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PRIVATIZATION: THE ROLE OF DOMESTIC BUSINESS

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ABSTRACT

A close examination of the links between privatization programs and domestic business, both in theory and in practice, suggests that the relationships are not nearly so vigorous, uniform, or predictable as conventional promotional arguments imply. It will be argued here that the nature of the relationships between privatization programs and the behavior of domestic business depends upon the goals, methods, and financing of specific national privatization programs as well as on the economic and social characteristics of the private sector in a given country and its macro- and microeconomic policy regime. Privatization programs in themselves are likely to be a secondary and transitory influence on the aggregate behavior of national business with somewhat differing effects and responses within individual sectors of those economies with relatively diverse domestic business communities. As a result, privatization programs are likely to be less important to the incorporation of domestic business into a market-driven development process than other components of economic restructuring and liberalization. These conclusions will be examined briefly in light of the historical record of privatization in Chile, Argentina, Mexico, and Brazil and of interview data with business leaders in Brazil and Chile before and after the installation of their current democratic governments.

RESUMEN

El análisis detenido de los vínculos existentes entre los programas de privatización y las empresas locales, tanto en teoría como en la práctica, sugiere que las relaciones entre éstos no son, ni con mucho, tan fuertes, uniformes, o predecibles como lo implican los argumentos convencionales. En este trabajo se argumenta que la naturaleza de las relaciones entre los programas de privatización y el comportamiento de las empresas locales depende de los objetivos, métodos y financiamiento de los programas específicos de privatización, así como de las características económicas y sociales del sector privado de un país determinado y de su régimen de política macro- y microeconómica. En sí mismos, los programas de privatización ejercen, probablemente, una influencia secundaria y transitoria sobre el comportamiento agregado de las empresas nacionales, con efectos y respuestas variados en sectores individuales en aquéllas economías que cuentan con comunidades empresariales locales relativamente diversas. Como resultado, los programas de privatización son, probablemente, menos importantes para la incorporación de las empresas locales a un proceso de desarrollo orientado hacia el mercado que otros componentes de los programas de liberalización y reestructuración económica. Estas conclusiones se examinan brevemente a la luz de la evolución histórica de las privatizaciones en Chile, Argentina, México y Brasil, así como de la información obtenida a través de entrevistas con líderes empresariales en Brasil y Chile antes y después del inicio de sus actuales gobiernos democráticos.

Introduction

In the conventional appreciation and promotion of the process of economic liberalization in Latin America, especially among multilateral lenders and other international interests, there is generally assumed to be a strong positive relationship between privatization policies and the healthy incorporation of the private sector into a market-driven development process. It is assumed that the privatization of public enterprise will in various ways stimulate development-oriented behavior within national business, and that the opportunities created for profitable business activity will put privatization high on the list of priorities for economic policy among domestic entrepreneurs, management decisionmakers, and investors.

However, a closer examination of the links between privatization programs and domestic business, both in theory and in practice, suggests that the relationships are not nearly so vigorous, uniform, or predictable as conventional promotional arguments imply. It will be argued here that the nature of the relationships between privatization programs and the behavior of domestic business depends upon the goals, methods, and financing of specific national privatization programs as well as on the economic and social characteristics of the private sector in a given country and its macro- and microeconomic policy regime. Privatization programs in themselves are likely to be a secondary and transitory influence on the aggregate behavior of national business with somewhat differing effects and responses within individual sectors of those economies with relatively diverse domestic business communities. As a result, privatization programs are likely to be less important to the incorporation of domestic business into a market-driven development process than other components of economic restructuring and liberalization. These conclusions will be examined briefly in light of the historical record of privatization in Chile, Argentina, Mexico, and Brazil and of interview data with business leaders in Brazil and Chile before and after the installation of their current democratic governments.

Relating Goals and Methods of Privatization to Domestic Business

Privatization as a catchword has come to stand for any withdrawal of government from economic activity. Programs encompassed by privatization policies, however, can vary widely with differing implications for the private sector. Privatization in liberalizing Latin American countries typically refers to the sale of assets by governments, but those sales can take the form of financial securities, e.g., equity shares, or of physical assets. The sales may pertain to once private firms previously nationalized, as in the first wave of Chilean privatization in the 1970s and the current privatization of Mexican banks; or the sales may be of firms that had been saved from failure in the private sector by nationalization; or the privatization may be of enterprises created by governments under *dirigiste* national development regimes, as in the sale of Argentine and Mexican national airlines and public utilities. The sales can be of entire functioning enterprises, of minority or majority partial ownership in joint enterprises, or simply of the physical remains of liquidated enterprises. Privatization can also take the form of leases of government-owned assets, e.g., oil and mineral deposits, to private management or of contracts for management and other services formerly performed by personnel directly employed by the government.

