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PRIVATIZATION OF PUBLIC ENTERPRISES IN LATIN AMERICA

Edited by William Glade

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INSTITUTE OF THE AMERICAS
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Preface

Privatization, or the turning over of some government enterprises and activities to private investors, has become a key part of Latin America's drive for modernization and revived growth in the last decade of the twentieth century. Latin American governments have come to realize that they have had too large a role in the production of goods and services.

When governments try to produce what the private sector can do as well or better, the state's managerial and financial resources are diverted from essential services that only the state can provide on an equitable basis to all its citizens—education, public health, and roads, among others. As Mexico's President Carlos Salinas de Gortari has pointed out, privatization is thus not necessarily a conservative's dream of shrunken government, but rather a neoliberal conception of government concentrating on what only it can do, thus doing it better. As William Glade persuasively argues in his conclusion to the book, privatization is most successful as part of a broad program of structural reform to infuse the whole economy with competitive market forces—a set of reforms that much of Latin America now sees as a key for its economic revival and long-term growth.

With the exception of Chile, Latin American governments began the privatization process slowly and selectively, with relatively minor enterprises targeted for transfer to the private sector. In recent years, however, these governments have become increasingly committed to accelerating and broadening privatization, both as a matter of preference and as a

response to fiscal realities. Labor conflicts in state-owned enterprises, inability to gain more substantial relief from the external debt service burden, the need to further reduce inflationary government deficits by eliminating subsidies to unprofitable state-owned enterprises, the need to generate significant new resources to attack the massive "social deficit" resulting from nearly a decade of economic crisis and austerity budgets, and the huge capital investment needs of even profitable state-owned enterprises that are urgently in need of technological modernization—all played a part in the intensification of government efforts to privatize. Opinion polls showing broad public support for the policy—in Mexico, even for reprivatization of the banking system, nationalized in 1982 by President José López Portillo—undoubtedly encouraged governments to proceed.

Accordingly, the terms of the debate over privatization in Latin America have shifted dramatically. Increasingly, the issue is no longer *whether* to privatize, or even *what* to privatize, but *when* and *on what terms*—selling price, foreign or domestic buyers, buyers' commitments to invest in modernization and so forth. Nevertheless, important questions remain unanswered about the feasibility of large-scale privatization programs under prevailing international market conditions and their effects on income distribution and sectoral concentrations of capital in the long term.

Privatization of state-owned enterprises is an experiment in progress on a global scale, and only through systematic comparative analysis can the strengths, limitations, and long-term consequences of this policy be fully understood. In planning the May 1988 conference from which the book *Privatization of Public Enterprises in Latin America* resulted, the Center for U.S.–Mexican Studies and the Institute of the Americas thus felt a need to examine a wide range of experiences in Latin America. This executive summary presents the main findings of that volume.

The study takes an in-depth look at early experiences with privatization in six Latin American countries. The lessons drawn by the Latin American authors of the case studies and editor William Glade constitute a valuable guide to the opportunities and pitfalls in Latin

America's next phase of privatization and structural reform processes, now gaining increased momentum and political support throughout Latin America.

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Summary of Conclusions

The book *Privatization of Public Enterprises in Latin America* looks at experiences with privatization in six countries—Argentina, Brazil, Chile, the Dominican Republic, Mexico, and Trinidad and Tobago—to draw lessons about the timing and implementation of privatization for the future. Despite all the talk about privatization, the steps actually taken to advance the process differ from country to country. Of the countries studied, only Chile has followed the process to its logical conclusion. By transferring a broad range of decisions on resource allocation to the market, Chile has, in effect, privatized major macroeconomic variables. In the other five countries studied—Argentina, Mexico, Brazil, the Dominican Republic, and Trinidad and Tobago—much less has actually been accomplished in the way of privatization.

1. One important impediment to privatization has been the functionaries of the public enterprises. These workers—white-collar employees, managers, directors, and associated professionals—have the most direct interest in resisting change. It is small wonder that they should resist privatization launched in an economic environment bereft of job opportunities, adequate employment compensation, retraining, job counseling, and placement assistance. The economic anemia that intensifies the need for privatization is thus a major obstacle to its implementation.

