

THE RIGHT PRIVATIZATION: WHY PRIVATE FIRMS IN PUBLIC INITIATIVES NEED GOOD GOVERNMENTS

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GOVERNMENT FAILURE LEADS TO POOR SERVICES AND BAD INVESTMENTS



**IS
“PRIVATIZATION”
THE SOLUTION?**

A CONTROVERSIAL CASE: PRISONS

The New York Times

Inside a Private Prison: Blood, Suicide and Poorly Paid Guards

By Timothy Williams

April 3, 2018



Surveillance footage recorded in East Mississippi Correctional Facility shows prison guards taking nearly 30 minutes to respond to an assault on an inmate.

OLIVER HART AND THE *COST-QUALITY TRADE-OFF*

Private operators have higher incentives to be productive...



... but they may cut costs at the expense of (noncontractible) “quality” (Hart, Shleifer and Vishny, 1997).

Private management therefore has an ambiguous effect on *effectiveness*:

$$\text{Effectiveness} = \frac{\text{Social benefits ("quality")}}{\text{Costs}}$$

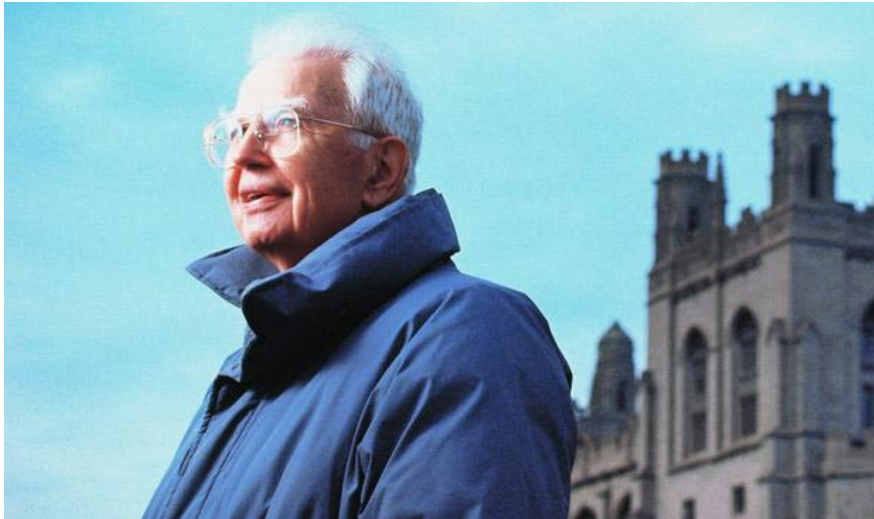
PRIVATELY OUTSOURCED PRISONS IN PARANÁ, BRAZIL (1999-2006)



**Private operation with
public supervision
attenuated the
cost-quality trade-off
(Cabral, Lazzarini and Azevedo,
2010, 2013).**



RONALD COASE AND THE LIGHTHOUSE



Public goods do not need public management.

Embrace “the richness of the social alternatives between which we can choose” (Coase, 1974).



WILL PRIVATE OPERATORS TARGET VULNERABLE GROUPS?

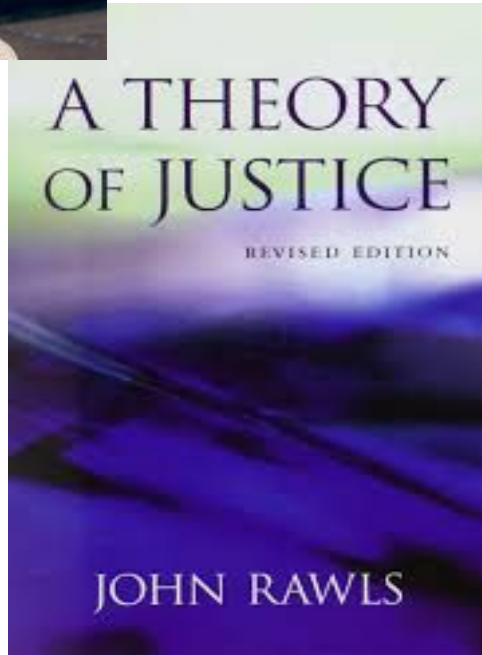


**Paulo Egydio de Oliveira School,
São Paulo, Brazil
(PUBLIC)**



**Ken Ade School, Lagos, Nigeria
(PRIVATE)**

WHEN *INCLUSION* IS A PRIORITY

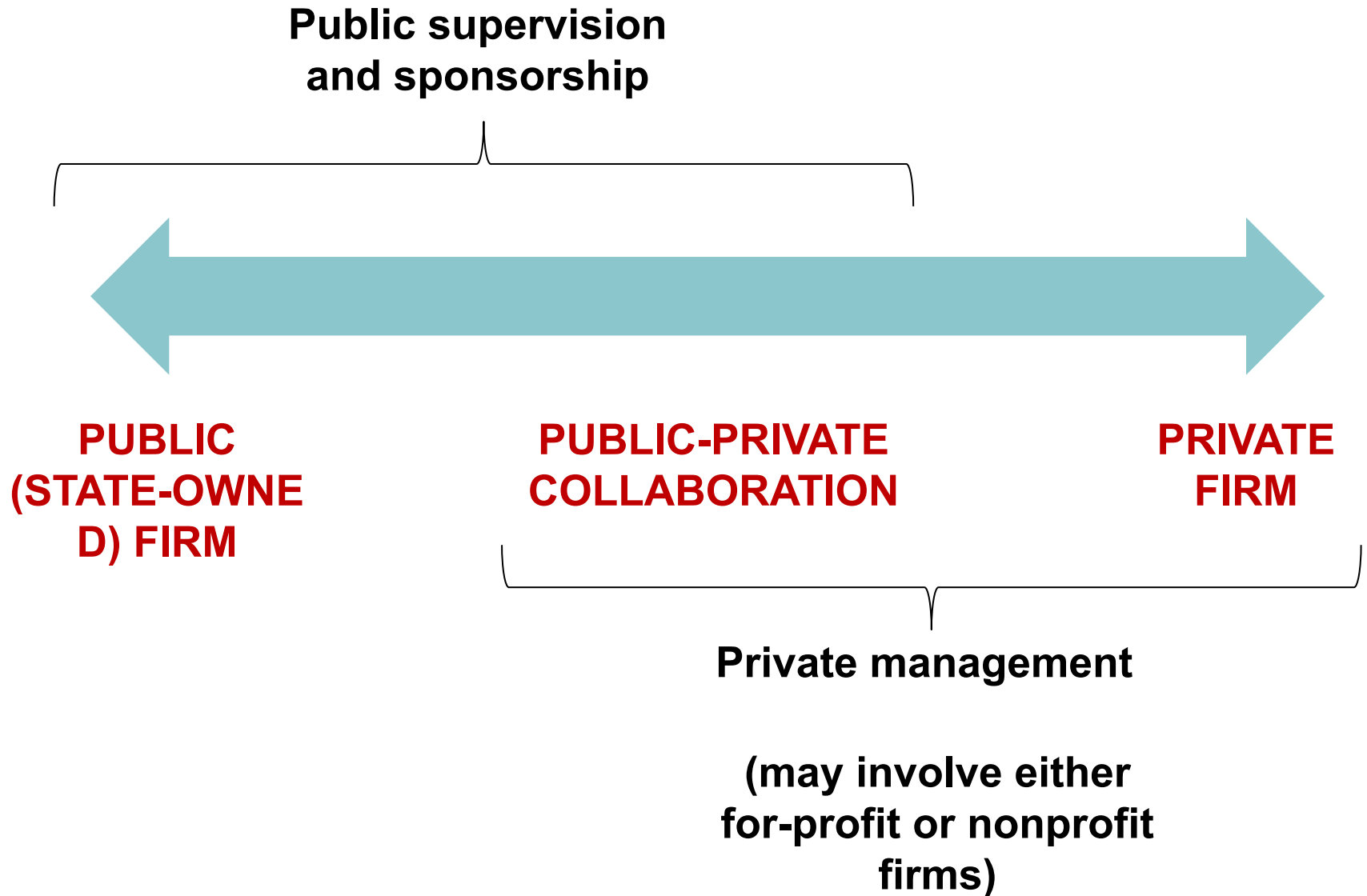


In education: inclusion achieved “either by subsidizing private schools or by establishing a public school system.”

