Employment Concerns or Productivity Considerations? Political Selection of Firms into Privatization Programs: Evidence from Romania

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Non-Technical Summary

The aim of this project is to analyze the process of political selection of state-owned enterprises (SOEs) into privatization programs. In virtually all countries in Central and Eastern Europe, SOEs were not privatized at the same time, but some early at the beginning of the transition process, while some later on. This paper contributes to this literature by modeling this process and analyzing Romanian firm-level data to assess the relative importance of several factors that most likely played a crucial role in selecting firms into privatization programs: efficiency enhancement of the old socialist production sector, factors related to workers' well being, and state subsidies to SOEs.

The early Romanian privatization is particularly apt for studying political preferences related to privatization. A peculiar institutional feature of the Romanian privatization program permits us to distinguish between SOEs that were slated to or banned from becoming private. In 1990, in advance of launching any privatization program, the Romanian government selected about 370 SOEs and prohibited their transfer to private owners; this ban was lifted more than seven years later, after the party governing between 1990 and 1996 lost the elections. This feature permits the unambiguous separation of firms put down for privatization from those that the government decided to keep in long term ownership, even if the privatizable firms were not actually privatized. The Romanian privatization is also well suited to such analysis because many unmeasured factors – revenues for the state budget, bribe maximization, or reputation building – are likely to have played only a secondary role: most of the privatizations were management-employee buyouts, which did not bring any revenues to the government or to politicians, and the privatization process was so slow that it is unlikely that it was used for reputation building.

We model privatization as having two effects on firm behavior: it alters the objectives of the owners and it increases managerial effort. When the politician has the ownership rights, he maximizes a weighted average of the profits and the employment level of the firm, while the private owner is interested solely in the profits. Second, we assume that private owners provide high-powered incentives to

the managers, while the state does not. Accordingly, managers work harder under private than under state ownership, which has a positive effect on firm productivity. Through the scale effect the level of production and the level of employment may also increase. The model predicts that efficiency maximizing politicians will privatize large and inefficient firms, while politicians with salient employment concerns choose small firms for privatization with better growth opportunities as they become more efficient.

In the empirical part of the project, we first test the model's predictions with probit estimations, to link pre-privatization firm characteristics to the probability of being in long-state ownership. The regressors include the key variables of the model, the average employment, firm performance and wages. In addition, we control for the main activity of the firm, and two variables measuring soft budget constraints: overdue payments and bad loans taken over by the government, compared to the value of sales. We find that Romanian decision makers selected relatively small and efficient firms to be privatized, while large, loss making SOEs were rather kept in long-term state ownership. In our model this corresponds to politicians being concerned with the employment loss of privatization, while productivity enhancement playing only a secondary role. Overdue payments and bad loans seem to have only a secondary or no effect at all on the selection of firms into long-term state ownership.

In the second empirical method employed, we use information on the effect of actual privatizations on firm behavior and simulate the relationship between pre-privatization firm characteristics and the effect of privatization on both privatizable and non-privatizable firms. First we estimate how the effect of privatization on employment, firm efficiency and wages varies in function of pre-privatization firm characteristics – the information known to politicians when they decided which firm could be transferred to private ownership. Then we use the estimated partial effects to simulate the employment, efficiency and wage effects of privatization for the privatizable and non-privatizable firms separately (including in the first group both actually privatized and not yet privatized firms). The comparison of the simulated effects for the two groups of firms reveals that those firms which were expected to shed employment as a consequence of privatization were sheltered from privatization programs even though their expected efficiency increase was large. The simulated wage effects are very small and similar for the two groups, suggesting that wage effects of privatization were of secondary importance.