2. In Chile, Argentina, and Brazil, the routine political processes were put on hold for varying periods and with varying degrees of severity. Removing the traditional political

hurdles from 1973 to 1988 allowed Chile to move fastest and farthest in privatization and to take the lead in experimenting with forms and procedures. Clearly, however, one cannot extract from these cases the recommendation that civilian politics be thrown into the deep freeze simply to neutralize the opposition.

3. It is important to begin privatization with reforms that provide a hospitable framework. Such reforms would include:

   - liberalizing trade
   - setting and maintaining a realistic exchange rate, with any deviation on the side of undervaluation
   - gaining control of the public budget by phasing out subsidies to public enterprises and decontrolling prices
   - stepping up tax administration
   - strengthening the capital market
   - broadening the ownership of capital
   - reducing the number of employees throughout the public sector

   These changes would eliminate a multitude of opportunities for economic rent and in so doing would enhance the social acceptability of the whole economic package, including privatization, and improve efficiency of decision making.

4. The bold approach to privatizing appears to be more successful than piecemeal measures, for two reasons:

   - The rapid adoption of these policies clearly places major adjustment costs on the shoulders of those most able to bear them and forces entrepreneurs to link success with production virtuosity in contestable markets.
   - These broad measures force public enterprise managers to take a more commercial view of their operations. Reduced

access to subsidies, coupled with installation of better performance monitoring and evaluation systems as in Brazil and Chile, seems to impel public enterprise management to embrace a host of organizational changes that improve efficiency in the public enterprise sector—provided, of course, that their hands do not remain tied in matters such as deployment of the labor force and pricing.

5. A hospitable environment need not in every case be in place before privatization begins. Indeed, semiprivatization (joining public capital and management and private capital and management in mixed enterprises) and simulated privatization (requiring that public enterprise managers emulate the performance norms of private enterprise) are an integral part of the first phase, regardless of whether a decision is made subsequently to move on to outright privatization. The Brazilian, Argentine, and Chilean cases all reinforce the view that reprivatizations can readily get under way while preconditions are being put in place.

6. Measures to bring labor in the public enterprise sector into consultation on organizational improvements and to relocate workers to other parts of the job market while payroll reduction takes effect are essential. The Chileans have taken the lead in fostering employee stock ownership programs. The willingness of the Mexican government to transfer some of its public enterprises to "social enterprises" owned by unions may well have aimed to mollify the labor movement in that country. In addition, there is limited evidence that in certain fields characterized by a highly skilled labor force and dynamic prospects, public enterprise functionaries may themselves take the initiative in seeking privatization.

An Overview of *Privatization of Public Enterprises in Latin America*

In today's development crisis brought on by the debt crisis, privatization of public enterprises appeals to many developing countries. As part of a larger set of structural adjustment policies that aim to give less-developed and newly industrializing economies a better shot at making their way in the world economy, privatization can be beneficial in several ways. Privatization strategies can address the twin needs born of balance-of-payments difficulties: to consolidate the financial position of the public sector and to improve the competitiveness of the economy. Governments have also felt the need to get the public enterprise sector in hand so that by lowering public sector borrowing they may arrest inflation, regardless of the level of external indebtedness. More generally, privatization is a response to new policy imperatives originating in the restructuring of production patterns that took place in the world economy in the 1980s.

Experiences of Six Countries

The authors of the book examine privatization efforts in six countries, and their findings are summarized here.

Chile. By many standards the current effort in Chile has been the most successful privatization project in Latin America to date. The chapter on privatization in Chile by José Piñera and William Glade notes that of the twenty-nine enterprises originally included in Chile's 1985–1988 privatization program, eight have been totally and twelve partially privatized, with the remainder now moving toward privatization. Property ownership has thereby been greatly diversified; the number of individuals owning stock grew by 77 percent in the 1985–1988 period.