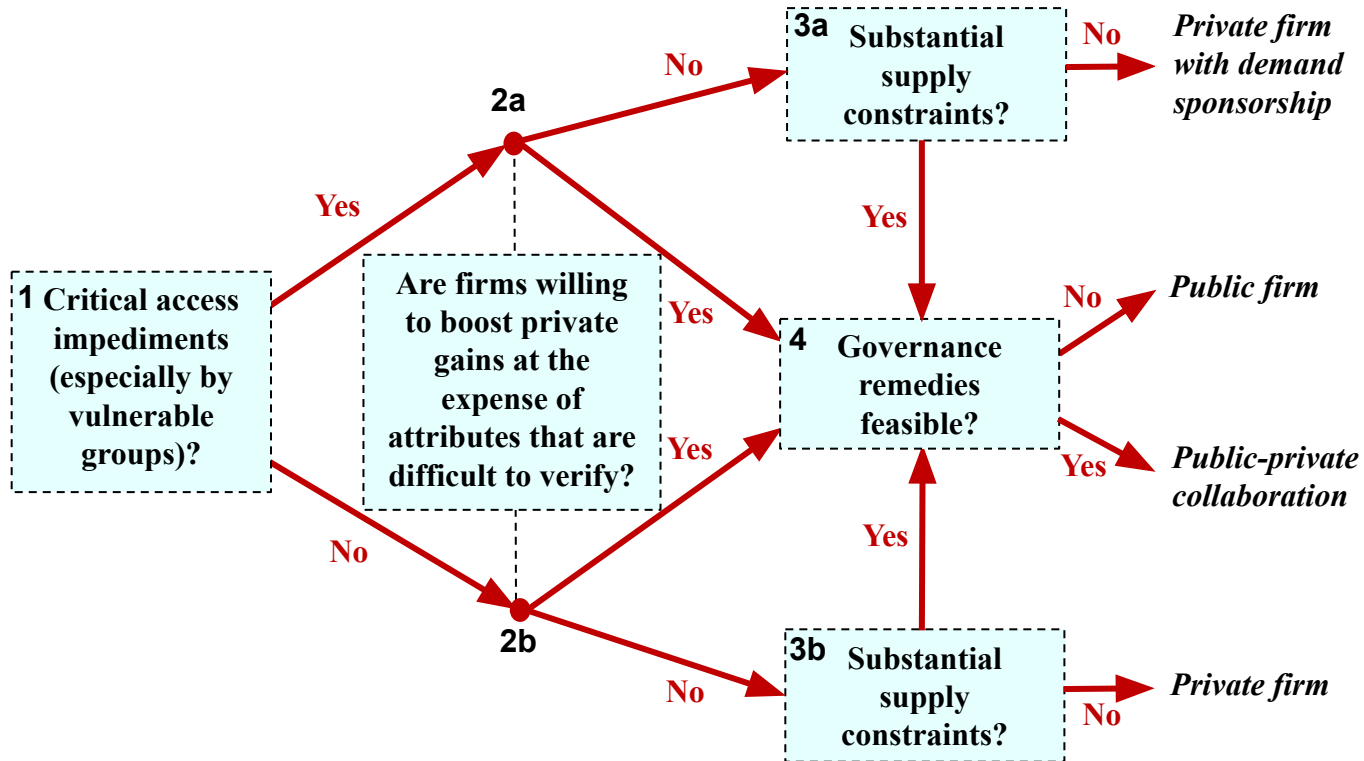
“... the question then becomes one of comparison of possible alternatives”

(Rawls, 1971, 1999).

THE MENU OF DELIVERY FORMS



A SIMPLIFIED DECISION TREE



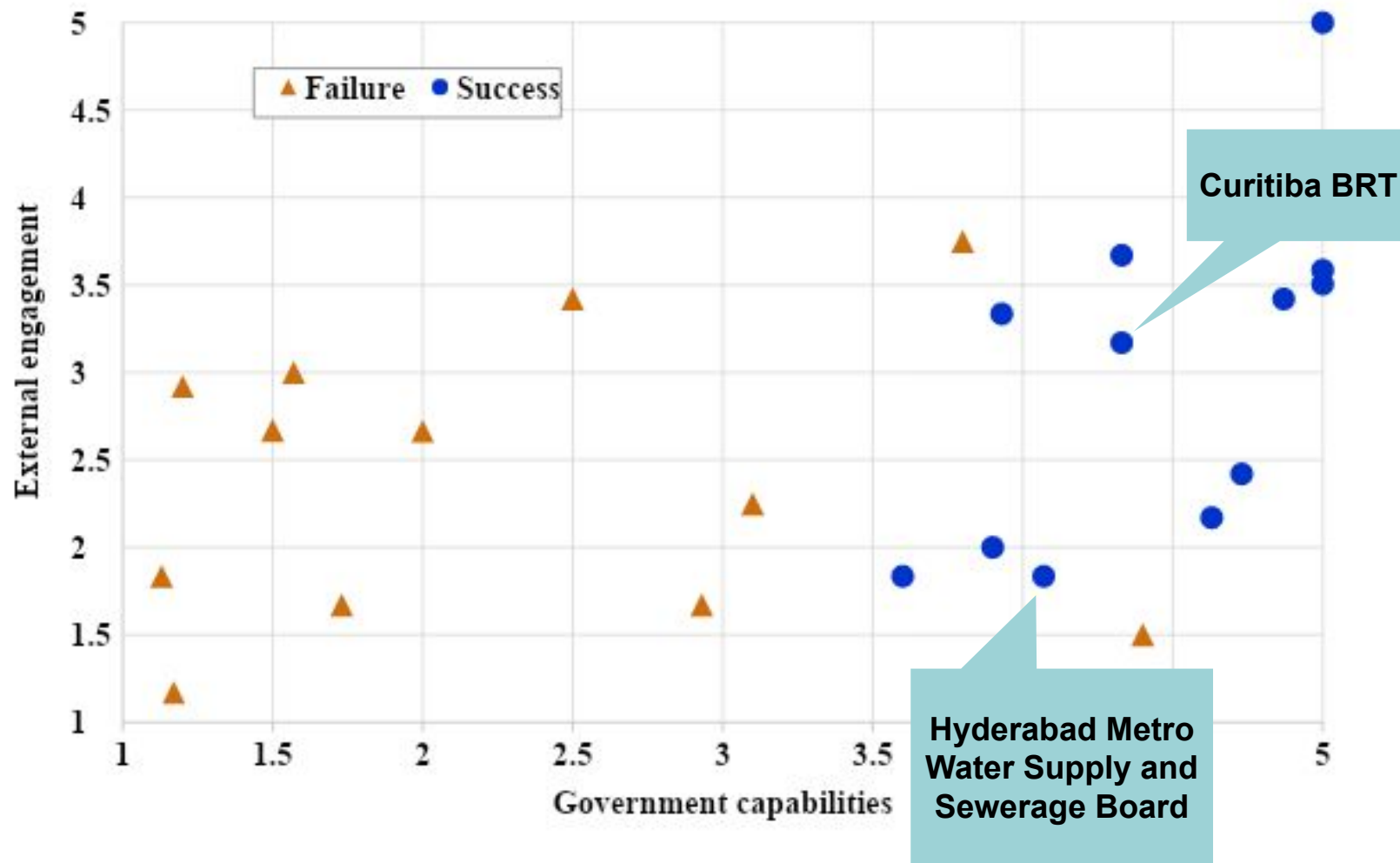
ALL DELIVERY FORMS NEED GOOD GOVERNMENTS



