Balancing Opposition and Economic Benefits in Privatization Policy: An Analysis of Brazil, South Africa and India

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Abstract

Privatization of state-owned corporations can benefit an economy in many cases. However, some segments of society lose from privatization and privatization is generally an unpopular policy even among segments of society that are not directly affected. Successfully implementing privatization requires overcoming these sources of opposition while not sacrificing the economic benefits of the policy. This paper analyzes privatization across Brazil, India and South Africa to understand how these countries implemented privatization and what measures were effective in overcoming opposition without sacrificing efficiency. Based on the case study analysis, Government propaganda on the costs and benefits of privatization policy accompanied by compensation packages to vested interests (primarily labor) that are directly linked to the continuation of the privatization program were the most effective means of overcoming opposition while maintaining the efficiency of the policy.

Introduction

Many if not most economists recommend privatization of state-owned firms as a means of increasing efficiency in individual firms and in society as a whole. Both the World Bank and IMF recommend privatization[1] of state-owned firms and in many cases have made receiving IMF and World Bank funds conditional on implementing privatization programs.

Public ownership is associated with inefficiency primarily due to the non-financial motivations of bureaucrats and politicians. The basic intuition for this inefficiency is that when governments manage firms they attempt to maximize financial and political returns, whereas a traditional private firm only maximizes financial returns. For example, government owned firms are frequently over staffed because politicians pressure managers to hire more employees, and managers and workers who perform poorly are not let go due to political connections or statutory difficulties in firing employees.[2]

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[1] Banerjee and Munger (2004) point out: "Privatization can mean denationalization (direct sale of assets), deregulation (introduction of competition in sectors previously monopolized under government authority such as electrical power, natural gas, and water), or contracting out (lease, contract for concessions, build-own-operate, build-own-operate-transfer etc)". For the purposes of this memo, I will include all of these categories as aspects of privatization.

[2] For empirical studies of privatization, see (Megginson and Netter, 2001; Angrist et al., 2002; Galiani

Despite the apparent economic benefits that accompany privatization the policy generally faces stiff resistance from vested interests who benefit from the state-ownership of firms and from the general public. In their seminal work on privatization in Russia, Boycko et al. (1997) state, "Even though the ultimate economic objective of privatization is restructuring, privatization is always and everywhere a political phenomenon." Essentially, politicians are faced with a delicate balancing act between achieving the economic efficiency gains of privatization and not having the policy halted by political opposition.

What complicates the balancing act is that most of the methods of reducing political opposition to privatization also sacrifice some of the economic benefits of the policy. For example, a politician faced with opposition to a privatization proposal from labor unions at state-owned firms may make guarantees that there will be no labor retrenchment after privatization. This guarantee may be very effective in reducing opposition, however, the economic benefits of the privatization will be greatly reduced if one of the major inefficiencies of the state-owned firm is overstaffing. Of course, if opposition interests (e.g. labor unions) block the policy then no benefits are realized. Thus, the question facing policy makers is how to ensure that privatization is not blocked by political opposition while sacrificing as little of the economic gains of the policy as possible.

The goal of this paper is to identify what methods are most effective in reducing political opposition while maintaining as many of the economic efficiency gains as possible. To do this, I analyze the experience of the IBSA economies: Brazil, India and South Africa. I find that the Governments that were able to most effectively manage opposition to privatization used 1.) propaganda to inform the public and vested interests about the costs and long-term benefits of the policy, and 2.) compensation packages to labor unions at state-owned firms that were directly linked to privatization and the continuation of the policy, as opposed to compensation packages that were simply meant to reduce overstaffing.

The paper proceeds in three sections. In the first section I outline the literature on why privatization is politically unpopular in many contexts with a focus on democracies. In the next section, I outline the history of privatization in the IBSA countries and analyze how Governments attempted to manage opposition to privatization in each country. In the last section, I draw policy implications from the three cases.

Why is Privatization Politically Dangerous?

The literature on economic reforms and public opinion revolves around a very basic question: if reforms are beneficial for an economy, why do they generate widespread resistance?[3] There are two common answers to this question: 1.) Perhaps the general public is myopic and unable or unwilling to give economic reforms sufficient time to improve the economy (Stokes, 1996; Haggard and Kaufman, 1992), and 2.) That it is vested interests that are the main obstacle to economic reforms because they are able to effectively organize whereas the general public that benefits from reforms cannot (Haggard and Webb, 1994). Both of these explanations relate to the temporal and spatial dimensions

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et al., 2005).

[3] This question is most explicitly addressed in Rodrik (1996).

of privatization, i.e. the costs of privatization accrue in the short-term whereas the benefits occur in the long-term, and at the same time, the costs tend to be highly concentrated (i.e. large costs for a small number of people) whereas the benefits accrue to society as a whole (i.e. small benefits for a large number of people).

Opposition to Privatization from the General Public

Across developing countries, privatization is generally unpopular even in cases where other pro-market policies are popular. Baker (2009) argues that the explanation for the contradictory opinions on privatization and broader economic reforms comes from the public's position as consumers and not as workers or producers. Consumers want cheaper goods. Market reforms such as free trade provide cheaper goods. Privatization on the other hand increases prices in many cases, because publicly owned firms often hold prices artificially low to win votes.[4]

Other authors argue that the opposition to privatization stems from the public not understanding the benefits of the policy.[5] Hainmueller and Hiscox, 2006 find that opposition to privatization decreases as education increases. In the developing world there are a number of studies that suggest a broad-based public understanding or concern with privatization programs does not exist (Mengistu and Vogel, 2009; Kumar, 2004). Furthermore, privatization is often popular in developed economies, which suggests that the unpopularity in developing economy may be due to lack of information.[6] However, it is also possible that the public believes, perhaps correctly, that privatization is more likely to lead to crony capitalism in developing countries.

The general public may also oppose privatization for nationalist reasons. Johnson (1965) observes that in developing economies “nationalist economic policy will tend to foster activities selected for their symbolic value in terms of concepts of national identity and the economic content of nationhood; in particular, emphasis will be placed on manufacturing, and, within manufacturing, on certain industries possessing special value symbolic of industrial competence (such as the steel and automotive industries) (Page 183)."[7] There are a host of empirical examples of this phenomenon[8], as well as cases where privatization

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[4] This is particularly true in utility privatizations which has seen high levels of opposition in many countries.

[5] Privatization may provide higher expected utility for some subset of the population, but may also provide higher expected volatility for that same subset. So, despite the higher expected utility of privatization, individuals may oppose it because they place utility on the future stability that state-owned enterprises provide (Bates and Krueger 1993).

[6] Thompson and Elling (2000) find survey evidence that respondents in the U.S. support privatization in sectors where they believe there will be efficiency gains, and oppose privatization in sectors where they believe the government will be more efficient (e.g. prisons and police protection). In the case of France, Feigenbaum and Henig (1994) argues that politicians used privatization policy as a means of gaining support. (Vickers et al., 1988) makes a similar argument in the case of Margaret Thatcher's privatization program in Great Britain.

[7]Breton (1964) comes to a very similar conclusion as Johnson, but treats nationalism as a public good that the government can supply to the public at a cost.

