

# **Take the Money and Run? Privatizations and Rent Extraction**

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# This paper:

- We study corrupt and non-corrupt privatizations in Chile
- Corrupt privatizations
  - Extract rents from State during dictatorship (1973-1990) and democracy (1990-)
  - Acquire political connections and illegally finance political campaigns
  - Expropriate minority investors

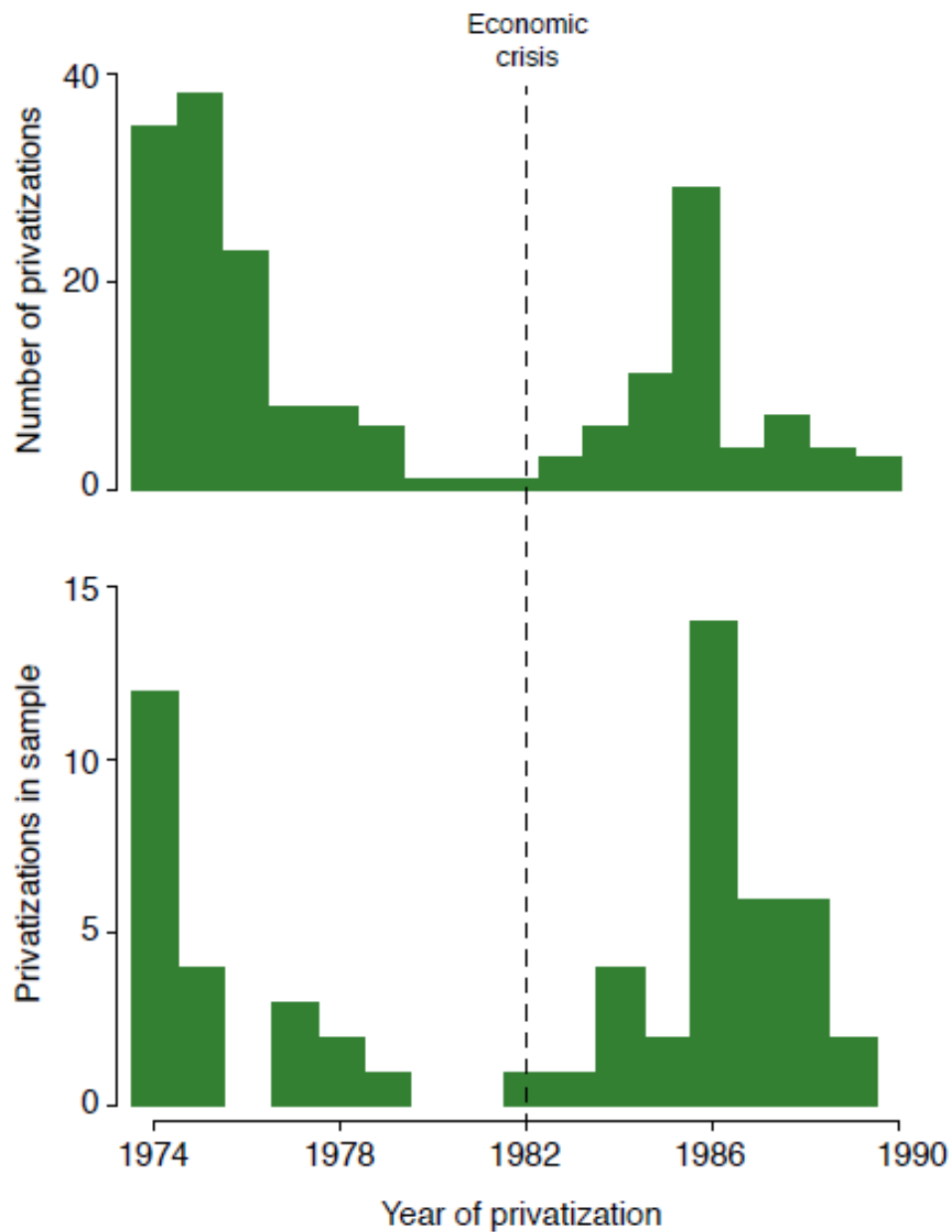
# Corrupt Privatizations

- We know very little about them, even though common in many places (Russia, China, Argentina, Poland, etc.)
- In China Fisman and Wang (2014) find lower performance and evidence of tunneling

