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Journal of Banking & Finance 29 (2005) 1981–2013

Journal of BANKING & FINANCE

www.elsevier.com/locate/jbf

Bank privatization in developing and developed countries: Cross-sectional evidence on the impact of economic and political factors

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Available online 8 April 2005

Abstract

We examine how political, institutional, and economic factors are related to a country's decision to privatize state-owned banks. Using a panel of 101 countries from 1982 to 2000, we find that political factors significantly affect the likelihood of bank privatization only in developing countries. Specifically, in non-OECD countries, bank privatization is more likely the more accountable the government is to its people. In contrast, none of our political variables affects the bank privatization decision in developed countries. Economic factors (such as the quality of the nation's banking sector) are significant determinants of bank privatization in both OECD and non-OECD nations.

JEL classification: G15; G21; G38

Keywords: Privatization; Bank; Developing countries

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0378-4266/$ - see front matter
doi:10.1016/j.jbankfin.2005.03.004

1. Overview

In this paper, we address a country's decision to privatize state-owned banks. Because state-owned banks (SOBs) often provide governments with important policy tools, privatization of the banking sector is often regarded as a sensitive issue. Previous evidence suggests that privatization generally improves firm performance, raises revenue for privatizing governments, and helps develop capital markets.[3]

Our analysis uses a comprehensive dataset of all countries that have had any privatization activity since 1982. In about half of these countries, the state has privatized at least one bank.[4] We seek to explain why some countries have privatized banks and others have not. Generally, the decision whether and when to privatize a SOB has political implications and the government needs to consider the benefits and costs of privatizing. Benefits include revenues from the sale, increased efficiency of the bank, and development of the capital market. Costs are more nuanced and include the loss of the government's ability to use the bank for political purposes. These purposes include patronage, job creation, and the ability to channel money through the bank for political purposes (such as offering favorable loans to political supporters and providing off-budget financing for the government). The situation is especially complex because national politicians, who usually make the privatization decisions, consider the costs and benefits to themselves, but the impact is often felt more by local politicians.

One way to study the decision process that leads to bank privatizations is to focus in detail on specific countries. This approach makes it easier to control for many institutional, legal, social, and economic factors that are difficult to deal with in cross-sectional studies. In the area of bank privatization, Clarke and Cull (1997, 2000, 2002) provide excellent examples of detailed country analyses. For example, Clarke and Cull (2002) examine how the implementation of the Argentinean Convertibility Plan in the early 1990s affected the political and economic incentives for provincial governments to own banks. They find that poorly performing banks were most likely to be privatized. In addition, higher levels of provincial unemployment and larger proportions of public employees reduced the probability of privatization.

A second approach, the one we choose in this paper, is to study a broader cross-section of countries. While it does not allow us to investigate detailed country-specific issues, we believe it complements the individual-country analyses. We acknowledge the potential shortcomings of a broader approach, because partially incomplete data and inconsistencies across countries limit our ability to draw general inferences (see Megginson and Netter, 2001, p. 346).[5] On the other hand, we can focus on systematic variations across countries and identify the conditions that appear to be

[3] See, e.g., Megginson and Netter (2001), Djankov and Murrell (2002), and Denis and McConnell (2003) for thorough discussions of the privatization phenomena. Megginson (2005) discusses bank privatization.

[4] We define banks as financial intermediaries that accept deposits and make loans.

[5] For example, we can not examine the detailed tradeoffs between local and national political factors that Clarke and Cull (2002) are able to identify in their investigation of Argentina.