEs were divested in France between 1986–88, and a privatization process was then underway or in advanced preparation in most other OECD states, including Italy, Germany, Austria, Portugal, Canada, and New Zealand.

In the 1990s, the scope and pace of divestiture was to grow greatly in "the OECD 30," save for Luxembourg, Norway, Switzerland and, interestingly, the US.[5] This process was to continue in these countries, at least up to the time of the financial crisis in 2008–09. This partly was in response to the European Union's limitations placed on direct state aid by member states to enterprises operating in competitive or potentially competitive markets (China's assumption of the lead role in privatization, of a sort, post-2005 is discussed below).

The World Bank's concern, of course, was public enterprise reform and divestiture in its client countries. Here too, the process simply exploded after 1989. William Megginson, a leading academic researcher of divestiture in all its forms, calculates that the total amount raised by all selling governments in the period 1988–2005 was $2.26 trillion (Megginson, 2017, 13). Close to half of total proceeds came from privatizations in Europe, but significant sales and transfers took place in World Bank client countries as well.

First, a large number of traditional borrowers, with Latin American and sub-Saharan African countries in the lead, almost all with World Bank encouragement—and sometimes insistence—and support, expanded their SOE restructuring efforts. Post-1988, divestiture components of Bank operations became more numerous, more expansive, and more demanding. Many more loans included measures to transform SOEs by means of management contracts, joint ventures, leases and concessions to private operators, corporatization followed by offerings of shares, and the sale of ownership. A World Bank retrospective analysis of the effects of economic reforms of the 1990s concluded that whereas 14 percent of SOE-related loans in the 1980s contained a divestiture component, the incidence rose to 52 percent of operations in the 1990s (World Bank, 2005).

A second way of gauging the scope and impact of Bank efforts is by looking at the total number of privatizations accomplished in the area served by the World Bank, regardless of

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[5] Interesting but explicable. Unlike the bulk of OECD states, the US had never developed a large PE sector. Prior to 1988 the government had taken over and privatized a bankrupt rail freight company, Conrail, but proposals to divest other government functions and services, such as the Post Office, were thwarted by legislative opposition.

whether or not any particular divestiture was initiated or assisted by the Bank. To illustrate, a second Bank study, also from 2005, calculated that "120 developing countries carried out 7,860 transactions between 1990 and 2003, generating close to $410 billion in privatization proceeds, or 0.54 percent of total developing country GDP during that period" (Kikeri and Kolo, 2005, 3).

The numbers presented by Kikeri and Kolo, impressive as they are, still greatly underestimate the number of firms divested in Bank client countries in the 1990s. The main reason is that observers had difficulties calculating the precise extent and scope of divestitures that occurred in the formerly communist economies in the decade.

The transition from plan to market that began in Poland and the Deutsche Demokratische Republik in 1989 spread to Hungary, and the then Czechoslovakia and Romania in 1990. The USSR collapsed in 1991, resulting in the independence of the former Socialist Republics in the Baltic, Caucasus, Black Sea and Central Asian regions. The break-up of the federated state of Yugoslavia followed. By the mid-1990s some 30 unleashed or new states had arisen from the communist ashes, and most of them embarked on privatization programs of one sort or another, the vast majority with assistance from the World Bank.[6]

For example, a World Bank report on the heavily Bank-supported Russia program alone stated that "by the end of June, 1994, between 12,000 and 14,000 medium-size and large enterprises had been transferred to private ownership…." (Lieberman and Nellis, 1994, 1). Many additional thousands of privatizations occurred in the 1990s, in the former East Germany, the Czech Republic, Slovakia, Estonia, Romania, Bulgaria, Poland, Lithuania and elsewhere.

Sales revenues are also an unreliable indicator of the scope of post-communist privatization. Thousands of SOEs in transition were "sold" at zero or low cost to management/worker coalitions inside the enterprises, and many other firms were transferred by means of "voucher" schemes and rapidly created investment funds. There often was little formal recording of the transactions (as they were frequently of dubious legality) and the sales proceeds raised by the selling state were far more modest than anticipated.

Note that leading privatizers in the non-communist regions, such as Argentina, had in this period gone well beyond the sale of commercial, manufacturing and service SOEs and divested major infrastructure firms; e.g., Aerolineas Argentinas, the national airline, the state railways corporation, the state telecommunications firm, the national and some regional water distribution enterprises, a number of state and regional banks, and much more, including portions of the government-owned oil industry. At this stage, privatization programs in many

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[6] Of course, there were and remains varying degrees of enthusiasm for the process. Privatization was a welcome and principal concern of the Central European, non-former USSR countries, and the re-independent Baltic states. Privatization was, at first, supported by the governments in Russia itself and (to a lesser extent) Ukraine. Commitment was much lower in a number of former Socialist Republics that were more remote, physically and historically, from Western markets and methods, such as Belarus, Uzbekistan, Moldova, Turkmenistan, and Tajikistan.

other countries, especially outside of Latin America, concentrated more on the divestiture of non-infrastructure SOEs, holding these, and banks, for reform later in the decade, or in the early 2000s.

