

Privatization, Competition and Welfare

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Abstract

We compare alternative market equilibria (ME) that could emerge, following privatization, in non-natural monopolies with dominant public firms. We characterise these equilibria both in terms of static social welfare and in terms of incentives for cost-reduction. We show that, in terms of both of these dimensions, the best ME is that which would arise if, through its precommitment in sunk capacity, the privatised firm can credibly play a Stackelberg leadership role. This ME would also maximise the government's utility if its preferences are described by a lexicographic ordering with respect to revenues from the sale of the firm and social welfare. We also consider when the best ME can be attained under public ownership.