Bus rapid transport (BRT) system in Curitiba, Brazil

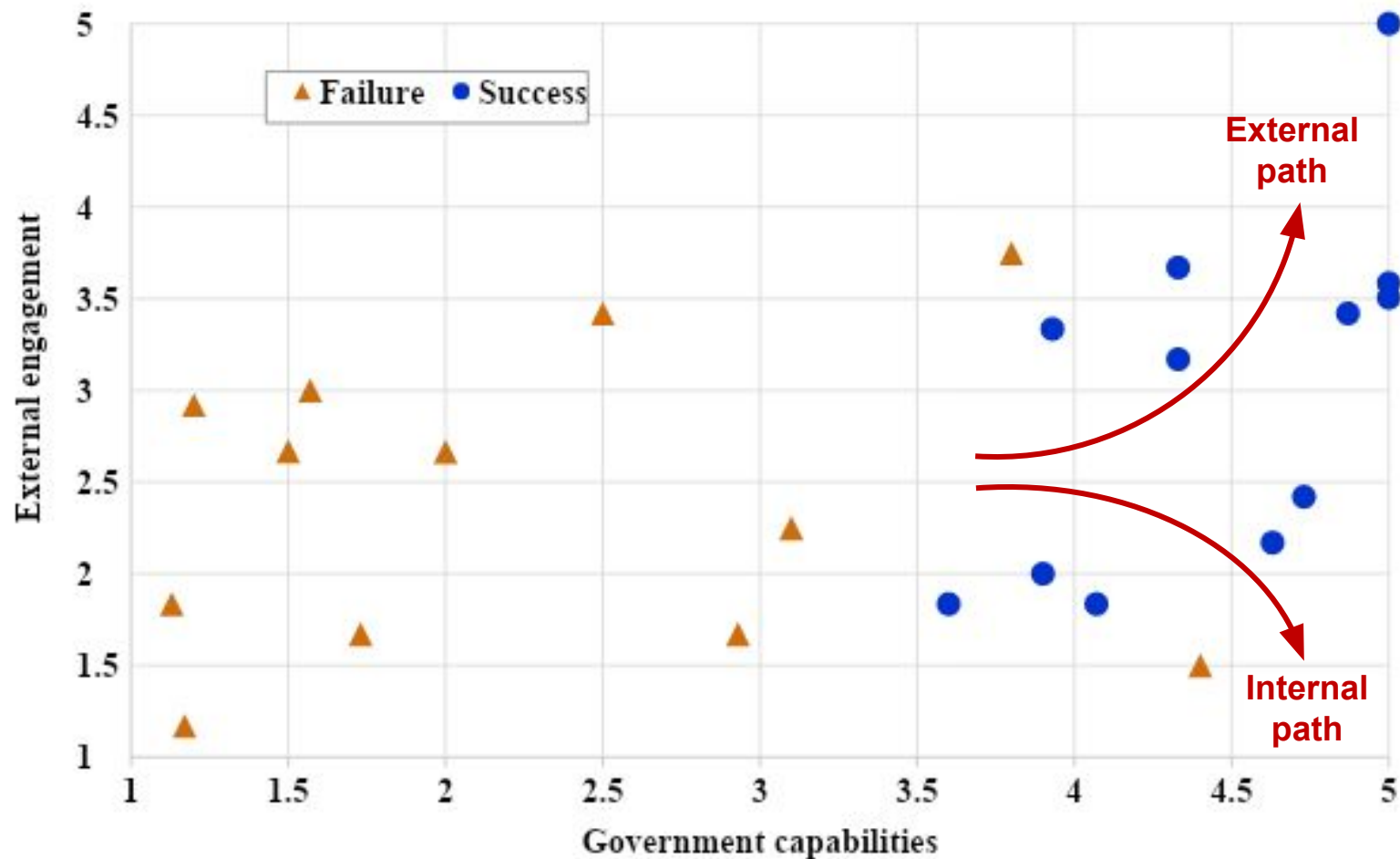
MULTIPLE ROADS LEAD TO ROME

Public initiatives in Brazil, India, and South Africa. “Success” as evidence of effectiveness (Lazzarini, Ito, Pongeluppe, Medeiros and Ovanessoff, 2020)



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BEYOND (GENERAL) STATE CAPACITY: GOOD GOVERNMENTS ARE ISLANDS OF CAPABILITIES

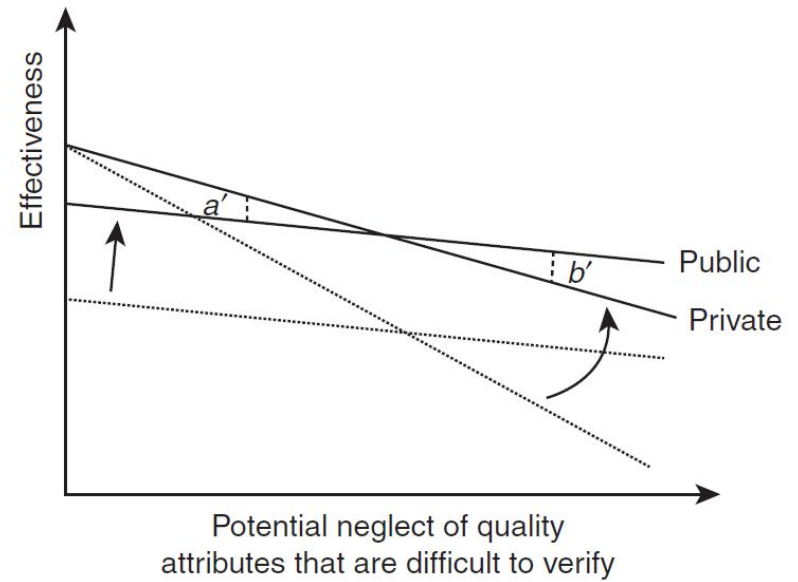
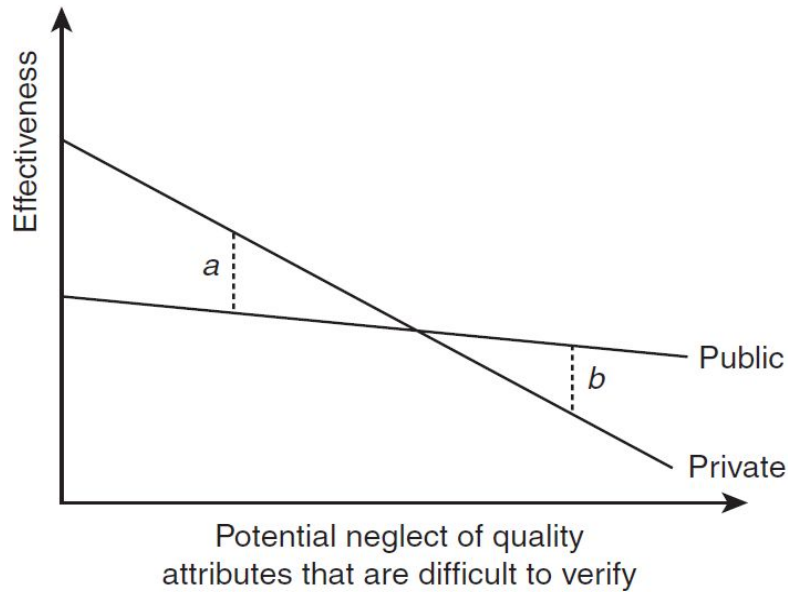