[8] See Nayar (1972), Kohli (2004) and Panagariya (2011) for the case of India, Overy (1994) and Ault (2002) for the case of pre war Germany, (Kinzer, 2008) for the oil industry in Iran, (Mabro, 2007) for Latin America, Trebat (1983) for Brazil, Nolan (2001) for the case of China, and Chua (1995) for nationalization examples across the developing world.

is opposed using nationalistic rhetoric.[9] Lastly, there are numerous cases of state-owned industries inspiring nationalist sentiment in the public: Francois (2000) and Chi et al. (2011) argue that in some cases workers in state-owned firms work harder than workers in private industries because of nationalist pride, Raguraman (1997) and Thurlow and Aiello (2007) argue that loss-incurring national airlines are valuable because they help create a national identity, and in Mexico, Expropriation Day is a public holiday commemorating the nationalization of the state oil company PIMEX (Toyin Falola and Genova, 2005).[10]

Ultimately, though, the most basic explanation for why privatization is often unpopular with the general public despite the long-term benefits of the policiy relate to the high short-term costs of privatization. The costs of privatization, just like most structural economic reforms, occur before the benefits of the policy accrue (Banerjee and Munger, 2004; Przeworski, 1991; Geddes, 1994). For example, privatization may cause an increase in consumer prices in the short-term as price controls and subsidies are removed whereas the efficiency gains of privatization will take a longer period to trickle through the firm and through the economy as a whole. Similarly, employee retrenchment at SOEs, a cost of privatization, may be required before the gains of the privatization can be realized. If the public does not understand or does not believe that the benefits of privatization will accuse later they are unlikely to support the short-term costs of the policy. Furthermore, if the public has low levels of faith in the Government and/or Government institutions then they are unlikely to believe that the promise of future benefits of privatization will ever occur.

Opposition to Privatization from Vested Interests

There are a host of vested interests that benefit from state-ownership of firms and these groups are often capable of blocking privatization entirely. Effectively, the benefits of privatization are diffuse whereas the costs are concentrated (Haggard and Kaufman, 1992; Olson, 1996; Makhija, 2006). For example, labor at SOEs may represent a very small percentage of an economy, however, they may suffer heavy costs from privatization. All other members of society may benefit from privatization as it improves the economy, however, the benefit will be far smaller than the costs to labor. This is a basic collective action problem wherein the benefits to an individual in society are not large enough to incentive mobilizing in favor of privatization despite the benefits to society as a whole, whereas the cost to individual workers at SOEs is large enough to incentivize strikes.

According to Haggard and Webb (1994) “Organized labor almost always loses in the initial phase of a traditional adjustment program."[11] This opposition is the result of fears of employee retrenchment at SOEs, as across the world SOEs tend to be massively overstaffed.

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[9] See (Dugger, 2001), (WSJ, 2012) and (Gurtoo, 2006) for the case of India, Lewis (2004) and Trebat (1983) for the case of Brazil, (Tangri, 1999) for the case of Ghana and Pitcher (2002) for the case of Mozambique.

[10] There is also an abundance of literature on the determinants of individual attitudes towards free trade that makes a similar argument in terms of nationalist sentiments affecting public opinions, e.g. Margalit (2012), O'Rourke and Sinnott (2001), Mayda and Rodrik (2005), Mansfield and Mutz (2009).

[11] Unions were a major impediment to privatization in Europe (Vickers et al., 1988), Latin America and the post-Soviet nations (Stokes, 1996; Haggard and Webb, 1994). In Bolivia, Columbia, Cost Rica, Dominican Republic, El Salvador, Guatemala, Mexico, and Peru unions were able to block or reverse privatization completely (Baker, 2009).

This overstaffing is a large part of the inefficiency at SOEs and private owners have an interest in retrenchment after privatization. However, as Haggard and Webb (1994) observe, the ability of unions to block reforms depends on a number of variables. In authoritarian regimes labor is often not legally allowed to strike, thus diminishing its ability to halt privatization. The sectoral allocation of organized labor and the level of organization are also key variables in determining the ability of labor to block privatization. When a large share of organized labor is employed in state-owned firms, reforms can be difficult because strikes can affect a broader segment of the economy and are instantly politicized (Haggard and Webb, 1994). In addition, when organized labor is concentrated in sectors that are strategically important (such as coal in Poland and England) they may have a higher probability of successfully blocking reforms because the damage of strikes in strategic sectors can have dire consequences for the entire economy. In some cases the corporatist relationships between governing parties and labor unions can determine whether labor will attempt to block privatization (Katzenstein, 1985; Hicks, 1988; Lange and Garrett, 1985; Haggard and Kaufman, 1992). The intuition is that when governments pursuing reform have connections to labor they can integrate labor into the political system in ways that provide the basis for "compromise, social pacts, and enhanced policy credibility (Haggard and Webb, 1994)."

Many politicians also benefit from state-ownership of firms and are uniquely well positioned to block privatization (Haggard and Webb, 1994). Politicians can of course use their influence and votes to block privatization directly. Furthermore, politicians can use their influence to mobilize opposition to privatization among the public and/or vested interests (Chhibber and Eldersveld, 2000).

Politicians often use state-owned enterprises that they oversee as sources of patronage for their supporters and for their own personal enrichment. For example, even the most pro-liberalization Indian politicians have attempted to block privatization when it threatened state-owned industries under their own control or within their own constituency (Dinc and Gupta, 2011; Sinha, 2007; Makhija, 2006; Kapur and Ramamurti, 2002). Sapienza (2004) finds that the lending behavior of state-owned banks is affected by the electoral results of the party affiliated with the bank: the stronger the political party in the area where the firm is borrowing, the lower the interest rates charged." Mwenda and Tangri (2005) cites the head of the Ugandan government's privatization program as saying: "Over the years politicians have used public enterprises as centers of patronage to reward or appease relatives, friends, political supporters or as sources of profit in one way or another."

Governments that implement privatization use a range of policies to limit the opposition to privatization. However, as discussed in the introduction, many of these policies sacrifice the efficiency benefits of privatization. Thus, the question is how politicians can successfully manage opposition to privatization while maximizing the economic gains of the policy. In the next section I look at the case of Brazil, India and South Africa to analyze how politicians in these countries attempted to manage the balance between opposition to privatization and economic gains from the policy.

Case Studies

There are a number of similarities in the privatization programs of Brazil, South Africa, and India. For example, all three countries focused on privatizing valuable manufacturing SOEs in the earliest stages. In fact, in both Brazil and South Africa the first major privatization was of the national steel manufacturer, which interestingly enough was among the oldest SOEs in both countries. Furthermore, all three of the countries implemented their privatization policies in the late 1980's or early 1990's. Most importantly, the process in all three countries began with selective sales of a relatively small number of SOEs. In India, the Government sold approximately 20% of equity in about 20% of their SOEs in the first years of the policy. In Brazil the process began with some very small and failing SOEs and then shifted to the largest steel producer. In South Africa the Government began by selling strategic shares in the major steel producer and the major electricity generation SOE.

The analysis will focus on the divergent outcome across the countries in the pace of privatization following the initiation of the policy. In South Africa and India the process stalled after the initial implementation and now, 25 years later, has still made very limited progress. On the other hand, in Brazil, strategic privatization has occurred in all but a handful of important sectors. Essentially, in India and South Africa political opposition to privatization halted the process, whereas in Brazil the Government successfully overcame the opposition. The question then is what are the factors that made Brazilian leaders able to overcome opposition and to what degree did these sacrifice the efficiency gains of privatization and what factors caused the process to stall in India and South Africa?