More broadly, privatization can refer to shifting to the private sector the provision of services previously provided by government, by contracting, e.g., of health services, or by entitlements, e.g., tuition grants to students in private schools. Privatization may also be accomplished through less restrictive government regulations, that is, by allowing private firms to enter markets previously restricted to government entities, e.g., the recent issuance of private television broadcasting licenses in Chile. In the broadest economic sense, privatization can also refer simply to the shifting of the cost of services from taxpayers to consumers,[1] e.g., through the removal of subsidies on public services frequently included in the conditions for restructuring of Latin American public debt by the IMF in the 1980s. Typically, the significance of privatization policies in Latin American countries is evaluated by the extent of transfer to the private sector of the controlling interest in economically viable enterprises. The other alternatives, however, are relevant to policymakers seeking the most effective approaches to liberalization for the achievement of a broad range of social and economic goals.

The methods of privatizing are further distinguished by the financing techniques used to effect them. Sales of government assets, for example, may be made directly in exchange for payment in domestic currency or foreign exchange; or the exchange may involve securities, e.g., through the sale of stock in the privatized enterprises or through the conversion of public debt instruments in the form of debt-equity swaps.

The methods chosen by a liberalizing government for privatization and for its financing, along with the related issues raised for domestic business, will depend upon the goals and objectives of the privatization effort. Those goals and objectives can be diverse and not necessarily consistent with business interests or with one another. Theoretical discussion of the economic justification for privatization tends to focus on arguments for the efficiency and constraints of market discipline, both in the internal management of enterprises and in the allocation of national resources.[2] Presumably, private ownership creates both positive and

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[1] Pan A. Yotopoulos, “The (Rip) Tide of Privatization: Lessons from Chile,” *World Development*, Vol. 17, No. 5, 1989, pp. 683-702.

[2] *Vd.* John Vickers and George Yarrow, *Privatization: An Economic Analysis* (Cambridge, Ma.: MIT Press, 1988), esp. Chs. 1-4.

negative incentives for efficient management. Reward structures are typically based on profitability, and in a free market economy inefficient management leads to takeovers or bankruptcies. Moreover, if the conditions for theoretically competitive markets are realized, prices and costs will be kept at levels sufficiently low to preclude unearned rents.

Political and historical justifications for privatization in Latin America by both analysts and decisionmakers in public and private sectors typically incorporate elements of these arguments for economic efficiency into discussions of ideology or of the historical failures of public enterprises.[3] Lacking the discipline of the marketplace, public enterprises have often grown noteworthy for their high costs, low productivity, waste, and vulnerability to political corruption.

In practice, however, the objectives of privatization may be of a more immediate and urgent character, not necessarily related to or consistent with long-run theoretical arguments. One long-run objective, for example, may be to increase internal efficiency in firm management, in which case the least profitable firms may be the most appropriate candidates for privatization. On the other hand, in the short run the priority of macroeconomic stabilization during a time of fiscal crisis may press governments to privatize simply to generate revenues needed to reduce budgetary deficits in government accounts as well as foreign exchange needed to cover deficits in current balance of payments accounts. Under such circumstances foreign investors may be more likely to be courted than their domestic counterparts. However, only the more profitable and well managed public enterprises may readily find buyers, and then perhaps only at prices well below the capitalized value of prospective long-run earnings, which may be heavily discounted by investors for fear of the same fiscal and monetary problems that provoked the privatization effort. Similarly, the lack of sufficient financial capital from tax revenues and other public sources during fiscal crises may induce governments to privatize in order to maintain levels of national investment necessary for growth targets or simply to replace and modernize existing capital stocks through increased access to private capital markets, as in the case of Chile Telecom.

Examples such as these suggest that effects of privatization on the private sector, along with the corresponding reactions to privatization initiatives from the business world, both domestic and foreign, will depend upon a range of issues raised by the objectives, methods, and financing of privatization efforts that affect business behavior. An examination of those issues indicates that privatization in itself is unlikely to be a major determinant of development-oriented behavior by domestic business in Latin America.