Still, despite incomplete and sometimes shaky data, it is absolutely clear that in the 1990s a huge wave of privatization swept the industrialized and developing worlds, and in most of the European states in the formerly communist bloc as well. Megginson refers to 1988–2000 as "the Golden Age of Privatization" (Megginson, 2017, 9). By 2000, while some few countries were still in the preparation stage of examining how to go about the divestiture process, most had launched a sales program. Very few states remained completely resistant to the allure of privatization. It is also clear that, outside the OECD group and a few outlying countries, the World Bank was deeply implicated in the privatization process as instigator, promoter, financier, implementer, and evaluator.

4. Impressive first results

In the mid-1990s, detailed assessments of the first wave of privatizations in non-OECD settings began to appear (Galal et al., 1994, Boubakri and Cosset, 1998, LaPorta and Lopez-de-Silanes, 1999, Havrylyshyn and McGettigan, 2000, and Megginson and Netter, 2001). Almost all were positive, showing widespread and significant performance improvement in the studied privatized firms, as measured by productivity gains, profitability, return on sales, and other indicators. Particularly impressive were the results reported in the World Bank-sponsored Galal et al. study. Three of the four privatization experiences examined, in Chile, Malaysia and Mexico, were in developing countries. In these and in the fourth, British case as well, the privatized firms mostly demonstrated improved financial and operational performance. And, the authors found that that in all four cases privatization had contributed significantly to overall economic welfare gains, the most demanding test of privatization's utility.[7]

All these findings led Megginson and Netter, in their 2001 survey of the literature, to state:

> The evidence is now conclusive that privately owned firms outperform…state-owned enterprises…Empirical evidence clearly shows that privatization significantly (often dramatically) improves the financial and operating performance of divested firms (Megginson and Netter, 2001, 321).

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[7] Welfare studies estimate the counter-factual, i.e., what would the firm and the economy look like in the absence of the divestiture? The difficulties of counter-factual construction are notorious; relatively few have been carried out on privatization cases (see section 4 in Nellis, 2012, 15–16, for a discussion of the issue). The Galal et al. study is regarded as an excellent example of how to go about the approach.

Academic evaluations thus supported the use of privatization and seemed to validate its widespread application. "Privatization, it appeared, had swept the field and won the day" (Nellis, 2001, 160).

Despite the glowing early academic reviews, privatization never achieved the status of a panacea for troubled SOEs, though critics insisted that the World Bank regarded it as such. Measures aimed at improving management and supervision of SOEs not slated for imminent divestiture continued to feature in most operations and, indeed, often received more resources than components related to sales. Moreover, many Bank analysts had long acknowledged the problems that could arise from privatizing firms, especially infrastructure firms, in weak legal, regulatory and institutional settings, and they continued to argue their viewpoint.

But the need for improved performance was usually judged as sufficiently urgent to outweigh their concerns and justify an emphasis on speedy transformation.[8] The argument was that one had to seize the perhaps fleeting opportunity offered by this moment of "extraordinary politics"[9] to push for fundamental reform. Voices arguing for a slower, evolutionary, institution-building approach found their arguments dismissed by those who reasoned that the need for speed trumped a counsel of caution. Besides, they argued, clients who said they wished to move cautiously and slowly on privatization often used this argument to mask the fact that they did not wish to privatize at all.

Thus, for most commercial SOEs, the prevailing tendency inside the Bank was to view divestiture as the first option to be considered. The situation was more nuanced for SOEs in infrastructure, energy, and banking SOEs, and those using very large amounts of labor—especially if they were the principal employer in an isolated region or town. Most officials in borrower countries argued that a slower path of reform was required and justified in these cases. Faced with client (and sometimes staff) push back, Bank decision-makers tended to countenance a supposedly time-limited restructuring period for "strategically important" SOEs. The idea was that it made sense to prepare these firms for market, and deal with the issues of mass labor layoffs, murky cross-debts, lack of regulatory bodies and numerous other concerns, while the enterprise was still in public hands. In theory, private involvement would come—eventually.

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[8] This was especially the case in the ex-Communist states in general, Russia in particular (See Nellis, 2008, esp. 115–119).

[9] The term used by Leszek Balcerowicz, whose "shock therapy" rapidly took Poland from plan to market.

5. A shift in perspective

Well before the end of the 1990s, criticisms emerged of privatization and the World Bank's involvement in the process. These concerns were of three main types: issues of evaluation of results, issues of implementation, and issues of unintended consequences.