India

In 1951, India formally launched its economic plan of development with the first 5-year plan. The newly independent Indian government had inherited an economy that was all but stagnant, having grown at an estimated 1% annually over the first half of the twentieth century, implying stagnant or declining per capita incomes (Kohli, 2004). Factories accounted for only 7% of the economy, while agriculture contributed over 50%. The industrial base was extremely low even by the standards of other recently independent nations (Kohli, 2004). [12]

The Indian leadership (specifically Jawaharlal Nehru) established a strongly interventionist role for the government in the economy in an effort to achieve rapid industrialization.[13] According to Panagariya (2011), the U.S. government and the scholarly community had high hopes for India's economic success, and predicted India would quickly outpace other recently independent East Asian nations such as Korea and Taiwan. For the first decade or so after independence, India's development model was largely successful by most accounts (Bhagawati and Desai,1970; Panagariya, 2011) as the country experienced industrial growth of 7.4% between 1950 and 1964 (Kohli, 1989). However, beginning in the early

[12] Specifically, (Kohli, 2004) compares India to the cases of Brazil South Korea, and Nigeria. It is important to note, however, that at the time of independence manufacturing was rising at a much faster rate than overall growth in the economy and most of the factories were owned by Indian industrialists Roy (2006).

[13] All factions of INC leadership did not agree the need for rapid industrialization on. The two opposed strategies were that of Nehru and that of Gandhi and were a function of their larger ideas about the centralization of the Indian state. Gandhi proposed reliance on the village level economy; Panagariya (2011), whereas Nehru sought rapid industrialization.

1960's the country stumbled from economic crisis to economic crisis and GDP growth was approximately 3.5%, which was well below the growth of the population.

A key component of India's state-led development model was the establishment of state-owned enterprises across nearly all sectors of the economy. Nehru often stated that state-owned enterprises (SOEs) would occupy the "commanding heights" of the economy (Nayar, 2000), and frequently referred to SOEs as temples of modern India (Majumdar, 2008).

The initial wave of SOE creation consisted mostly of large manufacturing units such as ITI, BEL, BHEL, HMT, BEML and Hindustan Aeronautics. The focus for SOE investment was in industries where private investment was not forthcoming due to lack of investment capital or lack of markets (Majumdar, 2008), and specifically in the heavy industrial manufacturing sector (Nayar, 2010). The next major wave of SOE creation occurred between 1975 and 1980 under Indira Gandhi and included the nationalization of the coal and gas sectors as well as a number of individual private firms. Along with these nationalizations there was a general emphasis on reducing the role of private investment in the economy.

However, by 1981 the Government was shifting back towards encouraging private investment in the economy (Kohli, 2006; Rajakumar, 2011). This shift was much more pronounced when Rajiv Gandhi became Prime Minister in 1984. Rajiv Gandhi attempted to increase the scope of reforms and clearly stated his intention to reform the Indian economy. However, within 6 months of his 1985-86 pro-reform budget the Government rolled back reform plans due to strong opposition within the Congress Party and outside (Kohli, 2006). By 1985, a government spokesperson was assuring the public that SOEs would be protected (Kohli, 2006). In 1986 the government again made clear that privatization was not on the table. By 1989 SOEs were actually larger in terms of total employment and in terms of contribution to total GDP than in 1981.[14] Profitability of SOEs in India is notoriously difficult to measure due to the huge levels of state investment that is not repaid, however, the general trend of profitability is that it saw steady increases until the 1980's when profitability began to decline rapidly due to competition and loss of monopoly status (Baijal, 2002).[15]

Economic Crisis and Privatization in 1991

From 1988 to 1991 India recorded GDP growth of 7.6% annually, the highest three years of growth India had experienced (Panagariya, 2011). However, by 1991 the Indian economy was facing a balance of payments crisis caused in large part by excessive foreign borrowing to fund domestic fiscal expansion (Joshi and Little, 1994; Chhibber and Eldersveld, 2000). Leading up to the 1991 parliamentary elections, the Congress party billed itself as the centrist party between the right-wing BJP and the left-wing United Front coalition, and the

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[14] Public sector manufacturing employed 1,871,100 persons (30% of total manufacturing employment) and mining employed another 959,140 persons (91% of total mining employment). Public sector mining contributed 3.1% of GDP and public sector manufacturing contributed 3.5% of GDP (Joshi and Little, 1994).

[15] Lastly, it is important to note that the extent of the 1980's reforms on SOEs depends on the sector. For example, the mining, energy and petroleum related sectors were untouched., whereas the telecommunications sector was opened up to competition from private industry (Baijal, 2002).

only party that could solve the numerous state succession struggles as well as the failing economy (Varshney, 1998). Congress won the most seats in the 1991 elections and Prime Minister P. Narisimha Rao formed a coalition government.[16] By the time of the election, the Indian economy was entering the balance of payments crisis and the newly elected Prime Minister Rao used the crisis to undertake reforms that followed the same general scope as earlier reforms but did so to a much larger degree and with a `big bang' (Ghate, 2012).

The New Economic Policy (NEP) was instituted within months of the election and IMF loans were secured to cover the balance of payments crisis. The NEP called for dramatic economic reforms including limited privatization. It should be noted that some authors (Panagariya, 2011; Varshney, 1998) do not believe that the reforms of this period were a result of the crisis and need for IMF funds as much as the crisis was used by the Government to force through reforms. Regardless of the importance of the IMF and World Bank in pushing through broad reforms, there was little pressure on privatization specifically (Sapat, 1999).

The liberalizing reforms of the early 1990s directly affected Indian SOEs in a way that the reforms of the 1980s never approached, and not just though privatizations. Gradually, nearly all of the sectors that had been reserved for the public sector were opened up to private enterprise (Gouri, 1996).[17] The increased competition coupled with a enormous fiscal deficit in the national budget meant that public firms had their profits collapse at a time when the government was completely unable to provide the endless cushion that it had provided in the past.

The actual privatizations in this period were minor relative to the size of the public sector as a whole. There were no SOEs that were strategically privatized by the Congress government from 1991-96. Furthermore, the government did not even use the word privatization and instead opted for disinvestment (Dinc and Gupta, 2011; Kapur and Ramamurti, 2002). In total, an average of 19.2% of 40 SOEs was sold (out of the over 200 SOEs) (Makhija, 2006).[18] Following the INC-led Government, privatization halted between 1996 and 1998 as a coalition of Left-leaning parties held Government. However, it should be noted that this Government did not attempt to roll back the previous Government's privatization policy or it's economic liberalization program in general.

The BJP came to power in 1998 at the head of the National Democratic Alliance, and in 1999 the government resumed the privatization program. A Department of Disinvestment was established which declared that majority shares of SOEs would be sold. Between 1999 and 2004 the BJP sold majority shares in the case of 17 SOEs (Dinc and Gupta, 2011). The Disinvestment Minister during this period, Arun Shourie, was a particularly strong

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[16] A number of authors have attributed the success of Congress in this election to a `sympathy vote' following the assassination of Rajiv Gandhi in 1991 (Ganguly, 2003).

[17] The allowance of private firms into these sectors previously reserved for public industry is sometimes termed "greenfield privatization" Gouri (1996) Secondly, and perhaps more importantly, foreign portfolio investment was allowed for the first time in 1992 (Varshney, 1998).30 In addition, budgetary support for failing CPSEs was also reduced, though by no means eliminated, during this period Sapat (1999).

[18] The Congress government also classified 14 companies `sick public enterprises' and recommended they be `wound up', however, none of these firms was closed Gupta (1996).

advocate of strategic sales, i.e. ensuring that management of SOEs actually passed into private hands (*dberg*, 2001).