[3] *Cf.* “Desregulación y privatización: Fundamentos teórico-conceptuales,” *Desregulación y privatización de empresas publicas en Bolivia* (LaPaz: CIEDLA, 1990), Ch. 4; Steve Hanke, “Lecciones de privatización para América del Sur,” *Estudios Públicos* No. 37, Verano, 1990, pp. 147-164; Horacio Boneo, *Privatización: Ideologías y praxis* and “A Talk with Carlos Menem: ‘Subsidies No Longer Exist,’” *Business Week*, 2 October 1989, p. 46.

Domestic Business and Specific National Privatization Experiences

As already indicated, the objectives and methods of the wide range of Latin American privatization schemes intersect the interests of domestic business variously. Privatization schemes are most likely to intersect the interests of business in ways that are conducive to development objectives when privatization is designed to be instrumental to a larger and coherent scheme of liberal restructuring of the domestic economy that is directed to greater efficiency in national production.[4] If privatization is to be useful, not only symbolically but as an incentive and mechanism to elicit efficient, growth-oriented business behavior, the economic restructuring of which it is a part must emphasize certain key elements. These include consistent and broad reliance on market prices for resource allocation; the enhancement of competitive market conditions, e.g., protection of property rights and the opening of domestic markets to international competition; the development of reliable credit markets with the capacity to mobilize the financial capital necessary for national growth targets; and the avoidance of burdens on the private sector, such as costly regulatory compliance and nonshiftable taxes, that can act as deterrents to domestic investment and entrepreneurial response.

Moreover, even when these elements are present, privatization must take place in a stable macroeconomic climate that makes the transfer of productive assets from public to private sectors politically and economically viable for both parties to the transactions. If domestic business is confronted with losses, cash flow problems, political uncertainty, and the problematic demands of survival in a recessionary environment or in a period of excessive inflation, it cannot be expected to respond to new investment opportunities, nor will credit sources be available to support its development. In times of recession and fiscal crisis, governments are more vulnerable to criticism for selling public enterprises to private purchasers at the bargain basement prices likely to be required to find buyers, especially when such sales are apt to result in short-run layoffs of redundant employees, once market criteria begin to dominate enterprise management. Consequently, given the inherent limitations on market transactions between the public sector and domestic business, privatization, which is typically heralded as an instrument for attainment of macroeconomic targets, itself depends upon attainment of certain levels of macroeconomic performance to become a feasible policy instrument. Even a summary look at the history of some major Latin American privatization schemes reveals multiple objectives and methods of privatization, as well as widely differing macroeconomic contexts and market characteristics, that

[4] *Vd.* William Glade, “The Contexts of Privatization” and “Toward Effective Privatization Strategies” in William Glade, ed., *Privatization of Public Enterprises in Latin America* (San Francisco: ICS Press, 1990), Chs. 1 and 7.

are not directly conducive, and perhaps even counterproductive, to the attainment of market driven goals of efficiency and growth through a reformed private sector.

Chile

In Chile, which is credited with the most successful history of privatization in Latin America, there was heavy participation by domestic business in the earlier, relatively simple, and least successful phases. In the more successful later phases privatization was a single component of a more comprehensive integrated liberalization program with broader distributional objectives. Foreign participation, however, became increasingly important in the later phases and, as we shall see below, has been a dominant influence in the privatization schemes launched more recently in other Latin American countries.

The first wave of privatizations under the Pinochet regime in Chile, in 1974 and 1975, consisted mostly of reprivatization of about 250 firms nationalized without legal transfer during the socialist regime of Salvador Allende. During the next decade the Chilean government disposed of 200 or more remaining state-owned enterprises, among them firms owned by the government since the Frei years in the fisheries, forestry, and cellulose industries, which were to become important sectors in Chile's recent export led boom.[5] The majority of these divestitures of both enterprises and banks were made to domestic business elites, both corporations and individuals. Although most sales were made by auction bids, some company assets were transferred by direct, noncompetitive sale, and a disproportionate number of purchases was made by a handful of domestic conglomerates, or *grupos*. There were no limits on the amount of equity one purchaser could buy, and the government in effect assumed part of the risk of transfer to private ownership by accepting payment in installments.[6]

Although the Pinochet regime during this period was committed to comprehensive liberalization of the Chilean economy under the direction of like minded 'Chicago boys,' over 25 of whom occupied positions of significant influence on economic decisions in the Pinochet government, the strong, coherent, and stable macroeconomic context upon which the success of privatization depends was not in place during this period. Rather, it was the rapid privatization itself that was intended to be a principal policy instrument in the achievement of macroeconomic stabilization, presumably by bringing government budgets into balance through divestiture of subsidized, inefficient, and loss-making public firms.