# Bit of Chilean history

- Allende was Chile's president between 1970-1973
  - Nationalizes 85% of financial sector, 100% utilities, 70% communications, etc. (Lüders, 1993; Larrain and Meller, 1991)
- After 1973's coup Pinochet implements economic reforms and privatizes almost everything
  - Mainly two privatizing rounds, first returning Allende's nationalized firms and then the "rest"

Figure 1: Privatizations by year



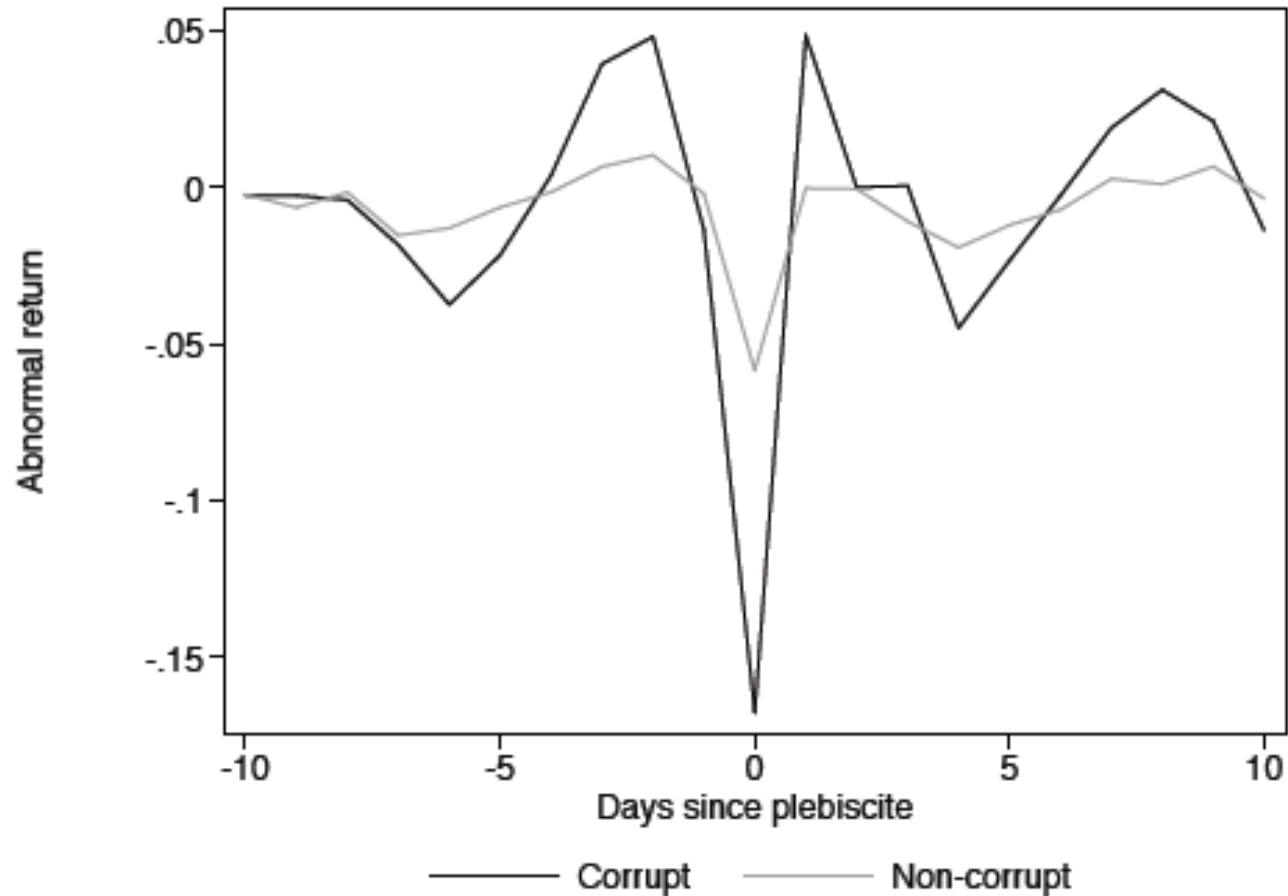
# Chile's Corrupt Privatizations

- Firms sold with significant discounts
- How did they take place?
  - “The conditions for the sale were decided by the same people behind the privatizations themselves, and these same people were able to purchase large packages of shares at very advantageous prices...” (Hunneus 2006)
- We find no significant differences pre-privatization
- In 1990 corrupt privatizations account for
  - 35% of Chile's stock market
  - 2% of GDP