However, the BJP only sold shares in 10 SOEs that had not had some equity sold under the Congress led government from 1991-96 (Dinc and Gupta, 2011).[19] Along with these strategic sales of SOEs, minority shares were sold in five other companies, all of which had already had minority sales under the Congress-led government. The method of sale under the BJP was generally not by individual bids for shares. Instead the government announced how much equity they would sell, and then took bids on the entire equity being offered (Uba, 2008). Foreign buyers were also allowed to purchase controlling shares in SOEs, whereas in previous privatizations they had only been able to participate as minority investors and only as financial institutions (Kapur and Ramamurti, 2002).

Following the 2004 elections, the Congress led United Progressive Alliance coalition took control of the government. From 2004 to 2008, the government sold minority shares in 11 companies, and in only one company that had not already experienced some privatization under a prior government. From 2009 to 2013 the same UPA Government sold minority shares in 19 companies. However, only 7 of these had not had shares privatized by previous governments and in no case was a majority share sold.

Ultimately, despite a privatization program that was initiated almost 25 years ago, large publicly owned firms still play an enormous role in the Indian economy. In fact 14 of the 20 largest Indian firms in terms of annual gross income are SOEs (moneycontrol.com, 2013) and SOEs (including banks) account for 6.30% of total GDP as of 2009 (GOI, 2010).

Why Has Privatization in India Failed to Accelerate?

The Disinvestment Minister under the BJP from 1999 to 2004 (Arun Shourie) stated that those in favor of privatization had won the intellectual debate and that “Now it's just the question of the pace" (Solomon and Slater, 2004). While it is true that there are fewer and fewer ideological arguments against privatization, those who oppose privatization for non-ideological reasons have been able to dominate the discussion of pace and forced the process to move at a very slowly.

Two clear trends in the politics of privatization in India are that: 1) All political parties have slowly moved away from opposing privatization (Ganguly et al., 2007; Suri, 2004), and 2) since 1991, when a party is in power they are in favor of privatization of SOEs, and when they are in opposition they are against privatizations. Despite the fact that all Governments in power at the national level (or state-level) enact some degree of privatization, no central Government has substantially accelerated the privatization program since its initiation in 1991

As stated above, all parties attack privatization when they are in the opposition; whether

[19] Majority shares were sold in Modern Food Industries in 1999-00, BALCO and Lagan Jute Machinery Company Ltd. in 2000-01, numerous state-owned luxury hotels, Videsh Sanchar Nigam Ltd., Paradeep Phosphates Ltd. HTL ltd. and CMC ltd. In 2001-02, Hindustan Zinc Ltd., Indian Petrochemicals Corporation, and ten more hotels in 2002-03 and Jessop and Co. Ltd. in 2003-04.

for corruption, ideology, or inefficiency. However, privatization is not an important voting issue in with the general electorate in India. According to Kumar (2004) there is no aspect of the economic reforms that was a big enough issue among the mass electorate to have accounted for the major shift against the Congress party in the 1996, 1998 or 1999 elections because the electorate was simply not aware of reforms. Similarly, Panagariya (2011) argues that economic reforms did not play any role in the defeat of the BJP in 2004 based on urban and rural voting patterns.[20]

While all parties privatize while in power, no major party has been willing to advocate privatization as a desirable and necessary policy. In fact, Prime Minister Rao who was responsible for the NEP reforms, expressed opposition to privatization despite his leading role in initiating economic reforms by saying “You don't strangulate a child to whom you have given birth (Majumdar, 2006)." This comes back to the fact that the Congress Party established and pursued state-led development since 1950, and breaking from this path was ideologically difficult for at least some portions of the Party leadership.

Despite the BJP being widely considered more in favor of privatization, the Party still attacks privatizations when they are in the opposition. They opposed privatization of water service in Delhi against a local Congress government that was in favor of privatization. In this case, the BJP used the fact that the private company that would take over is Israeli as part of their argument against the privatization. The BJP is also actively opposing private dams being built in Assam, again on grounds that the dams would be built by non-Indian companies (Baruah, 2012). When opposing the privatization of a hospital in Goa, the BJP simply focused on corruption in the privatization process (The Times of India, 2010).

At the state-level there have been some cases where individual leaders or parties have more openly embraced privatization. Furthermore, there are also cases of state-level privatization where the policy may have even been popular. In the case of water privatization in Delhi, there were protests in favor of the policy and some evidence that the public, at least the wealthy and more educated, supported the policy (Kale, 2007). Similarly, some state-level politicians were able to win public support for privatization simply due to their own charisma and popularity. For example, in his effort to privatize state electricity distribution, Chief Minister of Orissa Biju Patnaik emphasized to the public and to legislators that electricity costs money and those who want it need to pay. This is a position that a less popular Chief Minister is unlikely to have taken. However, it is also the case that Orissa does not have a strong farm lobby (generally the largest opposition to privatization of electricity) relative to other Indian states and so the case may be somewhat unique in that there were few effected and organized vested interests opposed to privatization (Ramanathan and Hassan, 2003).

Opposition from labor unions was also a major obstacle to privatization in India. The

[20] It should be noted that in state elections from this period, Gupta and Panagariya (2011) argue that incumbents are more likely to be win reelection in states where the economy performed well. This would indicate that economic factors affect voting. If this is the case and economic reforms (such as privatization) affect the economy negatively in the short-term then it seems erasable to believe there is some indirect effect of privatization and economic reforms in general on voting in India.

government gave up on privatizations in the case of 13 different SOEs due to opposition from various interests (Makhija, 2006), and fought hardened opposition in the case of every sale, particularly from labor at SOEs.

The Government attempted to use Voluntary Retirement Schemes (VRS) to overcome opposition to privatization among labor while also reducing the labor force across SOEs. The goal of Voluntary Retirement Schemes (VRS) in Indian SOEs is to reduce the number of workers while also 1.) Getting around India's strict regulations on labor retrenchment, and 2.) Gaining labor's support for SOE reform. In India, VRS amounts are determined by a government-generated formula based on years worked, years to retirement and current salary. The payments are generally lump sum payments that occur at retirement. The lump sum is well below what the government would pay the worker if they remained with the firm until retirement, thus the government saves money on a long-term basis.

VRS was never directly linked to privatization, and instead was presented to workers as a means of reducing the labor force. In fact, VRS was first offered as early as the mid-1980's in some firms (Roychowdhury, 2003; Guha, 1996), well before privatization was ever on the table.[21]

After the initiation of the New Economic Plan in 1991, the government viewed VRS as a primary means of appeasing labor unions. In October of 1992 the government created the National Renewal Fund with the objective:

(1) To provide funds for compensation of employees affected by restructuring and closure of industrial units, both in the private and public sectors; (2) To provide assistance to cover costs of retraining and redeployment of employees, necessitated due to modernization, technological upgradation and industrial restructuring;(3) to provide funds for employment-generation schemes both in the organized and the unorganized sectors.[22]

Despite increased funds for VRS, total VRS acceptance was still limited by the amount of funds that SOEs could access from the government (Guha, 1996; Srinivasan, 1999a), i.e. there was more demand for VRS than supply at many firms. In particular the more successful SOEs had difficulty accessing funds from the government because the Government prioritized reducing employment at failing firms. For example, Coal India had many times the applications for VRS from employees than they had funds to pay out and so they limited VRS to the oldest applicants (Guha, 1996). Even struggling firms such as SAIL were not able to secure guaranteed funding for VRS from the National Renewal Fund untill the mid-1990s. Despite this, between 1990 and 1994, 78,582 employees in approximately 100 SOEs accepted VRS packages (Guha, 1996). While a substantial number, it was far short of the Government's stated goal of separating 4.5 lakh employees (Khasnabis and Banerjea, 1996).