Although almost all of Chile's remaining public enterprises are profitable, a continuation of the privatization program should nevertheless bring a net social gain stemming from improved access to capital and foreign research and development. Privatization may have introduced more dynamic management and increased motivation among employees who now work in "their own" firms. This conclusion remains somewhat conjectural but appears to be reflected in the companies' improved operating results. In other words, through the free market's allocation of resources, privatization has likely created more jobs and opportunities, contributed to faster economic growth, raised wages, and reinforced a free-market economic philosophy. The privatization of public utilities or natural monopolies has also been accomplished in a reasonably efficient manner. Marginal pricing schemes have been instituted for these firms, and they seem to have experienced no difficulty in marketing their shares. The government has benefited as well, not only from the receipt of considerable sums of cash but also from the higher taxes privatized firms will likely pay in the future.

One of the most important elements of the Chilean program was the privatization of the pension system. This change played a large role in strengthening the capital market and facilitated privatization by providing a source of private investment. It set the stage for a considerable expansion of employee stock ownership plans in Chile.

Although it is too soon to fully evaluate the effects of the Chilean privatization program, there have been significant improvements in the average productivity of labor since the change in administration of these enterprises. Employees and labor unions have changed their attitudes toward the management of the firms and constantly seek means to improve their firms' efficiency. New firm managers are also pursu-

ing new investment and diversifying their enterprises. Chile has been subject to some political criticism for its program, but no more so than other developing countries.

Mexico. Oscar Humberto Vera Ferrer recounts Mexico's experiences with privatization. In an attempt to cope with the severe economic instability Mexico faced after the debt crisis began in 1982, President Miguel de la Madrid embarked in 1985 on a series of economic reforms that included a reduction in the number of public enterprises. In Mexico this process is officially known as disincorporation. Of the 236 entities to be disincorporated, 65 were to be sold, 55 liquidated, and 7 transferred to local governments. The results of the program, however, are unclear. Official figures on the number of disincorporations and the size of the public sector are inconsistent. Whatever the extent of disincorporation, its macroeconomic effects appear to have been quite small.

There has been some speculation about why de la Madrid announced early in his administration that disincorporations would take place, but did not actually activate the process until 1985. Oscar Humberto Vera Ferrer rejects explanations based on the government's poor financial position, ideology, and the denationalization of Mexican enterprises, and adopts the view that the program was an attempt to restore the government–private sector relationship. From 1940 to 1970, government and the business community maintained a partnership in which politics was reserved for the political class and the economy was reserved for the private sector. The expansion of the state into the economic arena during the administrations of Luis Echevarría (1970–1976) and José López Portillo (1976–1982) led to growing discontent within the private sector. It appears that the disincorporation strategy has indeed mended the relationship, and it is being continued by the administration of Carlos Salinas de Gortari.

Brazil. The concept of privatization has gathered surprising popularity in many influential segments of Brazilian society, according to Rogério L. F. Werneck. During the administration of Jose Sarney (1985–1990), the federal government emphatically reiterated its commitment to this idea and even announced an ambitious, though vague, privatization program. Yet the effective advancement of privatization has been modest.

Although the relative magnitude of transfers to the private sector is small, several privatization cases seem to have paved the way for a bolder effort in the near future. Most of the enterprises that have been privatized so far are former private concerns that were absorbed by the public sector when they were on the verge of bankruptcy.

A number of groups oppose extensive privatization of public enterprises, including managers of those enterprises, labor groups, and certain politicians and government officials who see public enterprises as important sources of power. In addition, economic factors may constrain further privatization. To sustain higher growth rates, the Brazilian economy will require a much higher investment rate, supported by higher domestic savings. Inadequate investment financing is bound to pose difficulties for privatization.

Argentina. Argentina's recent privatization experience has been influenced by three factors: the relationship between the public enterprise sector and the larger economy, the way in which the privatization program has been organized, and official perceptions of the process. Despite the efforts of of Raúl Alfonsín (1983–1989), few public enterprises were actually transferred to the private sector during his term. Javier González Fraga argues that this lack of privatization resulted from government indecision or inability to sell and a lack of interest within the private sector rather than from adherence to a specific political ideology or lack of a comprehensive plan.