<https://guidetothephilippines.ph/trips-and-experiences/outdoor-adventures-1/hundred-islands-pangasinan-private-day-tour-with-transfers-from-manila>

Dimensions of government capabilities:

- **Policy making.**
- **Mobilization.**
- **Execution.**
- **Accountability.**
- **Commitment (to follow a mandate).**
- **Collaboration (external *and* internal).**

CAPABLE GOVERNMENTS ENCOURAGE *PLURAL* FORMS



GOOD GOVERNMENTS INCREASE THE *LEGITIMACY OF PRIVATIZATION*

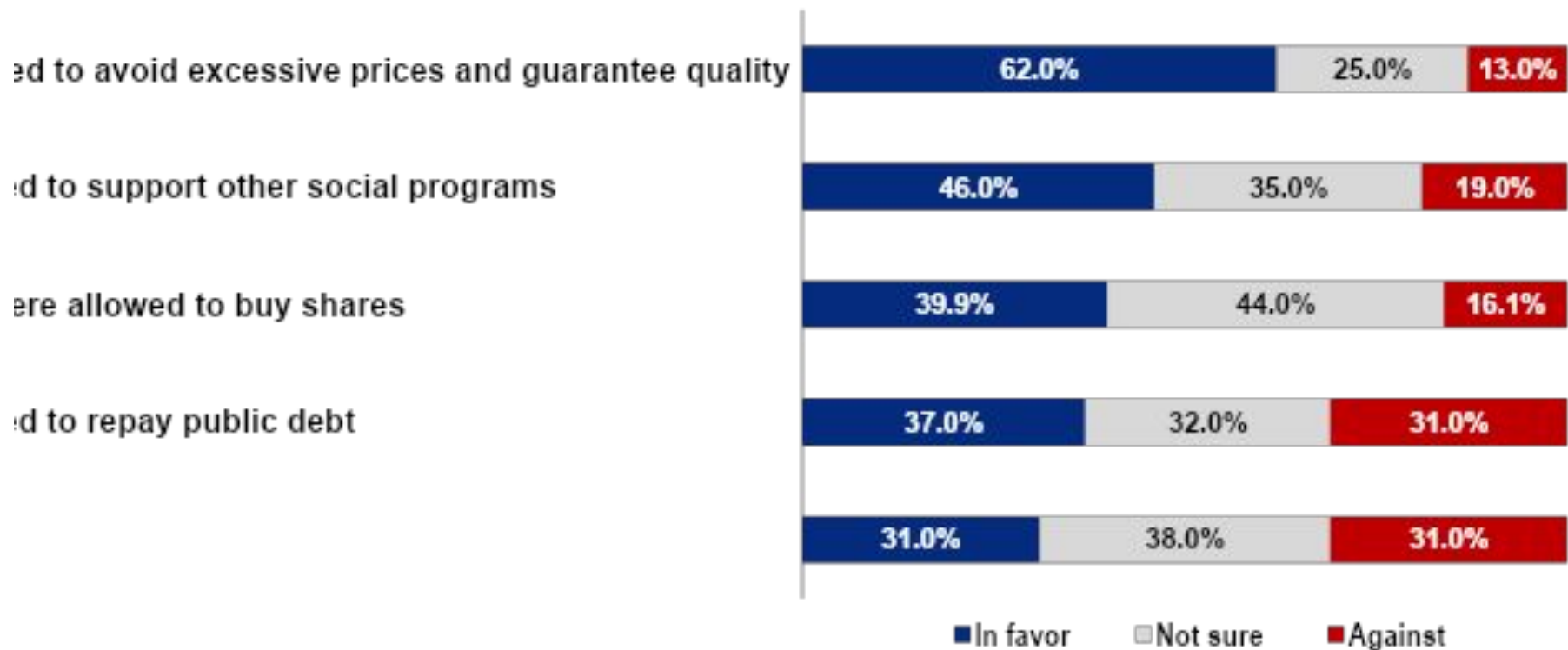
Survey with Brazilian respondents: “Do you support the privatization of state-owned enterprises?”



Source: Survey conducted in partnership with Ideia Big Data, novembro de 2019. 1.542 respondents, in all Brazilian regions.

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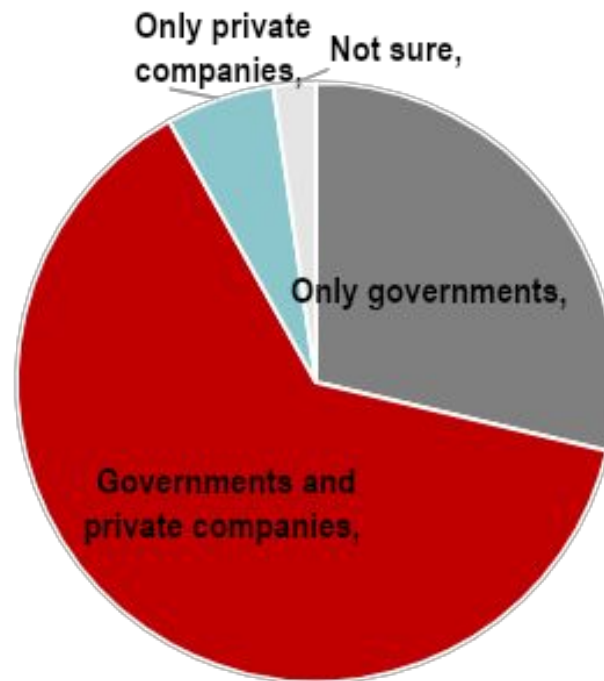
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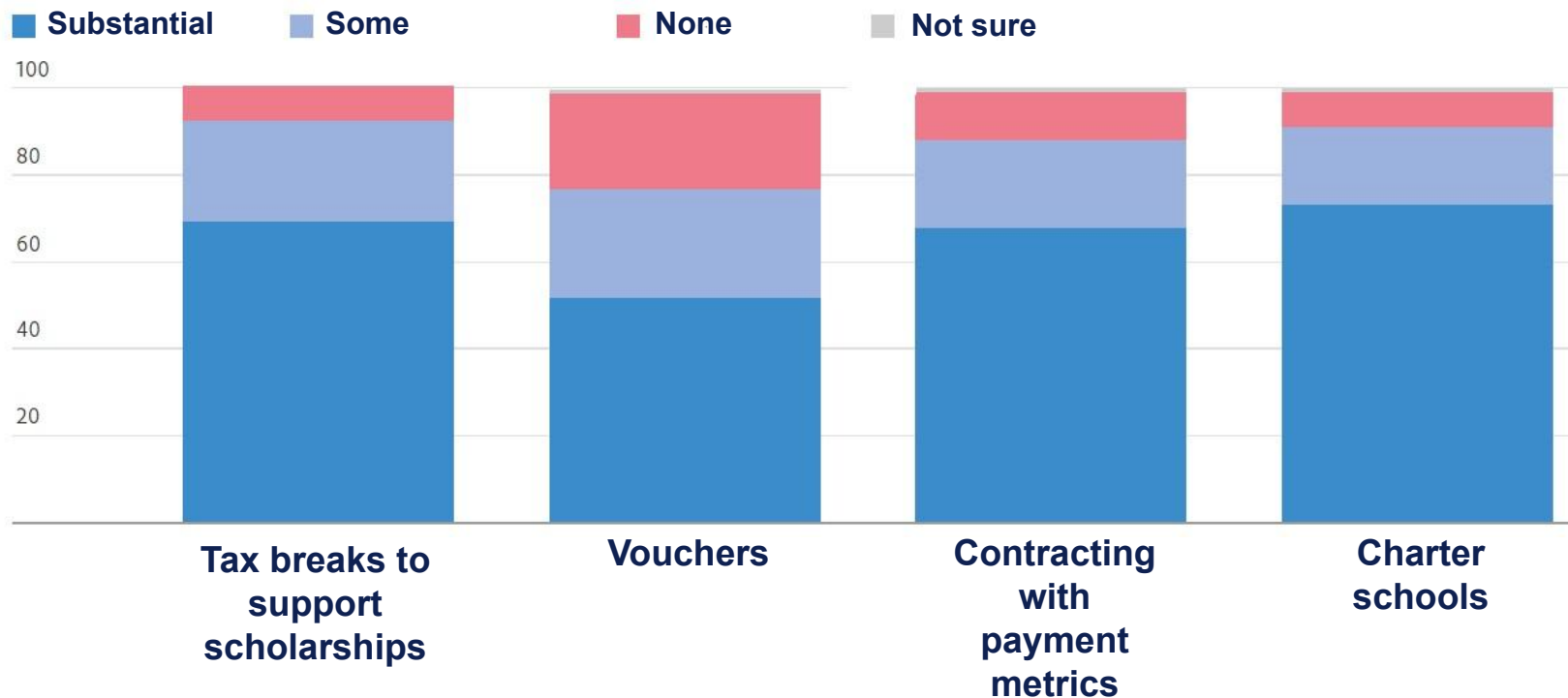
AND THE POPULATION SEEMS TO VALUE PLURAL SOLUTIONS...