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[21] The VRS offered at this stage was generally 30 days salary for every competed year of work with other retirement benefits (Roychowdhury, 2003). The average cost per worker of VRS was around 17,000 dollars (Haltiwanger and Singh, 1999). Again, the actual number of VRS packages offered at this stage was very low because the firms did not have funds from the central government to offer VRS to a large number of employees (Roychowdhury, 2003; Khasnabis and Banerjea, 1996; Guha, 1996).

[22] Objectives come from Khasnabis and Banerjea (1996) and directly from National Renewal Fund program.

It is widely accepted that the criteria for selecting firms for privatization is a function of size and value, i.e. larger and more valuable firms have been privatized first (Arun and Nixson, 2000; Rastogi, 2004; Mani and Bhaskar, 1998). The reason for this is that the primary impetus for privatization in India has been to raise funds to cover the deficit and for other more popular subsidies (Sapat, 1999; Gouri, 1996; Panagariya, 2011; Varshney, 1998; Rastogi, 2004; Mani and Bhaskar, 1998). Thus, privatization is a fiscal necessity to cover excessive spending as opposed to a policy that the Government implements so as to improve economic performance. Because of this, no Government has ever actively promoted privatization to the public or vested interests, and the compensation packages (VRS) that was given to workers at SOEs was not designed so as to create a base of support for further privatizations. This is in contrast to the following cases of success in the early privatization program in South Africa and the overall success of the policy in Brazil where we see Governments actively promote privatization as well as directly link compensation to privatization.

Brazil

Unlike in many developing countries, the dominance of SOEs in the Brazilian economy was not due to an ideology of state-led development (Trebat, 1983).[23] Instead, SOEs were as likely to be created under the populist regime of Vargas as the conservative military regimes that dominated Brazil in the second half of the twentieth century. Brazilian SOEs were established as a means of creating industry in capital-intensive industries where there was insufficient private domestic investment (Trebat, 1983). In Brazil, SOEs tended to proliferate in infrastructure sectors such as mining, transport, communication, and energy.[24]

In the second half of the 1960's through the 1970's the role of SOEs in the Brazilian economy increased dramatically (Trebat, 1983; de Almeida, 1998). SOEs continued to be concentrated in infrastructure related sectors, however, their number and size exploded. This expansion occurred under an economically conservative military dictatorship. Some of the expansion is simply a function of the expansion of the sectors in which SOEs dominated, in particular the oil, energy and mining sectors. By 1980 there were approximately 250 SOEs.[25]

Brazilian SOEs performed poorly on many basic financial indicators, however, as a means of initiating industrialization in the largely agricultural economy of early 20th century Brazil they were largely successful. Trebat (1983) conducts an in-depth study of Brazilian SOE performance in the 1960's and 70's and argues that SOEs led to increased industrialization and stimulated the growth of private industry rather than suppressing it. However, most

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[23] Although economic nationalism certainly played a part in the creation of SOEs as it has in many developing countries.

[24] There were a number of manufacturing SOEs and the government dominated the financial sector as well, however, the general emphasis was on SOE development in sectors where the private sector was not present due to the capital intensive nature of the sectors.

[25] The classification of an SOE is notoriously difficult, however, there were 250 state-owned entities that were organized as corporations according to Francisco Anuatti-Netto, 2003.

scholars agree that by the 1980's SOEs had become enormously bloated, were an increasing drain on the national economy, and were partly responsible for the rise in inflation during the 1980's (de Almeida, 1998; Montero, 1998). The main cause of the increasing inefficiency was massive worker redundancy (Macedo, 1985; Schmitz Jr. and Teixeira, 2008). Prior to the 1980's there was effectively a consensus that state-led development had benefitted the economy (de Almeida, 1998; Trebat, 1983), however, the economic decline of the 1980's coupled with the anti-authoritarian sentiment of the period slowly shifted public opinion away from a state-led model of economic growth.

Process of Privatization

Privatization in Brazil has been “major in scale and scope" by international standards (Macedo, 2005). Between 1980 and 1990 the Government privatized 38 smaller firms (for US $723 million) all of which were firms that were nationalized in prior decades when the private firms were no longer profitable (Hudson, 1997). None of these firms were large and the Governments that oversaw the privatizations were not fully embracing pro-market reforms. Privatization was first pursued in a serious manner beginning in 1990. Between 1990 and 2001 controlling shares of 119 SOEs and a number of minority shares were privatized. The sales raised $67.9 billion in cash for entire firms, transferred US$18.1 billion in debt, $10 billion from concessions, and $1.1 billion from minority shares (Francisco Anuatti-Netto, 2003). As will be discussed later, almost two-thirds of total revenues came from privatizations in the electricity and telecommunication sectors (Francisco Anuatti-Netto, 2003).

Many scholars argue that the primary motivation for the initiation of privatization in Brazil was to raise Government revenues to meet budget shortfalls (Hudson, 1997). The Brazilian economy was facing a severe downturn entering the 1990's and the government was on the brink of financial crisis. Thus, according to this argument, Brazil's privatization policy was the result of a financial crisis, which made privatization a better political option relative to complete economic collapse. This in line with a large strain of the literature on economic reforms which finds that reforms are most likely an economy is facing a financial crisis (Banerjee and Munger, 2004; Stokes, 2001). On the other hand, some scholars have argued that the financial crisis was an excuse for an executive that wanted to privatize as opposed to a cause of privatization (de Almeida, 1998; Montero, 1998). This argument is in line with another strain in the literature on the politics of economic reform that argues that politicians use financial crises as a means of pushing reforms onto the public (Pierson, 1996; Stark, 1991).

The first major wave of privatization was ushered in with the election of President Collor in 1990, the first election after almost twenty years of military rule. Privatization was a central platform of Collar's economic plan. Immediately after being elected he established the National Privatization Program under the National Economic Development Bank and charged the group with privatizing SOEs, which had been considered "strategic" under prior governments (Hudson, 1997). Collar resigned under pressure for corruption after only two years in office but in that time his Government privatized 15 SOEs for a total of

US$3.5 billion.[26] The bulk of the proceeds came form minority sales in the steel industry.

Under the Cardoso Government from 1995-2002 privatization was pursued more aggressively. A larger and more independent privatization administration was created (the National Privatization Council). One of the principle motivations of the privatizations were to increase investment in the industries without spending Government resources and to improve services (Ministry of Development, Industry and Foreign Trade, 2002). As such, the emphasis was on strategic privatizations of public services with an emphasis on electric power and financial institutions.

Privatization proceeds quadrupled between 1996 and 1997. Prior to 1996 privatizations did not attract substantial interest from foreign investors; however, between 1995 and 2002, 53% of total revenues from privatization came from foreign investors (Ministry of Development, Industry and Foreign Trade, 2002).[27] Between 1995 and 2002 80% of revenues came from the infrastructure and services sector[28] and 14% came from the industrial sector.[29] The remaining 6% came from minority sales across sectors. Again, the vast majority of revenue in this period came from sales of entire SOEs. The big exception to this is Petrobras, which was only partially privatized due to a clause in the Brazilian Constitution stipulating that firm cannot be fully privatized (Hudson, 1997).

