IMPACT OF PRIVATIZATION IN LATIN AMERICA

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By drawing on the experiences in Argentina, Chile and Mexico regarding structural adjustment by means of privatization, this paper highlights the point that such a reform does pay off despite implementational obstacles.

INTRODUCTION

The 1980s were especially difficult years for developing countries in general. Average growth was cut to half, from nearly 6 per cent in the 1970s to about 3 per cent. The depressed commodity and oil prices slowed growth, but the continued emphasis of these countries on outward looking policies and enterprise reforms has helped them counter some of the adverse effects. This success can be seen by the improvement in growth rates in the late 1980s.Of the various alternatives of privatization of state-owned enterprises, deregulation of industries, separation of control from ownership, liberalization of trade policies and financial markets, the most visible policy initiatives have included privatization of state-owned enterprises (SOEs).

Privatization is not a new phenomenon in Latin America. In recent times two waves of privatization emerged in the region: the first, in the mid-1970s, took place almost exclusively in Chile, and the second, beginning in the mid-1980s, continues to the present. The second has been far more extensive than the previous privatizations in regard to the number of countries involved, the number of state-owned enterprises for sale, the size of those companies, and the amount of each sale.

Since the mid-1980s, the offering of state assets to private investors has been spiralling. By 1990 nearly US $ 5 billion of state equities had been sold to the private sector. The leading countries in this second wave have been Mexico and Argentina, with sales of US $2.47 billion and US $2.29 billion, respectively. The sale of state equities has contributed considerably to the overall increase of private foreign investment in the region, which rose from US $ 15 billion in 1989 to US $ 24 billion in 1990. Further, the progressive consolidation of economic stability in several countries and the attractive profits offered by local stock markets have created a massive inflow of foreign capital into Latin America. Some countries such as Argentina, Mexico and Chile have been explored here because privatization there is more advanced and the reforms more significant. The later privatizers are Brazil, Bolivia, Ecuador, Uruguay and Venezuela.

ARGENTINA

The Argentine privatization program took off rapidly after the election of President Carlos Menem in July 1989. The prime intent was to bring an end to the state-corporate hegemony that had governed Argentina for so long. With the adoption of the Convertibility Plan in early 1991, priva-

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tization took on even greater importance in increasing Argentina's international competitiveness. Argentina's privatization programme was characterized by its scope, speed and breadth. In 1989, the 13 largest public enterprises (PEs) (excluding defence industries) showed an operating deficit of $3.8 billion on revenues of $8.7 billion. This operating deficit had increased by 35 per cent for the first half of 1990 and 4 of the enterprises accounted for half the total losses. During 1990-92, the government closed or sold virtually all of its public enterprises. The total market value of assets sold is estimated to be over $22 billion. The proceeds have gone a long way towards reducing both the external and the domestic public debt.

Argentina's privatization policies of the 1990s seem to be pursuing multiple objectives: improving the quality of services; increasing private financing of investments; limiting the power of unions and big business; reducing the foreign debt by converting much of it to shares in privatized companies, thus alleviating pressure on the balance of payments, and obtaining additional liquidity for the public sector in an effort to stabilize the economy.

The process of privatization has generated substantial interest from foreign and domestic investors. More than 200 firms have participated so far, averaging about $50 million per transaction (excluding concession agreements and the sale of excess building and land). The main methods of privatization have been Private Sale and Joint-Venture (see Chart 1).

The proceeds from privatization have gone a long way towards reducing both the external and the domestic public debt. As of December 1992, the nominal face value of foreign and domestic debt was reduced

Chart 1: Argentina's Privatization from 1988-92

Enterprise	Activity	Year	Method
Austral			
EN Tel, TELCOM & TELEFONICA	Telecommunication	1990	Private Sale
Aerolines Argentines	Airlines	1990	Private Sale
POLISUR, PETROPOL, INDUCLOR, MONOMEROS, RIO TERCERO	Petrochemicals	1990	Private Sale
YPF S.A.	Oil Fields	1992	Joint Venture
SEGBA	Power Utility	1992	Private Sale
Railway Services	Railroads	1992	Private Sale
Gas del Estado Transmission & Distribution	Natural Gas	1992	Private Sale

by $ 12 billion. Debt reduction was particularly important in the first two major sales; the bidding documents required an up-front cash payment as minimum price, turning the bidding into a contest of external debt in instruments offered.

Furthermore, privatization is expected to generate at least $ 1.5 billion in annual savings through the reduction in federal government budgetary support to public enterprises. In addition, there should be a long-term impact on tax collections as the private corporations pay value-added taxes (VAT) and profit taxes; the former public enterprises rarely met their fiscal obligations. In the case of telecommunications, the two privatized companies paid a total of $74 million in profit taxes in their first year of operation.

The sale of public enterprises was relatively successful. Labour, economic, institutional and legal problems kept policy-makers busy in Argentina. A major factor affecting the process was the very important decision made by President Menem to proceed rapidly, completing most of the privatizations by the end of 1992. Combined with the speed of the Argentine programme was the decision to begin with the largest, most difficult enterprises: the airline, telephone company and railways.