Another survey: “Public services should be provided by...”



THE TYPE OF ARRANGEMENT MATTERS

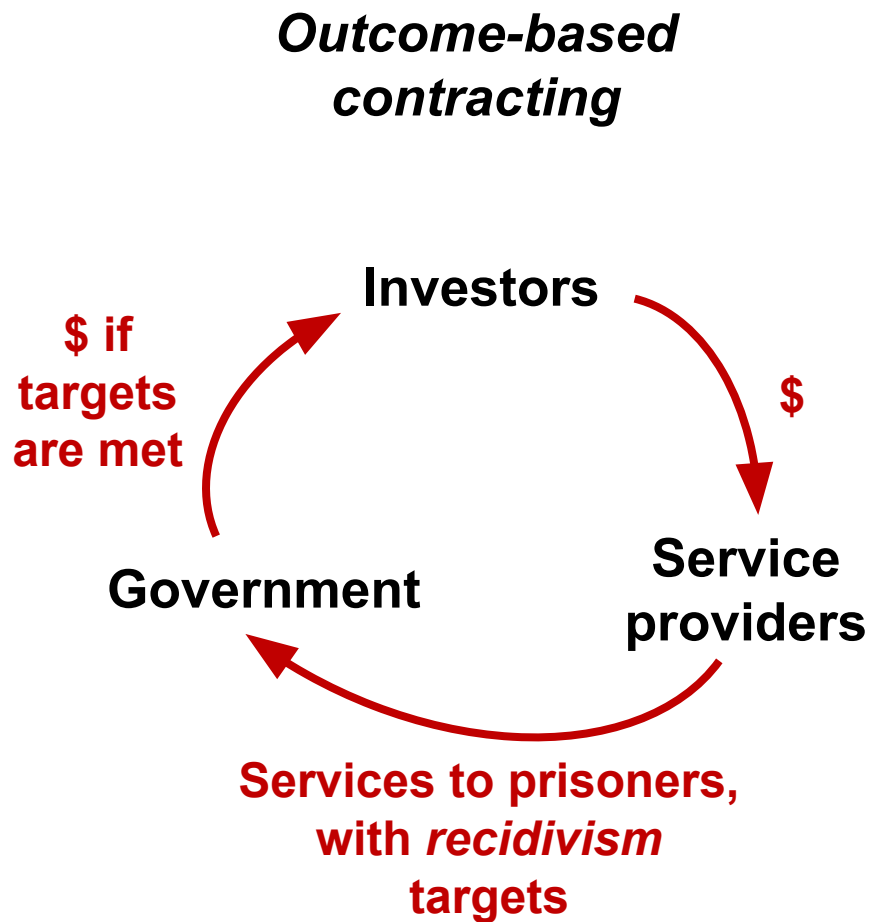
In education: “To what extent each arrangement could improve education in Brazil?”



Source: Survey conducted in partnership with Datafolha; 2,072 respondents, July 8-19, 2021.
<https://www1.folha.uol.com.br/mercado/2021/10/servico-publico-e-gestao-privada-sem-tabu.shtml>

ANOTHER REMEDY: “COMPLETING THE CONTRACTS”

Peterborough prison, United Kingdom. The focus of the first *social impact bond* (SIB)



<https://www.thinknpc.org/blog/post-peterborough-lets-keep-debating-the-value-of-sibs/>

**... POTENTIALLY
ATTRACTING
INVESTORS THAT
SEEK PROFITABILITY
AND IMPACT**

Survey with 294 *impact investors*: total assets of US\$ 404 billion at the end of 2019



ANNUAL
**IMPACT
INVESTOR**
SURVEY
2020

THE **TENTH** EDITION

10

OUTCOME-BASED CONTRACTS ANNOUNCED SINCE THE PETERBOROUGH SIB

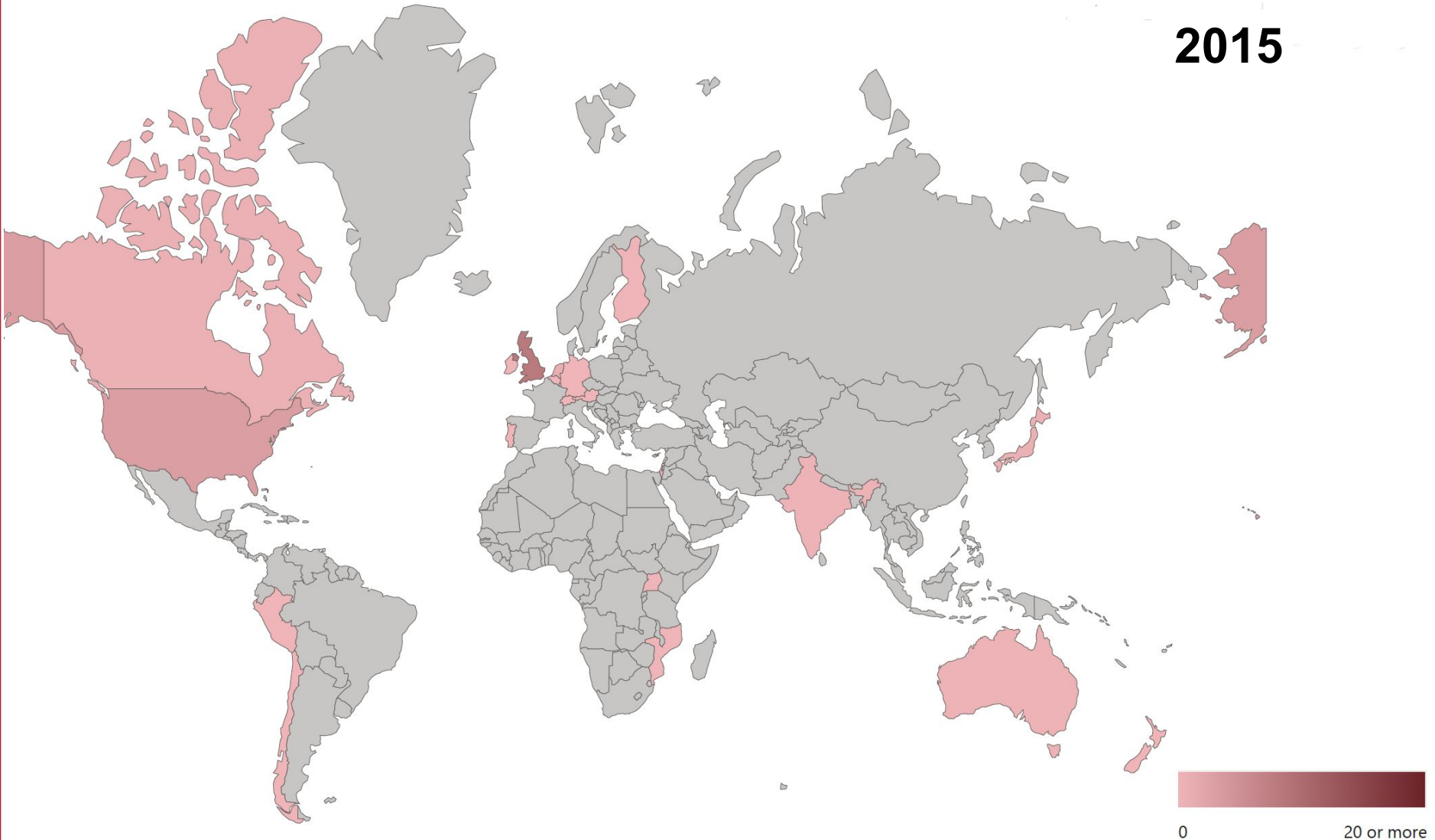
2010



Source: Database compiled by Lazzarini et al. (2021). In this figure only investor-based contracts are included.