- Concerning **evaluations**, critics acknowledged that the early positive performance findings were real, but—since almost all privatizations took place alongside other policy and structural reforms—the improvements may not have been due to ownership change, or ownership change alone, but might be attributable to the concomitant liberalizing shifts. This view supported gradualists who thought that the introduction of competitive forces and the imposition of a hard budget constraint were as likely to account for performance improvements as ownership change—and they were, perhaps, less contentious to implement.
- Or the good results might have arisen through "**selection bias**." That is, perhaps it was not that privatization made bad firms into good ones, but rather it was the good firms that had been chosen to be privatized.
- Regarding **sustainability**, others argued that most of the studied privatized firms had only spent a relatively short time in private hands, and that the good results might well fade, or be reversed, as they went through a business cycle or two.
- Regarding **implementation**, the main argument was that much more positive and sustainable outcomes could have resulted from privatization, especially in infrastructure firms, had market liberalization, regulatory, legal, and institutional reforms preceded ownership change, or at least been pursued as aggressively as ownership change.
- All these viewpoints above were strengthened by somewhat later analyses of the effects of privatization based on more, and more reliable, data. These (especially Djankov and Murrell, 2002, and Estrin et al., 2009), nuanced the blanket judgement of Megginson and Netter, showing that ownership change significantly improved performance when it was associated with enterprise restructuring and the imposition of hard budgets; that divestiture to previous managers and/or workers generally produced limited improvements, and that privatization was harder to implement and more likely to produce few or negative results in institutionally weal settings.
- It was problems of **consequences** that most affected the World Bank's efforts. Many client governments of the World Bank had been brought to the privatization table not because their leaders had been converted to a Thatcherite perspective, but rather because it seemed clear, or had been made clear to them, that acceptance of some form and amount of divestiture was a price they had to pay to retain the flow of international financial institution funding to cover their financing gaps. They expected and needed quick, positive results. They got them in most commercial enterprises divested, but less so in the larger, systemically important infrastructure enterprises that had gone to market.
- Private involvement in infrastructure encountered (and still encounters) a number of problems. Even with substantial external assistance, institutionally weak governments had very great **difficulty creating, monitoring, and enforcing the**

detailed contracts that guided lessees, concessionaires, management contractors, and independent power project operators. Many governments faced early demands for renegotiation of infrastructure contracts due to claims by the private party that the information given by the selling state was insufficient or just plain false. Several spectacular failures occurred, sometimes leading to re-nationalization, particularly in water supply and sewerage, energy generation and distribution, and transport—in Bolivia, Senegal, Tanzania, Pakistan, Mexico, and elsewhere. Even where the contracts held, the public usually objected to the higher utility tariffs often charged, and the more diligent fee collection/cancellation of service for non-payment policies adopted by private operators.

- Other concerns grew at the 1990s wore on. The Czech Republic's much-praised voucher privatization program (seen by the 1996 World Development Report, *From Plan to Market*, as "the most successful to date…" [World Bank, 1996, 56]), ran into trouble. **Insufficient regulation** of the new voucher funds and banks set up to finance them led to the defrauding of many small investors and costly delays in the needed restructuring of privatized firms. Growth slowed and halted; public dissatisfaction grew.
- The large Russian mass privatization program which seemed, to the World Bank at least, well-launched in 1994, slowed, became much less transparent and much more politicized. The infamous "**oligarchs**" rose to visible prominence after 1995. They manipulated the system to exclude, dilute or defraud outside investors and became the majority owners of the great mass of privatized assets, usually paying very little for them. In both countries, and elsewhere in the transition states, privatization became a dirty word. Russian and Czech privatization even drew the ire of the World Bank Chief Economist Joseph Stiglitz, who wrote in 1999 that privatizing in the absence of an adequate market-supporting "institutional infrastructure" was a serious mistake that could and did "lead more to asset stripping than wealth creation" (Stiglitz, 1999, 7).[10]
- Client country leaders heard and had to deal with the growing number of strident **voices opposed to privatization**, from representatives of labor, who predicted that privatization would often result in workforce reductions;[11] from those opposed to higher energy and water prices and increased tolls; from those who feared reduced access to essential services, especially for the poor; and from those concerned about a possible erosion of sovereignty as non-nationals took over management or ownership of SOEs. Added to all these was the opposition of both non-governmental organizations and local intellectual communities, most of whom thought that privatization was a corruption-ridden process benefitting the rich and the crooked at the expense of the average citizen particularly the poor.

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[10] Another Nobel laureate, Kenneth Arrow, gave a talk at the Bank in 1999 where he termed the outcomes of the Bank-supported Russian privatization program "a predictable economic catastrophe" (personal note from the meeting).