CHILE

Chile has had one of the most extensive privatization experiences in the developing world. It provides one of the richest case studies to date. In 1973, the government had to provide public sector subsidies amounting to more than US $500 million, while the fiscal deficit rose to 24.7 per cent of gross domestic product (GDP) and inflation bore down on consumers at a rate of more than 500 per cent per annum. Between 1974 and 1989, under the military rule of General Augustino Pinochet, more than 550 of the largest state-controlled enterprises were directly generating US $2.5 billion in revenues. In that period, the SOE share in gross domestic product (GDP) fell from 39 to 16 per cent. Deregulation, liberalization and privatization have been major elements of economic policy since 1973. The privatization process reduced significantly after Partricio Aylwin became the first democratically elected President in March, 1990.

In the first round of privatization (the 1970s), the main objectives of privatization were economic. They were : (a) to finance public sector deficit; and (b) to increase economic efficiency.

In the second round of privatization (in 1985), the list of objectives was expanded to include the following: the normalization of the financial and productive institutions of the odd sector; the generation of resources for public debt repayment and necessary investment in public services and general economic infrastructure; a strengthened financial position and increased investment in SOEs; an increase in the availability of investment instruments, especially for the pension funds and a strengthening of the capital market in general; and the spreading of ownership through the offering of favourable purchasing conditions.

Chile's privatization experience has been unique in both scope and diversity. The programme which started in 1974 lasted seventeen years.

The first round of privatization (1974-78) took place in the background of an unstable macro-economic environment. It also resulted in a high concentration of ownership of the privatized firms, since the buyers were mainly large domestic parties that already exercised considerable influence in the economy. The programme suffered a setback when many of the privatized enterprises failed and had to be re-nationalized during 1981-83 to rescue them from bankruptcy. The system resulted in the deep financial crisis of 1982-83.

The second round of privatization (1985 onwards) was characterized by more careful control of the process by the setting up of a strong organizational structure to implement the programme. Different forms of privatization were experimented with; for example, widespread share ownership, workers' participation or labour capitalism, purchase by large private and foreign investors, and debt equity swaps. The main modality has been public offering of shares. This round has been generally regarded as successful in improving efficiency, labour productivity, spreading of ownership, capital market development and attracting foreign investments to Chile (see Chart 2).

According to a World Bank estimate, the programme generated revenues averaging $300 million per annum between 1985-1990, which represented between 1-1.5 per cent of GDP every year. Further, as a result, the debt service ratio for Chile fell from 43 per cent in 1985 to 20 per cent in 1988.

Chile's unique privatization process was on balance successful. It distributed property ownership; it stimulated the private sector to improve efficiency; it opened new invest-

Chart 2 : Chile's Privatization during 1985-89 and 1990-92

A. Company during 1985-89	Activitity	Method
ENDSA	Electricity	Private Sale
CHILGENER	Electricity	Public Offering
CHILQUINTA	Electricity	Public Offering
CHILMETRO	Electricity	Public Offering
CAP	Steel	Public Offering
ENTEL	Telecommunication	Public Offering
LAB. CHILE	Pharmaceuticals	Public Offering
CTC	Telephone	Private Sale
SOQUIVMICH	Nitrate	Public Offering
IANSA	Sugar	Public Offering

B. During 1990-92	Activitity	Year
Compania de Telefonos de Chile	Telecommunication	1990
Zona Franca de Iquique	Freezone	1991
Empresa Minera de Aysen	Mining	1991
Edelnor	Energy	1991
Empresia Electrica de Aysen	Energy	1991
Fongoy	Services	1992

ment opportunities and created new responsibilities for the private sector; and it helped reduce practical and psychological dependence on the powerful and pervasive public sector.

Errors were committed in the process of privatization. Some were predictable; other were unavoidable; and still others put forward by some cirtics were non-existent. The most repeated error — though not unique to Chile — appears to be the lack of transparency in divestitures. The success and failure of privatization in Chile are closely related to certain features of the country's economic development. Because of the unusual nature of this massive privatization, Chile's experience offers numerous lessons to the developing countries who are embarking on the path of privatization.

MEXICO

The case of Mexico is one of a big ongoing privatization programme which has been viewed as a resounding success. By August 1982, Mexico could no longer pay interest on its $ 80 billion foreign debt, and international banks and governments had to come to the rescue with a $6 billion emergency loan package. Between 1982-1992, the government merged, liquidated, transferred or sold 928 out of its 1155 enterprises.

The new economic strategy dates back to 1985, when the then president, Miguel de la Madrid decided to take Mexico into the GATT and, thus, open the economy to trade. Then in December 1987, after the world stock market crash, de la Madrid launched his anti-inflation plan known as the 'Pacto'.