In fact, this wave of privatizations was a failure on several counts. Although it was directed heavily to domestic investors, only those with access to sufficient credit, mostly from foreign

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5 *Vd.* Raul E. Saez, "An Overview of Privatization in Chile: The Episodes, the Results, and the Lessons" (unpublished, 1992).

6 *Privatization in Latin America: New Competitive Opportunities and Challenges*, *op. cit.*, p. 25.

sources because of the underdevelopment of domestic capital markets at the time, could take advantage of the opportunities during a time of political uncertainty and poor economic performance. The result was a highly concentrated redistribution of financial and speculative wealth with its potential for social and political destabilization aggravated by the high rates of unemployment and low real wages that persisted throughout most of the Pinochet regime.

The timing and policy priorities of the macroeconomic restructuring that was launched with the first wave of privatizations also created economic constraints on the development of productive enterprises in the domestic private sector that were to prove costly to both domestic business and to the Chilean economy. Two policies deserve special mention. The first was the rapid reduction in the tariffs on imports that had protected domestic industry during most of Chile's post–World War II development. Without accompanying programs, services, and resources for the modernization necessary for competitive efficiency in open markets, Chilean industry was left vulnerable to a sudden invasion of lower priced, higher quality imported substitutes for its own products and unable to compete in its own domestic markets. Later in the 1970s, when the government sought to raise foreign confidence in the stability of the Chilean economy by pegging the Chilean peso to the US dollar at the very time that the dollar was becoming overvalued in purchasing power parity against the major world currencies, Chilean firms were faced with the declining competitiveness of their products on world markets because of an overvalued peso, even as they sought to modernize.

It is not surprising then that the annual number of business bankruptcies in Chile rose from 25 in 1973, the year of the Pinochet coup, to 810 during the 1982 recession. Even during the 'boom' years of 1978-81 the annual bankruptcy rate in the liberalized Chilean economy was double that of the economically unspectacular years of the Frei administration in the late 1960s.[7] Although an import-led commercial boom was able to be financed by heavy foreign borrowing during the era of petrodollar recycling, the industrial sectors were especially hard hit by liberal international trade policies, by the international oil shocks, and by the international economic slump of the early 1980s. By 1983 average industrial productive capacity in Chile had declined by over 9 percent from 1969 levels (over 19 percent, if the nonferrous metal basic industry sector is excluded). Out of 29 identifiable industrial sector classifications, 23 had experienced stagnation or retrenchment during that period.[8]

Moreover, the newly privatized enterprises, already highly leveraged in the transfer to private ownership, often could only be modernized by large infusions of new capital even while facing relatively poor earning prospects because of the weak macroeconomic environment. Many

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[7] Jaime Gatica Barros, *Deindustrialization in Chile* (Boulder: Westview Press, 1989), pp. 38-39.
[8] *Ibid*., pp. 32-36.

of the *grupos* financed their modernization of inefficient enterprises with infusions of credit from the banks they had come to control, so that when the external shock of the debt crisis hit in the early 1980s, major conglomerates failed and the Pinochet regime was forced to renationalize many of the banks it had privatized.[9] (In fact, it also had to take over most of the principal private commercial banks and a number of commercial and industrial businesses that were unable to meet their foreign debt obligations.) Clearly, privatization was not a magic bullet for the revitalization of the private sector and the creation of efficient, market-driven economic growth.

The Pinochet regime is credited with learning from some of its mistakes in the first waves of privatization when it entered upon a new phase of privatization, roughly from 1982 until 1989, with the addition of expanded economic and social objectives. During this period the re-nationalized banks and other enterprises that had been taken over during the crisis of the early ’80s were once again privatized, along with industries that had been deliberately excluded from the earlier privatizations, many of which were natural monopolies and public utilities. In addition, certain social services, especially social security and some health care programs, were privatized in ways that were intended to help develop capital markets for economic growth, while presumably introducing market efficiency into the delivery of social services.

To buttress social and political stability, there was also a deliberate effort to avoid the extreme concentration of private ownership that had resulted from the first wave of privatizations in the 1970s. Shares in privatized firms were frequently sold in blocks at staggered time intervals. To avoid domestic pyramiding, certain purchases by domestic *grupos* through open bids had to be paid for in cash with no reliance on debt.[10] Similarly, blocks of shares, e.g., in privatized pension funds, were deliberately sold to foreigners. Moreover, a deliberate effort was made to spread domestic ownership more widely among small investors through a program of so-called popular capitalism that was applied to the reprivatization of the Banco de Chile and the Banco de Santiago, as well as to a portion of the reprivatization of the two largest pension funds at the time, Provida and Santa María. An individual investor could purchase only a limited number of shares, but could do so outside the public bid process, making a down payment of 5 percent and receiving a 15-year loan for the balance at a real interest rate of zero plus a 30 percent discount for timely payment as well as tax credits. In addition, several firms were sold to employees wholly or in part. It can also be argued that sales of shares to pension funds redistributed ownership (though not control) to beneficiaries of those funds.