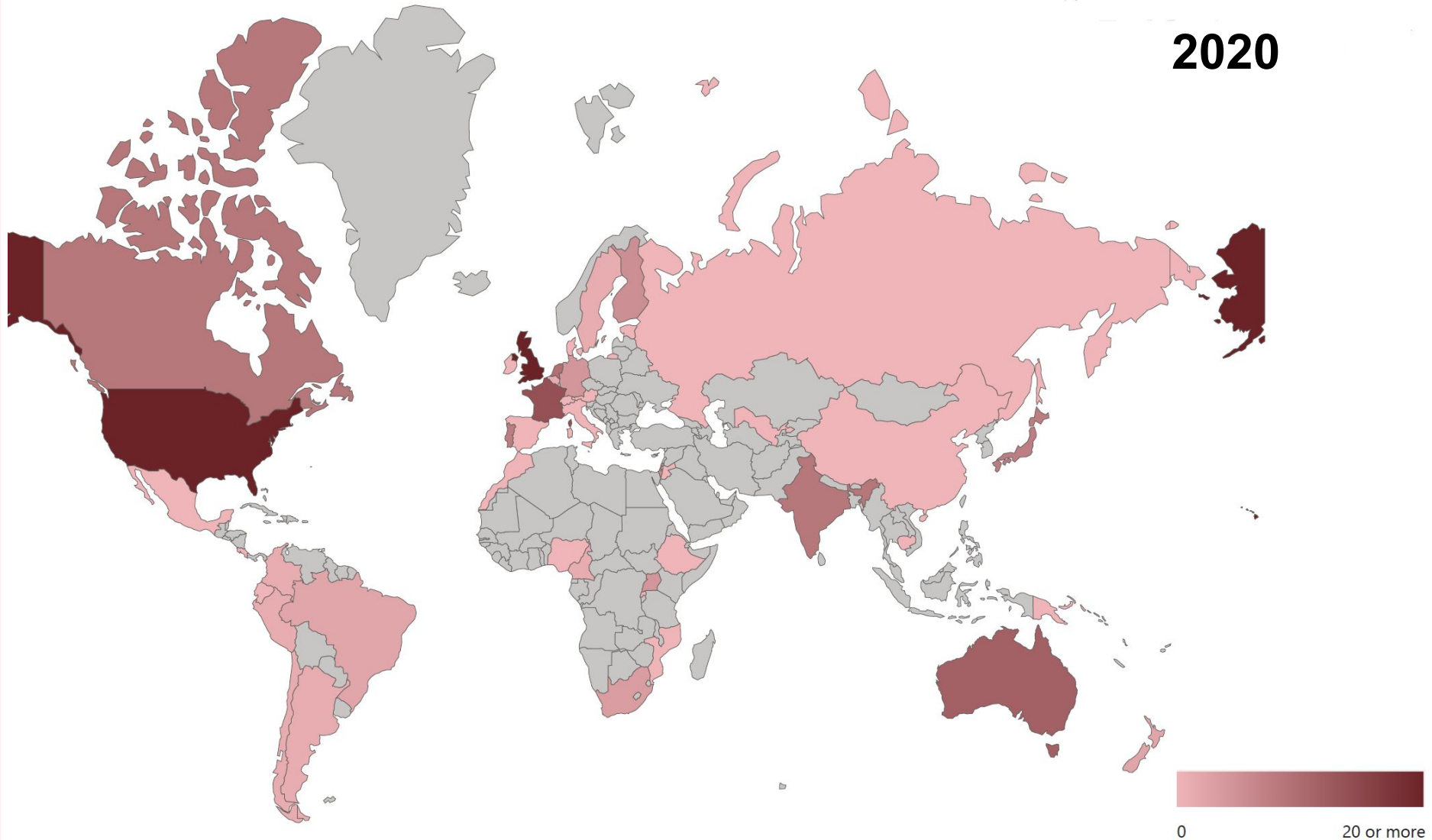
OUTCOME-BASED CONTRACTS ANNOUNCED SINCE THE PETERBOROUGH SIB

2015



Source: Database compiled by Lazzarini et al. (2021). In this figure only investor-based contracts are included.

OUTCOME-BASED CONTRACTS ANNOUNCED SINCE THE PETERBOROUGH SIB



Source: Database compiled by Lazzarini et al. (2021). In this figure only investor-based contracts are included.

YET, SUBSTANTIAL CONTROVERSY ON HOW TO MEASURE THE IMPROVEMENTS



The New York Times

Success Metrics Questioned in School Program Funded by Goldman

By NATHANIEL POPPER NOV. 3, 2015

Brenda Van Gorder, director of preschool services at the local school district, said she was happy with the program because it had induced Goldman to pay for a program that the state would not have otherwise supported.

But she and the researcher who tested the local children, Mark Innocenti, acknowledged that they lacked certain basic data on what would have been expected to have happened to the students without the Goldman-funded preschool, and the difference in the performance of the students in the program versus other similar students who did not attend preschool.

“If we had the data — if we could follow kids without intervention — we would be able to come up with a clearer idea of what is happening,” said Mr. Innocenti, a researcher at Utah State University. “Time for another study, I guess.”

CAN WE REALLY “COMPLETE THE CONTRACTS”?

Social Impact Bond (SIB) in Toronto (2018): government contract focused on homeless populations

Beneficiary



Agent (Math Radfar, works at a nonprofit, Mainstay)