[11] The fear was legitimate. Chong and Lopez (2002, 7) surveyed 308 privatizations in 84 developing countries and found labor reductions in 78 percent of their sample.

By the early years of the 21st century the stylized facts on privatization were these: a shift to private ownership of a previously state-owned and operated firm usually led to improved financial and operational performance. This point must be stressed. But improvements were more likely to occur and endure where SOEs were divested into competitive or potentially competitive markets. Positive results were strongest in middle- to higher-income countries possessing an adequate or at least modicum institutional framework. Privatization less often lived up to the expectations in infrastructure divestitures, particularly in low-income, institutionally weak settings.[12]

And there were, inevitably and everywhere, losers in the process who tended to be vocal and organized. Their plight, particularly job losses, elicited sympathy and support from the general populace, who were either unaware of or unimpressed with shorter wait times to receive a telephone, modest increases in the reliability of electric service, a few percentage points decrease in the government's budget deficit, or a perceptible but not enormous uptick in growth. Privatization began to lose whatever limited popularity and acceptance it might have once had, due to miserable past SOE performance. Wherever the public could be sounded on their views towards privatization, the sentiment was negative, increasingly so as time passed. Government leaders generally concluded that while privatization was usually an economic and financial asset, it was always a political liability. The loss of office, and in some cases ensuing prosecution, of privatization champions—in Argentina, Bolivia, Bulgaria, New Zealand, and Russia—further dampened official willingness to promote divestiture.

By 2005, this state of affairs was evident to all, including decision-makers at the World Bank. Bank management was already somewhat on the defensive because of the barrage of criticism generated by the supposed wholly negative social effects of structural adjustment lending conditions, and the World Bank/IMF role in advancing the supposedly wholly negative "Washington Consensus" liberalization program. Taking note of the difficulties of infrastructure privatization in low-income countries, the well-publicized lurid tales of corrupt and ineffective divestitures, the extent and intensity of anti-privatization push back among borrower government officials and populations, the Bank shifted its tone on SOE reform, away from privatization as a first-best option and back to a more agnostic position regarding the importance of the ownership question. The new, more nuanced and pragmatic view was summarized in Chapter 6, "Privatization and Deregulation: A Push Too Far?" of a major 2005 Bank report, *Economic Growth in the 1990s*. The Chapter concluded:

> There is no universally appropriate reform model. Every restructuring and privatization program needs to consider explicitly the underlying economic attributes and technology of each sector and its institutional, social and political characteristics….Privatization is less about finding better owners than the government than it is about separating commerce from politics….Privatization helps to achieve the separation but does

[12] See Estrin and Pelletier, 2018, for a comprehensive discussion of the literature on amount and effects of privatization in developing countries.

> not automatically ensure it…If privatization is oversold as a means of separating commerce from politics, restoring the link through regulation is underappreciated (World Bank, 2005, 193).

Looking back from the perspective of 2017, Megginson concluded: "Through the early 21st century, there was an unambiguous global trend towards reducing government ownership of business enterprise, but this trend has since at least been slowed, and perhaps even reversed" (Megginson, 2017, 1).

An additional and important catalyst for this shift in approach was the dramatic rise of the distinctly different, evolutionary, Chinese road to privatization.

6. China privatizes

Forty-eight percent of the total privatization proceeds of $1.37 trillion generated prior to 2005 came from sales and divestitures in European countries. In the following eleven years, global privatization revenues rose by an additional $2.26 trillion, but European transactions accounted for less than a third of these proceeds (Megginson, 2017, 13). A good percentage of the vast additional sums raised post-2005 came from sales in two countries that had hardly featured at all in the previous period: the United States and China. The US case was an anomaly and was not relevant to the World Bank's or its client countries' concerns.[13]

The Chinese case was far more intriguing. And complex. China had started to reform its gigantic SOE sector gradually since the early 1980s. For some time, neither the government's policy toward nor the legal basis of purely private property was made clear. In the early 1990s, more concrete steps were taken. China introduced a stock market; the aim was to sell minority shares, to Chinese citizens, in majority government-owned and operated firms. Government control was not, or only partially ceded, but private initiative was being tolerated and encouraged in a variety of sectors, due to the need for increased efficiency and production. Yet, at the same time, government continued to shield core SOEs from competition and cost-cutting measures, in order to maintain employment, social stability and political control. This ambiguous ownership policy was associated with an excellent and sustained rate of growth. China's GDP at market prices grew an astonishing elevenfold in the period 2000–2015.