Francisco Anuatti-Netto (2003) points out that prior to the major wave of privatizations in 1997, the Government had already begun deregulating price controls in some of the major sectors to prepare for privatization (e.g. telecommunications, electricity, iron and steel, fertilizers and plastics). This move substantially increased the value of firms to be privatized (and, thus the revenue generated by privatization) because private investors knew they would not be forced to subsidize the government's price controls.

By 1998 the privatization program was beginning to stall under increasing opposition and frustration about sluggish economic growth during the 1990's. In addition, the privatization of the telecom sector led to accusations of corruption that soured public opinion on privatization. This led to negative press for the privatization program as a whole.[30] Furthermore, as pointed out by Francisco Anuatti-Netto (2003), for the privatization program to continue it would need to tackle Petrobras (which is protected in the Constitution), state electricity provision boards (which are largely outside the control of the national government), and the Banco do Brazil which provides subsidized loans to farmers and enjoys massive political support. The Government had already strategically privatized nearly all SOEs in the steel, chemical, petrochemical (other than Petrobras), and

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[26] For comparison, India initiated its privatization policy in the same two years and raised less than 1 USD billion.

27 The Privatization of CVRD (the largest steel producer in Brazil) was particularly contentious due to nationalist interests who claimed that selling the firm to a foreign investor was a national betrayal. To get over these concerns the government eventually agreed to not allow Australian firms to bid on the firm's shares as Australia was the largest producer of Steel. Eventually the firm was bought by domestic investors (Schmitz Jr. and Teixeira, 2008).

[28] This consisted mostly of privatizations of telecommunications, electricity generation and provision, and banks.

[29] This consisted entirely of sales in the petrochemical, petroleum and mining sectors.

[30] This was accompanied by the resignation of the Minister of telecommunications.

fertilizer sectors.

Privatization was extremely successful in terms of economic returns according to most studies. Schmitz Jr. and Teixeira (2008) find that privatization of a small steel producer dramatically improved performance at the privatized SOE as well as private competitors who were now forced to compete with the more efficient privatized SOE. Privatization of the steel industry is considered to have been particularly successful in improving performance (Montero, 1998). Pinheiro (1996) analyzes fifty Brazilian SOEs before and after privatization and finds that across most financial indicators the firms performance significantly improved post-privatization. Anuatti-Netto (2003) update and expand the analysis of Pinheiro (1996), and also find that the post-privatization performance of SOEs improved across most financial measures: privatization increased sales, decreased operating costs and improved all management indicators in the study while consumer prices were not significantly affected.

According to Anuatti-Netto (2003) also finds strong evidence that employment declined in the short-term after privatizations, but increased in the long-term. The fact that employment declined in the short-term is not surprising given that over-employment was earlier cited as the primary reasons for sluggish SOE performance. The authors suggest that the improved performance of the privatized SOEs caused the gradual increase in employment after the immediate decline. As the authors point out, this overall process is likely beneficial for the economy as a whole as employees are employed in more productive areas. However, there is no reason to think that those who were initially laid-off are the same people who were later rehired. Thus, privatization in Brazil most likely caused high short-term costs on employees at SOEs, but long-term growth in employment throughout the country.

Why Was Privatization in Brazil Relatively Successful?

As of 2001, 53% of Brazilians polled believe that privatization had not benefitted the country (Lora and Panizza, 2002). However, this level of opposition was substantially lower than the average for other Latin American countries in the sample. Thus, privatization was unpopular in Brazil just like it nearly always is (Denisova et al., 2012), however, it was less unpopular than in the average South American country.
Despite limited public support, three successive Governments were successful in privatizing the vast majority of SOEs. There are a number of reasons for this success, all of which relate to the executives ability to negotiate with and manage various vested interests (de Almeida, 1998; Montero, 1998).

Labor unions at state-owned firms were a major obstacle to privatization, as it is in nearly all adjustment programs. Opposition from labor unions took two forms: public protest and appeals to the judiciary. Appeals to the judiciary slowed privatizations in many cases, however, in no case did the judiciary actually block a privatization (de Almeida, 1998). Public protest by labor unions was frequently violent,[31] and nearly every privatization involved large-scale rallies at the stock exchange where shares were being sold. However,

[31] In a few cases protests were accompanied by bombings from leftist unions or radical political parties (Montero, 1998).

the public protest also failed to impede privatization. The reason for this was in large part due to the lack of cohesion within and among labor unions, much of which was the result of government policies aimed at dividing workers from union leaders (de Almeida, 1998; Montero, 1998).

To gain support from labor during the first wave of privatizations in 1991-92 the Government promised $1.5 billion to a fund for worker severance packages (Fundo de Garantia por Tempo de Servigo, FGTS). The government didn't have the money to fund this guarantee, and therefore the government established a fund that owned a $1.5 billion IOU from the government. To gain support for the next wave of privatizations the government allowed workers to use the amount owed to them from the fund as a means of purchasing shares of SOEs. In addition, the government provided subsidized loans to workers at SOEs for purchasing shares of privatized firms. The largest SOE unions opposed the plan because they claimed it was an attempt by the government to not actually provide the severance. In actuality, it seems likely that this was an effort by union leaders to not lose control of their union. The Government then increased their offer by allowing the debt to be converted to shares in SOEs at a 70% discount by workers (Montero, 1998). The Government's policy was successful in driving a wedge between the unions, with some unions coming to support privatization, and between workers and their unions with many workers abandoning the unions that still opposed privatization. Furthermore, the move created a substantial constituency (the workers who purchased shares in privatized firms) that would support further privatizations in hopes that they would benefit from the increase in share prices. For example, 17,000 employees at a steel firm who teamed up to purchase ten percent of the firm then used their returns to purchase shares in an aeronautics firm that was privatized a few years later (Montero, 1998). In addition, this policy injected some $20 billion of buying power into the public market for shares of SOEs, which increased competition for shares and drove up prices.

Brazilian Governments also promoted privatization as a benefit to society as a whole and also to workers at state-owned firms as opposed to shying away from the policy. Montero (1998) argues that the Government was able to overcome opposition to privatization of the steel industry by framing and implementing privatization as a means of improving the firm’s performance as opposed to a move to remove the state from the industry. As discussed earlier, SOEs in Brazil were a source of pride in prior periods and are generally credited with having helped transform Brazil from an agricultural society to an industrial one. However, since the 1980's this pride was waning due to a number of factors, but in particular due to the poor performance of the firms and their inability to compete internationally. The Government, particularly the Collar Government that initiated privatization, was able to frame the policy as a means of rejuvenating the firms. This focus on improving the performance of the firms helped build support for the policy among managers at SOEs (Montero, 1998).

Lastly, the method of privatization in Brazil was an important factor in reducing opposition to the policy. As discussed earlier, labor was given advantages in purchasing shares, which helped reduce opposition from workers at SOEs. Furthermore, selling shares of firms on the stock market as opposed to in private auctions helped overcome claims by the opposition, particularly from the Workers Party, that privatization was corrupt and lacked transparency (Montero, 1998). The Government also used a host of policies to advantage domestic buyers to blunt criticism that the government was selling national assets to foreign investors.[32] Limiting foreign capital of course reduced the price that the Government was able to earn from the sales, and may have reduced the efficiency gains from the policy in some cases.