# Exploiting Chile's unique setting

- 1988's October referendum
  - Would allow Pinochet to continue for eight more years
- Surprisingly Pinochet lost (56/44)
- Provides exogenous source of variation into value of political connections (like Fisman (2001))
  - We perform an event study

# Abnormal Returns around Referendum





# Between Referendum and Democracy

- Referendum implies elections in Dec 1989
  - Almost certain change of regime, starting March 1990
- What do you do after losing your Dictator?
  - Do we see firms running to grab more rents?
  - We look at the only State-owned bank, Banco del Estado, studying whether it provides (cheaper) loans to corrupt firms in this time

	Indicator for loans with Banco del Estado	Average interest rate with Banco del Estado	Leverage
	(1)	(2)	(3)
<hr/> PANEL A: years 1988–1990 <hr/>			
Corrupt privatization	0.43** (0.16)	-0.03* (0.01)	0.05 (0.04)
Firms	48	12	50
R-squared	0.47	0.85	0.49
Pre-privatization controls ( $X_{ij}$ )	Yes	Yes	Yes
Industry fixed effects ( $\gamma_j$ )	Yes	Yes	Yes
Mean of dependent variable	0.30	0.11	0.33
<hr/> PANEL B: years 1986–1987 <hr/>			
Corrupt privatization	0.10 (0.17)	-0.00 (0.02)	-0.00 (0.08)
Firms	48	20	50
R-squared	0.48	0.58	0.19
Pre-privatization controls ( $X_{ij}$ )	Yes	Yes	Yes
Industry fixed effects ( $\gamma_j$ )	Yes	Yes	Yes
Mean of dependent variable	0.23	0.09	0.35

# Democracy arrives in 1990

- Change of regime since new government actively opposed Pinochet
- We study two dimensions
  - Political connections through revolving door and illegal campaign financing
  - Ownership and performance: looking for tunneling (Morck et al 2005)

Dependent variable:	Coefficient corrupt privatizations ( $\beta$ )	Mean of dep. variable
Hired any politician in 1995	0.52** (0.23)	0.17
Hired any politician in 2000	0.56** (0.23)	0.29
Hired any politician in 2005	0.41* (0.23)	0.31
Hired politician of the <i>old regime</i> in 1995	0.41* (0.21)	0.14
Hired politician of the <i>old regime</i> in 2000	0.62*** (0.21)	0.19
Hired politician of the <i>old regime</i> in 2005	-0.01 (0.22)	0.21
Hired politician of the <i>new regime</i> in 1995	0.09 (0.17)	0.05
Hired politician of the <i>new regime</i> in 2000	0.01 (0.10)	0.12
Hired politician of the <i>new regime</i> in 2005	0.52** (0.20)	0.13
Illegally financed political campaigns	0.51*** (0.18)	0.14
Firms	50	
Pre-privatization controls	Yes	
Industry fixed effects	Yes	

Dependent variable:	Coefficient corrupt privatizations ( $\beta$ )	Mean of dep. variable
Pyramidal ownership structure in 1995	0.39*** (0.12)	0.52
Pyramidal ownership structure in 2000	0.24** (0.10)	0.62
Pyramidal ownership structure in 2005	0.24** (0.10)	0.62
Wedge in 1995	0.28* (0.16)	0.33
Wedge in 2000	0.14 (0.17)	0.50
Wedge in 2005	0.12 (0.17)	0.52
Return over equity in 1995	-0.05 (0.05)	0.20
Return over equity in 2000	-0.06* (0.03)	0.17
Return over equity in 2005	-0.08*** (0.02)	0.17
Firms	50	
Pre-privatization controls ( $X_{ij}$ )	Yes	
Industry fixed effects ( $\gamma_j$ )	Yes	

# Corollary (not yet in the paper)

- We recently learnt that Chile's Socialist Party was investing its endowment in Soquimich
  - Soquimich was corruptly privatized to Pinochet's son in law
  - Soquimich illegally financed political campaigns, including those from the Socialists



# Conclusion

- Corrupt privatizations have significant and long lasting effects
  - Rent extraction both during dictatorship and democracy
  - Expropriate minority investors