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[13] During the financial crisis of 2008–09, major US banks, insurance companies, investment houses and some commercial firms such as General Motors teetered on the brink of meltdown. The US Federal reserve and Treasury then purchased $205 billion in non-voting, non-convertible preferred shares in 34 troubled firms, in an effort to keep them afloat. The US government had not the slightest intention of assuming any direct management role or long-term control in these firms. The announced goal was to sell the shares on the open market as soon as stability was restored. As calm returned, between 2010 and 2012 the US government sold off all its shares (and made a tidy profit on the sales). While acquisition of privately-owned equity and subsequent divestiture count as privatization, the US case was hardly a model that developing countries could take interest in or follow.

The sale of a minority of shares in "corporatized" Chinese SOEs, with decision-making on major issues remaining in the hands of, or at least influenced by, state-appointed officials, became the hallmark of the Chinese approach. Up to 2005, a large percentage of all shares sold was not tradeable, and managers were legally prohibited from selling any of the state's shares held inside the firm.

After 2005, China made all divested shares tradeable and the insider shares sellable. Both measures boosted the privatization process considerably. A recent survey of 80 mega-privatization transactions—i.e., all those raising over $5 billion per transaction—in the decade 2005–2015, reveals that Chinese divestitures accounted for 16 of the sales, with a total value of $148 billion (the US accounted for 17 such sales). Moreover, Megginson states that in the decade China also sold, over and above the mega-deals, over 1,000 "smaller" firms (Megginson, 2017, 23).

Exactly what Chinese privatization is, how it is carried out, and what its effects are on enterprises and general financial and economic performance, are the subjects of a burgeoning analytical literature.[14] No firm consensus has emerged, but the thrust of the analyses is that in China, as elsewhere, divestiture has generally produced improved performance at the level of the firm. The larger the percentage of equity divested, the greater the performance improvement. The more private the new owners and the less direct government intrusion, the more performance improves. Many thousands of SOEs have been at least partially divested through share issuance and sale, and it is possible that this process will gradually spread and deepen, towards greater majority private ownership.

However, this will be a slow process. Just a few years ago many observers believed that China would rapidly deepen and broaden its privatization efforts towards full and unfettered divestiture. This assessment now seems premature, if not simply incorrect. China has continued to privatize SOEs mainly by allowing them "to raise capital by selling newly-issued primary shares to investors, thus diluting state ownership only indirectly, rather than having the state sell its existing shareholdings directly…" (Megginson, 2017, 9). The Chinese state exercises its authority through retention of a large SOE sector and control of the banking and financing systems for all firms: SOEs, private and partially private firms. State officials still serve on the boards and controlling bodies of the large and important partially privatized entities. The state plays active policy and lender roles.

Thus, contrary to some expectations, it appears that the Chinese government has no intention of discarding fully its "guided capitalism" approach. It will continue to control the commanding policy levers, if not physical heights, of the economy, in the name of social stability and the maintenance of the Communist regime that has produced such sustained growth and poverty reduction.

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[14] About one-third of the over 100 articles on privatization surveyed in Megginson's (2017) comprehensive review deal with the Chinese case. IEG's structured recent literature review for State Your Business found that over half of the articles found dealt with China.

The point is that the undeniable Chinese success with this mixed approach suggests to both World Bank client countries, and the Bank itself, that there is a viable alternative policy path to economic progress that involves neither rigid austerity nor complete surrender of state control over enterprise direction. The relative success of other Asian countries eschewing a strict division between public and private control—Singapore, Vietnam and, to a somewhat lesser extent, Japan, Malaysia, and Korea—further encourages some World Bank client countries to seek a seemingly more balanced path to enterprise reform.

7. Results of the revised approach

So: Between 2000 and 2005, concern grew in client countries and the institution itself over the World Bank's comparatively un-nuanced stress on privatization. In response, more attention was paid to previously existing but not fully utilized SOE reform tools. These included public-private partnerships in general, and partial, policy and project risk guarantees in particular. These aimed at giving comfort and inducements to private creditors, investors, and operators to become involved in SOEs and other operations in risky settings. At the same time, the Bank rethought and greatly enhanced its efforts to improve corporate governance inside the SOEs. The goals were to improve government policy towards and supervision of SOEs and strengthen internal management capacity to fulfill the new policy directives. Measures returning to prominence included increasing the quantity and quality of SOE products and services, aiding cost recovery and control inside the enterprise, fostering expansion of infrastructure networks to better serve the previously excluded, and improving firm level management.[15] Another part of the program was increased efforts at domestic resource mobilization to spur infrastructure renewal and network expansion.