South Africa

SOEs in South Africa emerged after 1924 when a new government led by a coalition of the National Party and the Labour Party emerged as the dominant political force (Hentz, 2000). The largest SOEs to be created in this first wave were the Electricity Supply Commission (Eskom) and the South African Iron and Steel Corporation (Iscor) (Byrnes, 1996).

The government that established SOEs in South Africa had run on a program of not allowing black labor into the mining sector. Thus, the government was effectively trying to hinder market forces that would have led to an influx of black labor and a decline in wages for white miners. The government created the first state-owned enterprises in South Africa to secure employment for working class whites (Economist, 1999). Thus, state-owned enterprises in South Africa trace their roots to apartheid policies (Mbaku, 1991). While the companies did employ some black laborers, they were not allowed to advance beyond the level of laborer, earned less money, and were underrepresented relative to their proportion of the population.

In the 1950's and 1960's the government created many new SOEs and invested heavily in existing ones (Byrnes, 1996). The new SOEs expanded into fertilizers, chemicals, oil, and armaments. The goal at this stage was to increase the role of manufacturing in the economy so as to diversify from mining and follow an ISI (Import Substitution Industrialization) strategy of development. By the 1980's the government owned 40% of all wealth producing assets in the country (Byrnes, 1996).

Politicians interfered in SOE operation in terms of limiting employment of blacks. Other than this, however, South African SOEs were relatively free of government interference and run in similar ways as private firms. Many of the largest SOEs sold shares to the public in order to raise money and some were even allowed to raise funds from selling bonds (Byrnes, 1996). In addition, while the government appointed most SOE board members, senior management primarily ran the SOEs. Despite this relative lack of interference from the government, South African SOEs were largely unprofitable (Byrnes, 1996).

The South African economy experienced rapid expansion following the end of World War II and this kept South African SOEs afloat despite inefficiencies (Byrnes, 1996).
However, in the 1980's the global economy began to cutoff South Africa from credit markets due to apartheid policies, which caused a severe liquidity crisis in the economy. To help meet this crisis, President P. W. Botha announced plans to implement a large-scale privatization program to include most of the largest SOEs including Eskom, Foskor, and Iscor (Byrnes, 1996).

[32] In the case of the largest mining firm, the government blocked the SOEs major foreign competitor from bidding in the privatization auction (Francisco Anuatti-Netto, 2003).

The President framed the plan in terms of improving efficiency in the economy (Hentz, 2000); however, this does not appear to have been the primary motivation. As alluded to above, the Government may have pursued privatization in this period in order to raise funds. This is likely to have been a very important determinant of the policy especially as many of the debts that the international community was calling in were owed by SOEs (Byrnes, 1996).

An alternative explanation is that the government knew that the era of apartheid was ending and wanted to remove national assets from the future post-apartheid government's control. According to Hentz (2000): "The departing NP hoped to shrink the size of the state that the ANC would soon inherit and hoped to promote, thereby, the sectoral interests of its own constituency." In support of this argument, Hentz (2000) shows that by 1989 there was no other legitimate incentive to implement privatization in South Africa. The worst of the debt crisis was in 1985, four years before the privatization of Iscor. Inflation was also lower than it had been in the mid 1980's and appeared to be on the decline. In addition the government was not actually heavily indebted in this period and the debt crisis was due to global pressure as the result of apartheid as opposed to excessive spending (Herbst, 1994). Hentz (2000) also notes that the privatization program was not accompanied by any other policies that were meant to promote competition and efficiency. Instead, Iscor was essentially a state monopoly that was privatized into a private monopoly. Lastly, the ANC adamantly opposed the privatizations and repeatedly stated that they would renationalize any assets that were privatized without providing compensation when they came to power.

The government sold Iscor for over 3 billion USD in 1989 (Byrnes, 1996). Two state banks had been charged with determining a price for Iscor and there was large-scale interest from investors as the firm was run like a private firm already and viewed as relatively successful (Mohamme, 2008). Prior to the sale the government offered voluntary retirement schemes and froze hiring in an effort to reduce the workforce and increase the value of the firm.

In order to overcome opposition to the privatization the Government emphasized communication with labor and enacted a massive marketing campaign to win over the public and employees. Economic arguments were used along with statements that the public could buy shares. According to Mohammed (2008): "Publications, intensive press campaigns and interviews with financial analysts and the top management were used for marketing purposes." The result of this was that the opposition to the privatization was very limited, particularly among workers at SOEs.

Ultimately, this was the only major privatization to occur in this period. The Government scaled-back its privatization plans in 1990 with government officials stating that the investment climate was not ideal for privatization (Byrnes, 1996). This was the result of the global economy cutting off South Africa due to apartheid and the increasing violence in the country in this period. Essentially, there was not enough investment capital in the economy to successfully privatize. There is no evidence that the halt in privatization was the result of opposition from vested interests. This despite the fact that over one-third of the white population of South Africa was employed in SOEs in this period (Hentz, 2000).

Post-Apartheid

In 1994 the ANC published a blueprint of its economic policy in the Reconstruction and Development Programme (RDP). The report detailed the astonishingly high levels of poverty among black South Africans and proposed massive social and infrastructure spending to alleviate it. Specifically, the plan called for massive increases in spending on education, housing and road construction.

Upon taking office in late 1994, resident Nelson Mandela adopted the RDP as its economic program; however, Mandela was quick to assure donors and investors that the increased social spending would be funded by cuts to government spending as opposed to debt (Byrnes, 1996). The government was successful in implementing much of the increased spending outlined in the RDP but not in doing so without debt. Within a year of taking office the ANC realized that the costs of the RDP program would only increase overtime and began negotiations to privatize parts of some SOEs in order to raise funds (Byrnes, 1996). The government released a new development strategy document in 1996- Growth Employment and Redistribution (GEAR).

GEAR called for an emphasis on the private sector and the need for some economic reforms including limited privatization (Narsiah, 2002). In 1995 the Government announced its privatization program, which would include minority sales of Telkom and South African Airways and the outright sale of some smaller SOEs (Byrnes, 1996). The announcement caused large-scale protests from labor unions (Byrnes, 1996). Ultimately, between 1991 and 2001 there were only eight privatization transactions in South Africa due in major part to opposition from labor unions (Nellis, 2005).

In line with most countries that privatize in order to raise revenues the government only sold minority shares of SOEs in this period. In 1997 the government sold 30% of the public telephone economy and in 1999 the government sold 20% of South African Airways for $229m (Economist, 1999). The ANC Government did not embrace privatization on ideological grounds and was also unwilling to take on powerful trade unions at SOEs. At present the privatization program is haltingly continuing with incremental minority sales accompanied by large-scale labor union protest (Nellis, 2005, Narsiah, 2002).

Why Did Privatization Stall in South Africa?

Privatization by the apartheid government did not begin gradually. Instead the Government sold strategic shares in two of the largest SOEs in the country. Furthermore, the government was able to do this without substantial opposition from labor even while freezing hiring and cutting the workforce through voluntary retirement schemes prior to privatization. The reason for this success and relative lack of opposition is due to the privatization issue being dwarfed by the apartheid issue in national politics. The protest movements and violence that led up to the final end of apartheid government in 1994 caused privatization to be a minimal political issue in comparison. As noted above, the ANC vocally opposed privatization. However, relative to the larger anti-apartheid movement, privatization was not an issue the ANC focused on (Hentz, 2000). Therefore, there was no major political party that sought to mobilize support by opposing privatization.