Then Carlos Salinas, Mexico's President from 1988, began modernising the economy through deregulation, privatization and tax reform. One of Salina's first priorities was to bring the country's $100 billion debt under control. In February 1990, Mexico was the first to negotiate debt relief under the Brady Plan, a massive debt-relief programme initiated by the U.S. Treasury Secretary, Nicholas F. Brady. Carlos' successor Ernesto Zedillo Ponce de Leon joined office on December 1, 1994 after a year of turmoil that started with a rebellion in the state of Chiapas and included two major political assassinations. The tensions have disrupted the economy, spoked foreign investors and pushed the peso to the brink of a politically embarrassing devaluation. All this leaves Zedillo with an extremely difficult job.

The main objectives pursued in the divestiture of SOEs in Mexico were : to decrease the size of its structure and to improve the efficiency of the government as an economic regulator; to generate savings for the government by eliminating government subsidies and other related expenditures; and to produce increased productivity in the industrial sector by giving the tasks of production to the private sector in order to meet the new strategy for industrial reconversion and to open markets to foreign competition.

The "New Regulation of the Law of Foreign Investment", published in 1989, liberalizes foreign access to investment in the Mexican equity market.

In its efforts to overcome the crisis, the government implemented a profound restructuring of the economy based on the three main transformations: state reform (privatization of state-owned enterprises), opening of the economy (liberalization and trade reforms), and incentives for private sector growth (new, more lenient regulations for foreign and local investments).

By mid-1991, 826 state-owned enterprises had been transferred to the private sector and 138 more were slated to be privatized, liquidated, merged or dissolved in the near future. Liberalizing the economy was the second major task. The program started in 1983. By 1987 import tariffs ranged from 0 to 20 per cent. By 1990 the Mexican economy qualified as one of the most open economies in the world; the average tariff was 13.1 per cent, import licensing was required for only 2 per cent of the tariff items and the economic sector that still required import licensing (automobiles and pharmaceuticals) was gradually being liberalized. The third goal was the expansion of the private sector. The Salinas administration put into effect, on May 16, 1989, a drastic revision of the Mexican investment regulations. The existing 1973 'Law to Promote Mexican investment and Regulate Foreign Investment' was modified to increase the volume and accelerate the flow of investment capital by providing legal certainty and by simplifying and clarifying the administrative rules and procedures that apply to such transactions.

The first sectors targeted were mining and manufacturing, where small firms were sold in 1988-1989. They were followed by the major sale of a Canaea Copper company for over US $900 million. The Mexican government also put up for sale its ownership in the two airlines, shipyards, trucks and engines, chemicals, sugar and food distribution. Altogether these amounted to approximately US $1.6 billion.

Large scale privatization really became effective in the 1990s, when the government sold the first part of its national telephone company, TELEMEX to domestic and foreign investors for almost $1.8 billion. In 1991, Mexico started massive privatization of its banking sector which was largely nationalized in 1982 in response to the debt crisis. By the end of 1992, 18 banks were sold for a total $12 billion with Banamex for $3.2 billion and Bancomer for $2.5 billion as the largest two (see Chart 3).

Mexico's experience, which many have followed with great interest, was not the result of a rapid policy fix but the conse-

Chart 3 : Mexico's Privatization from 1988-91

Enterprise	Activity	Year	Method
AEROMEXICO	Airlines	1988	Sale of Assets
MEXICANA	Airlines	1990	Private Sale
		1992	Private Sale
TELEMEX	Telecommunication	1990	N.A.
		1991	N.A.
CANAEA	Copper	1990	Private Sale
BANAMEX	Bank	1991	Public Offering
			Private Sale
BANCOMER	Bank	1991	Public Offering
			Private Sale

quence of a persistent, courageous and difficult process of adjustment. The process of adjustment and adaptation was not without setbacks — policy initiatives were taken that proved insufficient to achieve the authorities' objectives; crucial structural reforms were implemented only later in the decade; policies taken in response to changing external conditions sometimes took time to be adopted; and considerable costs in terms of the required adjustment were expended to regain the credibility of government policies. In the end, the policy stance of the Mexican authorities, while involving risks, has paid off, and the country is now poised to enter a new phase of sustained economic growth and financial stability.

The observed success of Mexico has to be attributed first and foremost to the efforts of the Mexican authorities and support of the Mexican people, who, in the end, were the true protagonists in this process. Mexico was not alone in these efforts, however. Government policies were facilitated by the support of multilateral financial institutions (including the International Monetary Fund), the governments of creditor countries and their agencies and commercial banks. The process of co-operation was sometimes difficult but adequate solutions were found to address sometimes the conflicting demands of Mexico and its creditors.

CONCLUSION

The country-case studies indicate that most of the developing economies have been experimenting with privatization since the early 1980s. Their experience has provided a rich interpretation of privatization, both at the theoretical and practical level. Privatization has emerged as a response to both state and market failures, rather than the traditional unilinear vision of state failures only.

The benefits from properly executed privatization have proved to be considerable. Improved scope for expansion and diversification following privatization has contributed to higher labour productivity, increased projects and faster growth in many developing countries.

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