Has this revised approach produced superior results in terms of improved SOE performance following World Bank interventions? Up until recently, there were indications that the altered approach had not, or not yet, produced dramatically different and better results. An outstanding World Bank study from 2014, *Governance of Indian State Power Utilities* (World Bank, 2014b), described a set of corporate governance and regulatory regime reform measures introduced into sixty-nine publicly operated power utilities in nineteen Indian states. The reform package addressed the issues of the composition, powers, and functioning of the utilities' Boards of Directors, management practices and training, and a variety of performance reporting and supervision issues. It then examined whether and to what extent the 19 supervising State Electricity Regulatory Commissions implemented the recommended reform package, with regard to tariff setting and revision, operational standards, consumer involvement and information, clean energy, etc.

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[15] For details on these initiatives see: World Bank, World Bank Group Support to Public-Private Partnerships: Lessons from Client Countries, 2015; World Bank, Corporate Governance of State-Owned Enterprises: A Toolkit, Washington, D.C." World Bank, 2014a; World Bank, World Bank Group Guarantee Products: A Guidance Note, April, 2016, and James Leigland, "Public-Private Partnerships in Developing Countries: The Emerging Evidence-based Critique," World Bank Research Observer, 2018.

Not surprisingly, the study found a wide variation in the rate of adoption: "A handful of utilities and state regulators are at the forefront of recommended practices, but implementation varies considerably across the country. For the majority of utilities and states, governance clearly has a long way to go…." (World Bank, 2014b, xiii-xiv). The same was generally true of the regulation reforms.

The key contribution of this study is that it then asks, so what? That is, it tries to determine, empirically and quantitatively, the impact, if any, of the reforms on post-adoption performance. It concludes with some good news for proponents of improving institutional design and practice; i.e., it finds a positive, significant correlation between the extent of reform adoption and improved operational and financial action.[16] The problem was that so few firms and regulatory agencies have implemented or enforced anywhere near the full panoply of reforms, 10 years after passage of the law mandating their adoption. The great majority of firms have been slow or reluctant adopters; their performance continues to lag.

The ownership issue is generally not addressed in this study, but the lethargic and inadequate rate of adoption of the non-ownership reform measures is not encouraging. Of course, one cannot reach general conclusions from a single Bank study of a single sector in a single country, no matter how rigorously carried out. Still, given the similarities in problems faced in SOE reform the world over, it seems reasonable to think that reliance on non-ownership reforms will, at the very least, require very great patience.

The December 2020, release of the detailed IEG *State Your Business* evaluation provides much more information on the efficacy of the World Bank's revised approach to SOE reform in the period 2008 to 2018. A caveat: IEG's detailed findings are limited to operations in the financial/banking and energy sectors, though other sectors are more lightly reviewed. (*State Your Business* confirms that "privatization represents a small and declining percentage of the portfolio [at less than 6 percent throughout the evaluation period] …." (World Bank, 2020, 1, in the Overview). The other facets of SOE reform—corporate governance, business/operational reforms at the level of the firm, competition and regulation in SOE markets, and macrofiscal and public financial management reforms—form the bulk of the 2,185 components in the 1,008 SOE-related projects in the energy and the finance sectors, in the decade under review. IEG concludes that "on average, the SOE reform portfolio in the financial and energy sectors met the World Bank and International Finance Corporation corporate targets for project success…. [achieving]…. a success rate of 78 percent…" Privatization and corporate governance actions were the highest ranked. Can one conclude from this that the revised approach is producing superior results?

Many of the actions reviewed, especially in the privatization components, were "upstream." That is, they aimed at creating the legal, regulatory or financial actions preparatory to sale,

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[16] The study's authors are careful to label these positive results as "indicative" due to performance data only being available for 2010–2011, and because of the possibility of reverse causation; i.e., it is not that utilities improve performance following adoption of the reforms, it is rather that the it is the relatively well-performing utilities that adopt the reforms.

not actually divesting the entity. (Interestingly, IEG's interviews reveal that "after a period of client disinterest and political sensitivity, demand for privatization support has been growing). This was also the case with the governance actions; perhaps inevitably, was building the base through policy reforms for governance improvements.

In line with the assessment that divestiture is a more difficult undertaking in low-and lower-income countries, the relatively small number of direct divestiture operations took place mainly in middle-income countries. Ten client countries—Turkey, Serbia (upper-middle-income), Bangladesh, Egypt, Pakistan, Philippines, Mongolia, (lower-middle-income), and Burundi, Mali, and Nepal (low-income)—accounted for over 50 percent of all privatization support projects in the two sectors.