Furthermore, the apartheid Government actively promoted the benefits of privatization to workers at SOEs as opposed to blaming the privatization on debt as occurs in many cases (including India and post-apartheid South Africa). In addition, the privatizations that occurred in this period were of fairly efficient SOEs that were run as private firms (Byrnes, 1996; Mohammed, 2008). This decreased opposition to privatization as SOE employees did not assume they would be fired or they would be forced to work harder if the firms were privatized.

The reason that privatization subsequently stalled is also directly related to apartheid. The pre-apartheid government scaled back the privatization policy almost immediately after beginning it because they believed that the increasing instability due to the imminent collapse of apartheid would dissuade private investors from purchasing SOE shares for anything near their real value (Byrnes, 1996). Furthermore, the post-apartheid government has been unwilling to substantially privatize due to ideology. The ANC views SOEs as a means of employing the black population which was shut out of the economy under apartheid as well as providing services to this group (Economist, 1999). This reason applies to the service providing SOEs in particular (e.g. water and power utilities) but also to manufacturing SOEs in that employment at SOEs is viewed as a means of raising the living standard of the black population. Thus, South Africa may possibly still be in a period of its history where SOEs provide societal benefits despite their enormous economic efficiency. This would be a similar argument to those who argue that SOEs were beneficial because they established an industrial sector in Brazil (e.g. Trebat, 1983) and India (e.g. Kohli, 2004; Bardhan, 1999) in the earliest stages of their development.

Lastly, the ANC has faced substantial protest from labor unions in the few cases where they have attempted to privatize (Nellis, 2005; Narsiah, 2002). Unlike the pre-apartheid government, the ANC has not been able to convince unions that privatization will not be painful. This is partially due to increased hiring since the end of apartheid and the fact that the pre-apartheid government already privatized the most efficient firms. Additionally, approximately a quarter of South Africans are unemployed, which makes any policy that may potentially increase unemployment (at least in the short-term) extremely difficult to implement.

Policy Implications

Substantial and organized political opposition to privatization was present across Brazil, India and South Africa. In all countries, measures were used to appease and/or overcome this opposition. In India, Government's have largely avoided strategic sales of SOEs and appeased labor unions, and politicians and bureaucrats who oversee specific SOEs by assuring these interests that their role in SOEs would be protected because the Government maintained strategic control. In South Africa the Government followed two strategies. The pre-apartheid Government only privatized relatively successful SOEs in which labor would be secure after privatization while also attempting to persuade workers that they would benefit under private ownership. The post-apartheid government has followed a policy closer to that of the Indian Governments in that they have avoided strategic privatizations and assured labor that they would not suffer because ownership would still be under the Government and the SOEs would continue to be subsidized despite losses. On the other hand, Brazil attempted to persuade labor unions to support privatization by offering workers advantaged positions in purchasing privatized shares.[33]

Failing to implement majority privatizations so as to avoid confrontation with vested interests in clearly an example of sacrificing efficiency to appease opposition. However, this is an example where the sacrifice is most likely too large. Megginson and Netter (2001) survey a host of empirical studies on the economic benefits of privatization. The authors find that privatization is economically beneficial in a large majority of the cases studied. However, the beneficial effects are only observed in cases where strategic shares of SOEs are sold. This isn't particularly surprising on a theoretical level. If the primary reason for the inefficiency of SOEs is that politicians and bureaucrats make poor managers because they attempt to maximize non-financial returns of SOEs (e.g. political returns), then selling minority shares and leaving the management of SOEs with the government will not substantially increase efficiency. This is not to say that minority privatizations do not provide benefits. In the case of India, Naib (2003) finds that minority privatizations benefitted firm performance. However, without strategic privatizations the primary source of inefficiencies is not corrected.

The most visible area where Governments across Brazil, India and South Africa attempted to compensate vested interests in order to overcome opposition is in the case of opposition from labor unions. In all three cases some type voluntary retirement package and hiring freezes has been used in an effort to reduce total employment at SOEs prior to privatization. The difference across the more successful cases of privatization (Brazil and pre-apartheid South Africa) and the less successful cases (India and post-apartheid South Africa) is that in the successful cases VRS was accompanied by propaganda campaigns to convince workers that privatization would not be overly harmful as well as clear connection by the Government between compensation packages and privatization.

India began offering VRS at selected SOEs in the mid-1980s, well before the initiation of privatization as covered in a prior section. Despite this, the Government did not state that VRS was a means of overcoming opposition to privatization from labor. In fact, the Government did just the opposite and stated that privatization was off the table. When the Government did finally implement minority sales of SOEs in 1991 it was by "stealth" (Jenkins, 2000) and with assurances that no majority shares would be sold. Thus, the Indian Government never attempted to fully sell privatization as a beneficial and inevitable policy. This was likely the result of the Congress-led Government (as well as later Governments) having a history of supporting state-led development policies.[34] However, the net result is that the Government was unable or unwilling to advocate privatization as a necessary and beneficial policy.

On the other hand, in the case of Brazil the Government launched an extensive campaign in

[33] There was some share preference to employees at Indian SOEs as well (Mathur, 2006; Uba, 2008). However, compensation in the form of shares was only a small fraction of the total amount of compensation that occurred primarily in the form of Voluntary Retirement Schemes.

[34] Even in the case of the BJP, a party that is considered to the Right on economic issues, the party has generally maintained that the state should own firms in strategic sectors.

the media and individual SOEs to convince the public and labor that privatization was beneficial for Brazil as a whole and for SOEs. Furthermore, in Brazil, labor was compensated with shares in privatized SOEs and compensation packages were provided in such a way as to make them more valuable if privatization continued or even accelerated. As discussed in the prior section, this policy created a rift between Union members and the Union leadership, and more importantly, created a set of workers who would benefit from the continuation of the privatization program.

Similarly, in pre-apartheid South Africa the Government attempted to educate workers at SOEs facing privatization that the policy would actually benefit them. This was far easier in the case of these specific South African firms because they were relatively efficiently managed and profitable prior to privatization. Thus, workers at these firms were less threatened by privatization than workers at SOEs that were unprofitable and more overstaffed. However, workers at these firms still needed to be convinced that privatization was not a real threat and may even provide benefits, and the Government did this.

On the other hand, the post-apartheid Government has consistently sent mixed signals about its intentions to privatize. The Government has promoted SOEs as a means of improving the position of impoverished and unemployed communities, while also intermittently claiming that privatization is an important part of the Government's industrial policy. Voluntary retirement packages are still offered at many firms but they are not part of a privatization process. Instead, like in India, they are part of an effort to reduce overstaffing at firms that the Government does not appear ready to privatize. Again, this is the result of a ruling Government that is ideologically split on the question of whether privatization will benefit South Africans, however, the end result is that the Government is not able to create a base of support for the policy among even a subset of workers.

Thus, in Brazil and pre-apartheid South Africa privatization was more successful because the Government made its plans to privatize clear to vested interests and 1.) Attempted to convince vested interests of the benefits of the policy, and 2.) Associated compensation packages with support for privatization. In contrast, India and post-apartheid South Africa have attempted to implement small privatizations under the radar and have offered compensation packages only to reduce overstaffing, not as a direct method of winning support for privatization. This appears to be the primary reason for the difference in privatization outcomes across the countries: opposition is more easily overcome when the Government makes its intentions to privatize clear, and when it directly associates compensation packages with privatizations.

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