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Disentangling liberalization and privatization policies: Is there a political trade-off?

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ABSTRACT

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We empirically investigate the political determinants of liberalization and privatization policies in six network industries of 30 OECD countries (1975–2007). We unbundle liberalization and privatization reforms and study their simultaneous determination in a two-equation model. Unlike previous studies, we account for cross-effects between the two pro-market measures. Our findings unveil that both right-wing and left-wing governments implement liberalizations and privatizations, showing a common trend under the so-called neo-liberalism wave. However, although the privatization rate is higher than liberalization in right-wing environments, the opposite occurs under left-wing governments. We argue that ideological cleavages still affect pro-market reforms, particularly the combination of privatization and liberalization policies. We conclude that different deregulation patterns should be expected under governments characterized by different political ideologies. Our results shed new light on the literature investigating the political-economic rationale underpinning pro-market choices. *Journal of Comparative Economics* **xxx** (xx) (2013) xxx–xxx. University "G. d'Annunzio", Viale Pinadaro 42, 65127 Pescara, Italy; Sapienza University of Rome, Via del Castro Laurenziano 9, 00100 Rome, Italy; Toulouse School of Economics, James E. Rogers College of Law, University of Arizona, P.O. Box 210176, Tucson, AZ, United States.

1. Introduction

In the last three decades, most OECD countries have experienced a deep and extensive wave of pro-market reforms in sectors once dominated by State-controlled monopolies, such as network industries (Armstrong and Sappington, 2006; Guriev and Megginson, 2007; Roland, 2008). Policies aimed at removing restrictions to entry into previously heavily regulated markets (e.g., electronic communications, transportation, energy, postal services) and promoting government withdrawal from corporate ownership have been implemented throughout the world, and especially in OECD countries (Conway and Nicoletti, 2006), stimulated by globalization and by the diffusion of pro-market reforms.

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In addition to the analysis of economic determinants (Vickers and Yarrow, 1991; Levy and Spiller, 1996; Newbery, 1997, 2002; Armstrong and Sappington, 2006), a large group of scholars have investigated the role of institutional and political determinants of market-oriented policy in network industries, following the "political economics" approach (Persson and Tabellini, 2000; Persson, 2002; Besley and Case, 2003; Besley et al., 2010). Within this framework, empirical studies commonly consider privatizations and liberalizations as a whole, under the comprehensive umbrella of pro-market policies (e.g., Pitlik, 2007; Bortolotti and Pinotti, 2008; Potrafke, 2010). However, disentangling privatization and liberalization initiatives suggests that the extent and implementation of the two policies in OECD network industries followed quite a heterogeneous pattern. Some countries have actually focused more on decreasing barriers to entry (i.e., liberalization policies) in previously State-owned monopolies, and some others have been much more concerned with the reduction of State ownership in incumbent firms (i.e., privatization policies).[1] Thus far, the empirical literature has failed to acknowledge country-level variations in which liberalizations and privatizations have been differently combined in network industries. Consequently, we still lack a full understanding of how so many countries adopting similar reforms, simultaneously and in identical sectors, actually differ in their policy "bundling", intensity and implementation of, respectively, liberalizations and privatizations.

The purpose of this article is to investigate precisely the determinants behind such cross-government variations in pro-market policy adoptions. Different political and economic configurations, partisan politics, and interest concentrations may play roles in this respect. Here, all else being equal, we focus our analysis on the role of partisan orientation in the government in shaping the different liberalization–privatization patterns we observed in OECD network industries over the last thirty years.

A traditional view still supports the idea that governments dominated by right-wing parties tend to espouse liberal economic programs, including deregulation, privatization and liberalization, and, generally, the introduction of competition (Boix, 1997; Rodine-Hardy, 2013). Conversely, left-wing governments typically are assumed to foster stronger State intervention, defending "national champions" as massive employers and heavily regulated markets as a secure manner with which to control price and wage dynamics (e.g., Appel, 2000). According to this view, the enduring wave of pro-competitive initiatives should be exclusively attributed to right-wing executives. Recent empirical research shows, however, that after the nineties, the so-called "second-wave neoliberalism" also flooded left-wing governments, boosted by a process of policy diffusion and imitation in the global arena (Dobbin et al., 2007; Stiglitz, 2008). Accordingly, we should expect a convergent pattern between right-wing and left-wing governments, with the former fully embracing the entire range of pro-market policies and the latter progressing toward a similar path.

Surprisingly, available data, when properly parsed, suggest quite a different story. In Fig. 1, we report the intensity of liberalization and privatization policies adopted by right-wing and left-wing governments in OECD network industries, measured as the yearly variation of, respectively, the OECD's 2009 indicators of entry barriers and public ownership over the last three decades. Data show that right-wing governments pushed for privatization policies more intensively than left-oriented ones, whereas left-wing governments favored liberalization over privatization.

Disentangling pro-market policies reveals that, within the common neo-liberalism wave, a partisan trade-off between privatization and liberalization characterizes OECD countries' governance of network industries. Thus, on the one side, the alleged primacy of right-wing governments in advocating opening markets to competition – by both privatization and liberalization policies – is to be challenged. On the other, data suggest that traditional ideological biases have not been completely absorbed by converging policy diffusion processes in the globalization era. Rather, alternative pro-market paradigms, based on various combinations of privatization and liberalization intensity, appear to have emerged in OECD network industries, driven by governments' partisan orientation. If confirmed by rigorous econometric inquiry, this result would overturn the main conclusions reached thus far by the existing empirical literature, forcing reconsideration of the political and economic rationale behind these two alternative pro-market paradigms as they have evolved and been reinforced over the last decades.

In this paper, we investigate whether such observed patterns are robust enough for a rigorous econometric analysis. We employ the largest available database on pro-competitive policies (OECD, 2009). This database covers 30 OECD countries observed from 1975 to 2007. In addition to being the longest time span for which rigorous data are available, this period also includes the entire liberalization and privatization waves observed in OECD network industries. We used information on sectoral privatization and liberalization concerning six sectors (passenger air transport, telecommunications, electricity, gas, post, and rail) and thus utilized three sources of exogenous variation (country, time, and industry). We then estimated two equations (one explaining privatization interventions and the other explaining liberalization interventions) using Seemingly Unrelated Regression (SUR) to account for the presence of unobservable factors responsible for the simultaneous determination of privatization and liberalization. Our econometric analysis identifies the existence of a causal relation underpinning the graphical correlation between governments' ideology and pro-market policies displayed in Fig. 1, with right-wing parties favoring privatization over liberalization and left-wing parties favoring liberalization over privatization. These effects are shown to be robust in a number of different empirical specifications.

In addition to the econometric findings, our study contributes to existing empirical political and economic literature on pro-market reforms in three manners.

[1] In the Appendix, we provide a panel of graphics (Fig. A1) showing liberalization-privatization patterns of OECD countries.

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