The overall conclusion of *State Your Business* is that, across the board, the reforms enacted were basically sound, and the success rate more than acceptable. Well and good. However, as was the case in the 2018 Asian Development Bank's evaluation of its SOE reform activities, 2005–2017 (Asian Development Bank, 2018; this author was a peer reviewer of that exercise), there is a concern: evaluators in both institutions can see improvements in SOE performance in their review period. They then suggest that the improvements were brought about, at least in part, by the lending and technical assistance provided by their bank group's activities and investments. This is quite possible, and indeed likely. As *State Your Business* notes:

> "The literature consistently finds superior performance of private and privatized companies over public ones in both the energy and financial sectors….Rigorous national studies also yield evidence of the benefits of corporate governance reform for SOEs. There is strong evidence that competition improves SOE performance…and augments the effectiveness of both privatization and regulatory reforms" (*State Your Business*, Overview).

To reiterate: One sees an improvement in SOE financial and operational performance in the period. One definitely observes some progress in IEG's closely studied sectors. The World Bank Group made a substantial investment of some $ 71.7 billion for SOE reform in energy and finance from 2008 to 2018. However, given the complexity and multifaceted nature of SOE reform programs, and the lengthy time period needed to effect institutional reforms, it is exceedingly difficult, if not impossible, to specify causal links between a particular project or set of projects and a desired developmental outcome. One cannot state with any degree of certainty the extent to which World Bank operations have contributed to the evident gains in SOE performance. But what one can state, and which *State Your Business* acknowledges, is that serious problems continue to exist in the remaining, surprisingly large and still important SOE sectors in World Bank borrower countries.

> "SOEs play a critical role in the energy and financial sectors in many developing and emerging economies. Most countries still depend on SOEs to provide power. SOEs accounted for 71 percent of the Morgan Stanley Capital International (MSCI) Emerging Market Index in utilities, 56 percent in energy, and 39 percent in the financial sector

> in 2020. State control is prevalent in the oil and gas sector, with about 90 percent ownership of reserves and 55 percent of production. Although state ownership in commercial banks declined from 67 percent of total banking assets in 1970 to 22 percent in 2009, SOEs often retain a dominant role in banking …. In emerging markets such as China and India, SOEs hold more than half of banking system assets…" (*State Your Business*, Evaluation Purpose and Scope).

8. Conclusion

What next?

For 30 years or more, William Megginson has closely and continuously studied the empirical literature on the effects of privatization of state-owned enterprises worldwide. The conclusions he draws from his most recent and extensive survey of the issue (Megginson, 2017) are as follows.

First, there has been an explosion of rigorous analysis of privatization since 2005. Megginson reviewed over 100 articles published after that date.

Second, all seventeen surveyed studies specifically focusing on "before and after" performance "document significant improvements after companies are divested…" and "…all the [other] empirical studies surveyed show that private ownership is much more efficient than state ownership, sometimes massively so" (pp. 137–8).

Third, government decisions regarding what and when to divest are always intensely politicized.

Fourth, "most forms of pre-divestment corporate restructurings reduce net prices received" (p. 138).

Fifth, all but one of the studies of bank privatization "show that state ownership distorts banking decisions, capital allocation efficiency, and/or the arms-length provision of credit to firms with the most promising investment prospects…" (p. 139).

Sixth, "political connections….are beneficial for the companies (and politicians) involved, but these private benefits are usually associated with significant costs for the overall economy and financial system" (p. 139).

Seventh, "…state ownership has a generally distortive effect on corporate financial policies, most importantly capital investment spending" (p. 139).

Eighth, "Government guarantees of private financial transactions and bailouts of failing private firms are inherently distortive…."

These findings come close to, but are not quite, a blanket endorsement of privatization. Megginson notes the inevitable intrusion of political considerations into privatization decisions and processes. He recognizes that some bailouts will occur, as well as the placing of large, labor-laden but poorly performing state enterprises into expensive, and often interminable, restructuring programs. He acknowledges the appeal of a state capitalist approach, particularly in lower-income, institutionally weak states. He notes the benefits of interventionism to political and bureaucratic elites. Megginson also concludes that "the state capitalist model" is a proven failure, but that assertion seems hard to square with the good performance of many of China's partially privatized firms, and the earlier finding of Djankov and Murrell that "state ownership within privatized firms is surprisingly effective…", at least in transition economies. (Djankov and Murrell, 2002, 741). Still, the literature reviewed provides substantial evidence of the utility of privatization.

The situations in which privatization is more likely to encounter the costs and pitfalls Megginson describes are the situations and circumstances in which many World Bank client countries are found. Many borrower states still lack that modicum degree of institutional/legal/managerial capacity required to make a quick success of full-scale privatization, especially in water, energy, transport, banking, and telecommunications—listed in declining degree of difficulty.

But despite these problems, and despite the near universal acknowledgement that the quality of a country's legal, policy and regulatory institutional framework is a crucial determinant of whether that country will carry out privatization successfully, the fact is that "(W)e are still very ignorant about institutions…" (Williamson, 2000, 595). Years of effort have failed to establish workable guidelines, much less blueprints, on how to create and sustain them. The detailed, rich, rapturously received work of Acemoglu and Robinson (*Why Nations Fail*) persuades one of the critical importance of the "right" institutions to generating and maintaining a society's wealth and prosperity; but it is extremely short on concrete guidance as to how to go about putting these into place where they do not exist.