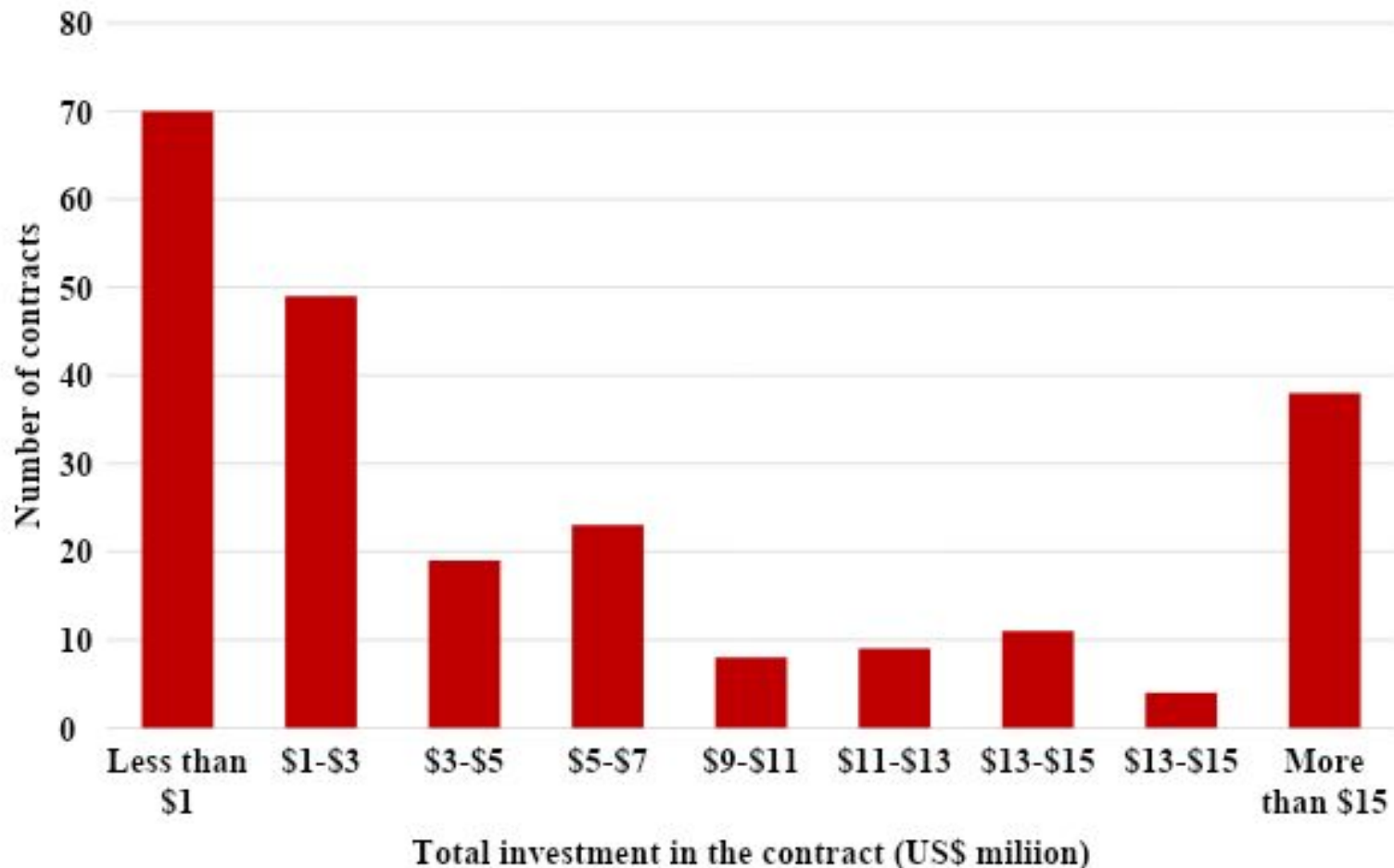
“The [human] quality part is the part that, you know... You can’t measure it!”

<https://livewirecalgary.com/2018/10/16/calgary-non-profit-has-social-impact-bond-in-the-works/>; quote from the movie *The Invisible Heart*.

TASK 1 (easy to measure)
Was the beneficiary successfully moved off the streets?

TASK 2 (difficult to measure)
Were the beneficiaries well treated? Are they now in “reasonable” housing conditions?

IN ADDITION, MOST OUTCOME-BASED CONTRACTS ARE STILL “PILOT PROJECTS”



Source: Database compiled by Lazzarini et al. (2021).

CAN THEY TAP INTO LARGER CAPITAL MARKETS?

Global capital markets: \$89 trillion



Impact investors: \$404 billion

Development banks: \$940 billion



April 3, 2020 12:47 pm by **Madison Darbyshire**

Investments

ESG funds continue to outperform wider market

More than half of ethical and sustainable funds beat the MSCI World index

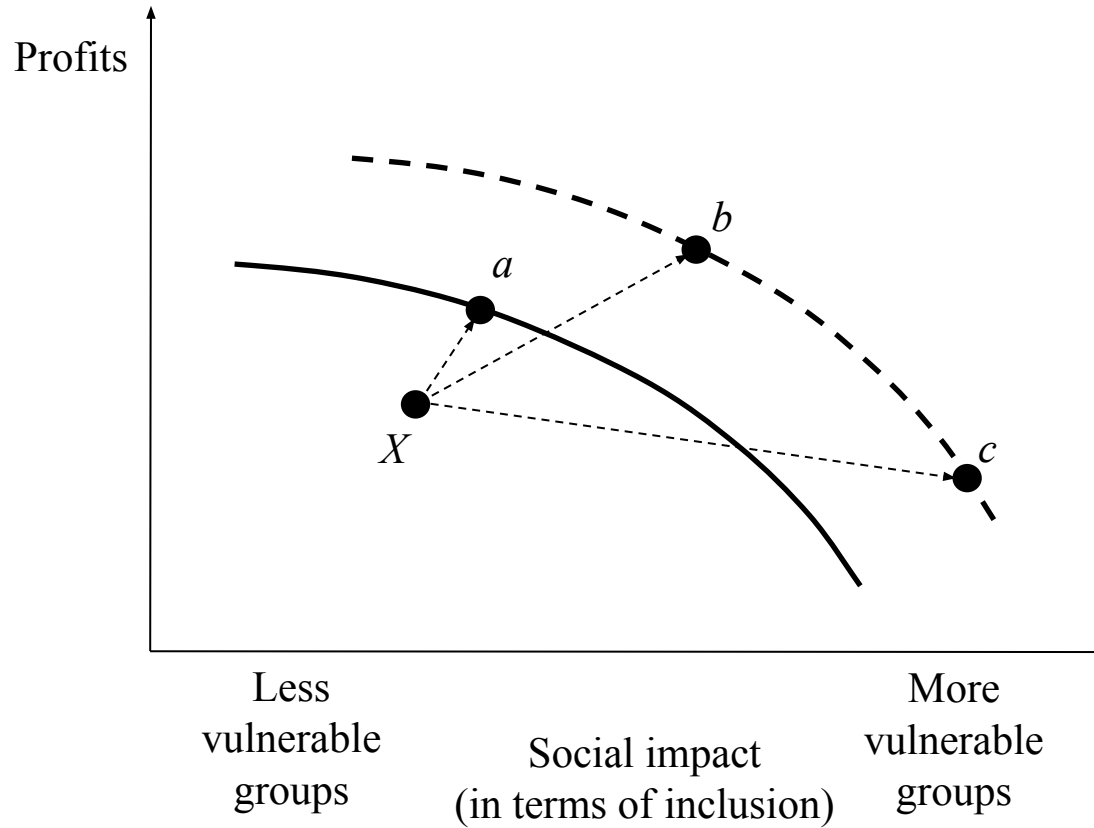


Distance learning - in this case enforced by Covid-19 pandemic - is one of the trends identified by ESG fund managers © Getty Images

**THE *ESG* TREND:
AN OPPORTUNITY
TO INCREASE
PRIVATE IMPACT?**

THE “NO TRADE-OFF ILLUSION”