The basic foundations for a more effective privatization process were laid during the first months of President Carlos Menem's administration in 1989. A number of important enterprises have undergone or are undergoing privatization, including the Argentine telephone company, several television stations, some highways, the railway system, a light and power company, and a shipping company. It is too early, however, to evaluate these efforts. Although some groups such as unions still oppose privatization, Argentina's fiscal crisis and the need to increase international competitiveness remain strong arguments in favor of privatization.

The Dominican Republic and Trinidad and Tobago. Privatization is increasingly recommended to the Caribbean countries as an alternative to inefficient and easily corruptible government-owned enterprises. Although

privatization of state enterprises in many cases clearly contributes to increased productivity, it is not always feasible in practice and may not lead to improved social welfare. Francisco E. Thoumi examines the cases of the Dominican Republic and Trinidad and Tobago, which face particular policy design and implementation problems related to the small size of their markets, the personalized nature of economic relations, the special characteristics of their power structures and political systems, and the historical role of the government.

Public enterprises in the Dominican Republic have generally been characterized by inefficient production, poor management, and high subsidies. Although several of them are strong candidates for privatization, including the state sugar council and the electric company, the government has not initiated a privatization program. This delay can be attributed to three factors. First, the public enterprises meet certain political needs and selling them would result in unemployment and tight internal controls, conditions the bureaucracy wants to avoid. Second, the state corporation that manages many public enterprises can subsidize inefficient firms with profits from the better run—hence, more salable—ones. Third, privatizing enterprises would mean that the government would have to assume their liabilities directly.

Trinidad and Tobago has also failed to adopt a privatization strategy, but the obstacles to privatization differ from those in the Dominican Republic. One candidate for privatization is the sugar industry, which the government nationalized when oil changed the country's comparative advantage. The government now needs to find ways to cut down on sugar output and entice people back to the rural sector, and the role of privatization in these changes is not clear.

Trinidad and Tobago's petrochemical industries cannot be privatized without foreign partners because the resources needed far exceed the wherewithal of the local private sector. Equally important, the export markets for these petrochemicals are already served by powerful transnational corporations (TNCs). Using TNCs as foreign partners creates special problems, however. Recent colonial history has engendered attitudes that make it politically difficult for the government to bargain with TNCs. Further, some potential partners have openly opposed or blocked Trinidad and Tobago exports. As a result, the road to privatization is not likely to be smooth.

Conclusion

It would be a mistake to try to distill an optimal privatization strategy from the six cases included in the study. The problem is partly the nature of the policy process itself. Typically, policy makers from different countries assign different priorities to various policy objectives, just as they are likely to hold different views on the effectiveness of particular policy instruments. Privatization has therefore worked quite differently from country to country during the past decade or so, though the expectations that accompanied its placement on the policy docket were probably fairly uniform. Governments normally saw privatization as part of a larger policy package that includes liberalization, rational pricing, fiscal and monetary discipline, and refocusing state efforts on priority activities.

One of the most valuable lessons to be extracted from the different experiences of various countries is that it is important to begin with broad reforms that will improve the overall environment for privatization. Countries should liberalize trade, set and maintain a realistic exchange rate, phase out subsidies to public enterprises, and decontrol prices to give management more autonomy. Countries should also strengthen their capital markets by measures such as gaining greater control over government spending, improving their tax administration, and broadening the ownership of capital. These changes would allow the private sector to respond to the opportunities offered by privatization and, incidentally, raise the amount the state might reasonably expect to garner from its divestitures.

The combined experiences of the six countries covered in the study suggest that privatization has been gathering momentum, especially if the concept is extended to include not only formal privatization and reprivatization, but also simulated privatization and semiprivatization. The driving force in these cases is essentially structural, not political. The debt crisis may have provoked more discussion of privatization's desirability, but it has simultaneously reduced the capacity to privatize, at least in the short run. It seems unlikely, however, that there can be any return to the now outmoded policy framework that propelled the region into the industrial age in the four decades or so that followed 1930.

About the Contributors

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