In addition, some analysts argue that, at least in the former communist countries, privatization with all its shortcomings still produces outcomes far superior to what would have happened in its absence.

> ….the (formerly communist) countries have transformed their militarized, overindustrialized, and state-dominated systems into service-oriented market economies based on private ownership and integrated into global commercial networks and regulatory (Shleifer and Treisman, 2014).

Shleifer and Tresiman insist that the speed and seeming radicalism of the privatization methods employed, given the circumstances, were unavoidable and ultimately beneficial. Not surprisingly, this argument is contested and, even if defensible, seems applicable mainly to the former socialist bloc.

So: Given the difficulty of doing privatization right, it is hardly surprising that the World Bank and its clients search for SOE reform methods that are less contentious, and more palatable socially and politically, than divestiture. To date, however, persuasive evidence of the superiority of a non-ownership related reform approach seems scant. Thus, while privatization is very difficult to enact correctly, and has at times been counterproductive (to put it charitably) it nonetheless remains the only SOE reform that holds out the prospect of rapid, dramatic and enduring performance improvement.

Until it is solidly established by rigorous research that the World Bank's present approach to SOE reform is producing sustainable improvements of the needed size, in a reasonable time frame, it would be unwise of the institution to continue its relative neglect of privatization.

Back to the future?

Admittedly, the Bank has not totally turned away from recommending and supporting privatization of SOEs, at least in those cases when and where the client is on board and the circumstances and settings appear to justify the action. Indeed, support for divestiture may soon return to prominence as the Bank policy pendulum seemed, in 2017 at least, to be swinging back towards greater enthusiasm for more direct private involvement in development operations in general. Why and how is this the case?

Despite the substantial increases in Chinese bi-lateral aid and investment, despite the coming on-stream of the Asian Infrastructure Investment Bank, despite capital increases, increased commitments and disbursements, and reductions in the costs of lending in the older IFIs, and despite improved domestic resource mobilization efforts in many client countries, it is nonetheless clear that the needs for investment capital in developing countries and emerging markets still greatly exceed current much less projected demand. This is especially true for infrastructure creation and renewal. Estimates of the needed amount of infrastructure capital bouncing around in the financial press range from $3.3 to over 4 trillion US dollars in the near to medium term – and these estimates were made before the COVID pandemic struck. If this amount of capital, and the entrepreneurial expertise to put it to good use, cannot come from donors and domestic sources, then one must turn to private suppliers.

This realization is the point of departure for the "Maximizing Finance for Development" (MFD) initiative, launched by the Development Committee of the Boards of the World Bank and International Monetary Fund in September of 2017. The objective is to:

> reserve scarce public financing for those areas where private sector engagement is not optimal or available. This means....testing—and advising clients on—whether a project is best delivered through sustainable private sector solutions (private finance and/or private delivery) while limiting public liabilities, and if not, whether WBG support for an improved investment environment or risk mitigation could help achieve such solutions ...... It also means sustained support at the sector and country level to strengthen the enabling environment

> for private sector solutions—including in developing domestic capital and financial markets to expand the supply of local currency financing available for development. (World Bank, 2017, 1).

The Bank (again, in 1917) envisioned its role as "supporting governments to crowd in the private sector to help meet development goals." While the language throughout is circumspect, and the terms "privatization" and "divestiture" never occur in the documents describing this initiative, MFD indicated a substantial shift in approach and emphasis from that put forward in 2005. The clear implication is in most situations the Bank would look first at the efficacy of private involvement, as creditor, manager or partial or full owner. As the MFD launch note states, "private finance and/or private delivery...."

To put this initiative in motion, the Bank intended to deploy

> new tools to support MFD. ......these include the Infrastructure Sector Assessment, a strategic planning tool that helps teams working with government clients to identify opportunities to maximize finance for priority infrastructure investments...... and the Country Private Sector Diagnostic (CPSD), which takes an investor perspective in reviewing all economic sectors to identify opportunities for action to spur private sector-led growth. (World Bank, 2017)

It would seem logical that in these assessments, situations will arise in which divestiture options would logically be considered. Admittedly, to date it appears that most actions classed as MFD apply World Bank Group partial risk guarantees to give comfort to private sector financing, and not involve direct divestiture.

Nonetheless, the studied ambiguity of the initial MFD documents seems a reasonably judicious way forward for an institution that needs to harness private sector dynamism and resources but tame its rougher edges and better tailor the approach to fit its client governments—and the watchful public's—needs.

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