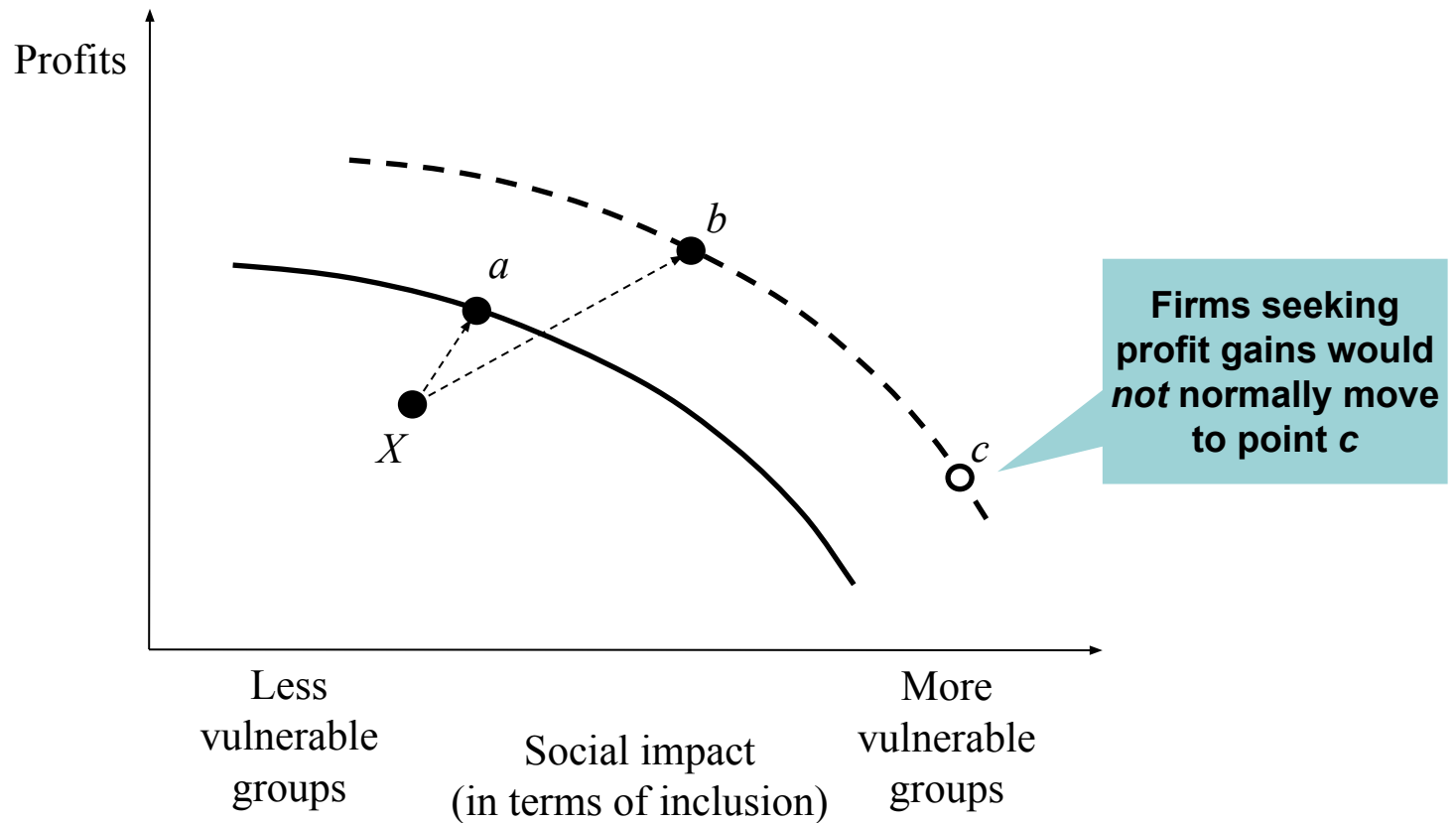
Example: microcredit



Note: The profit-impact frontier is inspired by the estimated presented in McCreless (2017).

THE “NO TRADE-OFF ILLUSION”

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A PROCESS OF PRIVATIZATION



Required steps to mitigate potential failure

- Building the case for privatization: expected social gains and costs.
- Open consultation and engagement of key stakeholders.
- Governance remedies to promote effectiveness and inclusion.
- Improvements in the authorizing legislation and regulation.
- Definition of the public unit responsible to carry out the process.

- Crafting competitive auctions with transparent information and selection criteria.
- External, independent auditing.
- Monitoring committees organized by the executing public unit.

- Monitoring of performance and contractual targets.
- Monitoring of pricing and competitive practices.
- Commitment to pre-specified rules if there is need to renegotiate contract terms or reverse the process.

Additional steps depending on type of privatization

- By delegation:
 - Creation of public-private collaboration units, especially in countries with low institutional development.
- By divestiture:
 - Due diligence and improvement in the governance of the companies.
 - Definition of the form of sale.
 - Compensatory measures (such as in the case of layoffs).

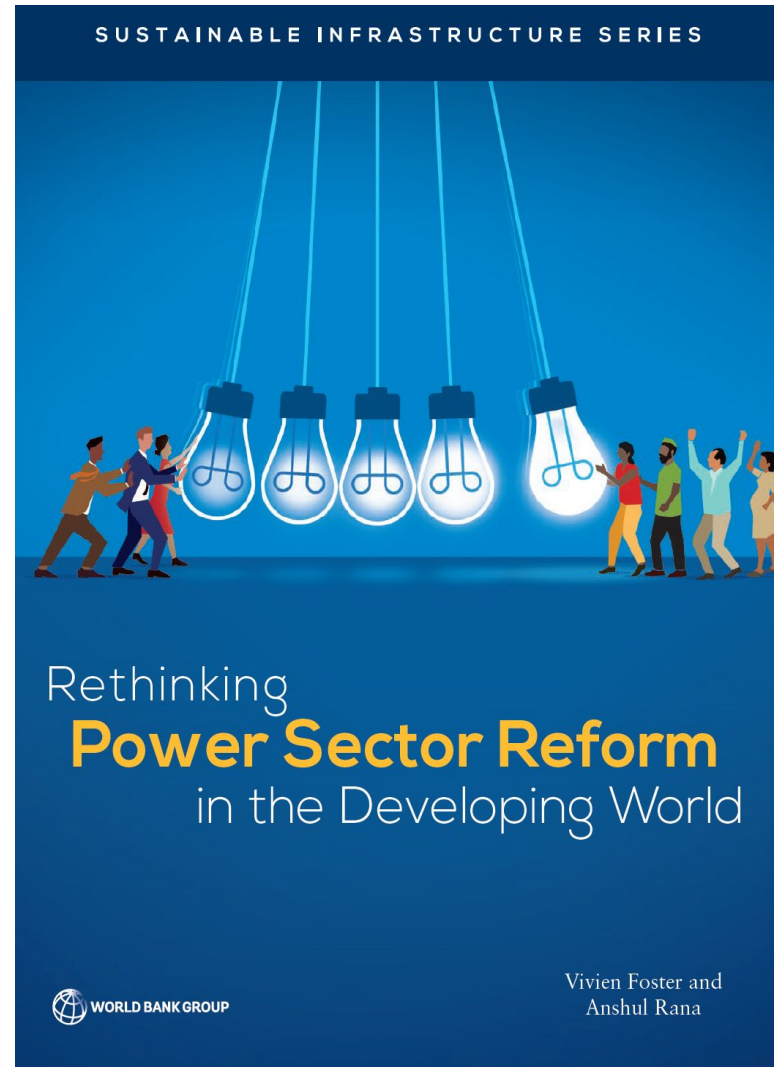
- By delegation:
 - Criteria to allocate public funds to potential acquirers, if necessary.
 - Government guarantees in case of sponsored long-term projects.
- By divestiture:
 - Anti-trust remedies, especially if potential acquirers are industry incumbents.

- By delegation:
 - Detailed studies of service impact.
- By divestiture:
 - Governance and legal mechanisms to protect private shareholders from remaining government interference.

MULTIPLE ROADS LEAD TO ROME, AGAIN

“Among the best-performing power sectors in the developing world are some that decisively implemented the 1990s reform model and others that retained a dominant and competent state-owned utility, guided by strong policy objectives...

This evidence makes a case for greater *pluralism* of approaches going forward” (emphasis added)



THE PLURAL CONSENSUS



Isaiah Berlin: societies evolve through distinct and plural paths.

Embrace “the richness of the social alternatives between which we can choose” (Coase, 1974):

- **Permeability and tolerance to distinct and diverging points of view.**
- **Emphasis on key social problems and their multiple potential solutions.**
- **Continuous assessment of performance and the causes of failures.**
- **Gradual improvements instead of radical reform.**

THANK YOU!

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