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[9] *Vd.* José Pablo Arellano, “De la liberalización a la intervención: El mercado de capitales en Chile: 1974-1983,” *Colección Estudios CIEPLAN* 11, December 1983.

[10] J. Marshall and F. Montt, “Privatisation in Chile” in P. Cook and C. Kirkpatrick, eds., *Privatization in Less Developed Countries* (Hertfordshire: Harvester Wheatsheaf, 1988), *cit.* in Raul Saez, *op. cit.*, p. 27.

However, there is also evidence that sale prices of privatized firms were lower than valuations of those firms based on calculations of future earnings, so that buyers in effect received public subsidies.[11] Moreover, the foreign debts of some of the privatized firms were transferred to a government agency prior to sale. Nevertheless, the subsidies were distributed among all classes of buyers and may have disproportionately accrued to purchases by workers, although the possibility that management buyouts benefited from information known only to insiders cannot be discounted.[12] Still, the increase in foreign ownership and various measures to diversify the domestic ownership of privatized firms in the second phase of Chilean privatization greatly constrained the possibilities for speculative windfalls by domestic investors that characterized the earlier phase.

Moreover, during the second phase greater attention was also paid to the economic condition of the companies being privatized. Many of the public enterprises were reorganized prior to privatization, and prices for their products and services were raised to reflect more fully the costs of production. At the same time regulations were introduced to limit price increases by natural monopolies to levels that reflected marginal costs in order to preclude monopolistic unearned rents.

Perhaps partly because of the nature and economic rationalization of the privatized firms prior to sale in the 1980s there was more foreign interest in acquisitions, and some of the largest firms were sold directly to individual foreign firms and to consortia whose majority interest was foreign. The methods used for sale make it difficult to identify directly the percentage of foreign ownership in the privatized companies. However, the portion identified as foreign is likely to be truly foreign, since Chile never experienced levels of capital flight commensurate with those in Argentina. Furthermore, starting in 1985, Chile initiated a bias in favor of foreign investors by allowing them to use debt-equity swaps to finance the purchase of privatized firms, while domestic investors were specifically excluded from eligibility to utilize the provisions of the same law authorizing the swaps. On the other hand, in comparison with other privatizing countries of Latin America, Chile has controlled the access of foreign capital to Chilean assets by a variety of regulations, including careful scrutiny of investments to be funded by debt-equity swaps before approval and regulating the time that foreign capital must remain in the country before repatriation. However, because of worries about the rising value of the Chilean peso that has accompanied the growth in foreign investment to a level of one billion dollars in 1991, the latter restriction on the foreign ownership of Chilean equities has recently been reduced from three years to 12

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[11] *Vd*. Dominique Hachette and Rolf Lüders, *La privatización en Chile* (Santiago, Chile and San Francisco, Ca.: Centro Internacional para el Desarrollo Económico [CINDE], 1992), pp. 120-138.

[12] *Ibid.* p. 127.

months.[13] Nevertheless, the Aylwin government has made it clear that it has no intention of pursuing privatization of the profitable copper mines of CODELCO, the last major enterprise still under public ownership. Ongoing measures have been taken to maintain the efficient operation of the mines, and the profits generated are identified by the government as a significant source of revenue for financing social programs.[14]

Argentina

In Argentina, the military government between 1976 and 1983 did privatize a number of firms, but these were mostly reprivatizations, principally of smaller firms that had begun as private enterprises, had subsequently languished, and were later taken over or bailed out by the government. There was, however, no comprehensive accompanying program of economic liberalization. There was instead the continued presence of high tariffs and other import barriers, multiple exchange rates, exchange controls, restrictions on capital movements, domestic price controls, and regulated markets, all of which combined to present an economically unattractive investment environment.[15] As a result, the privatizations had little impact on the behavior of domestic business, which continued to be characterized by rent seeking, short-run financial speculation, and capital flight.

After the transition to democracy, the government of Raúl Alfonsín was noted more for its concerns about the vindication and restoration of human rights than about efficiency and growth in economic output. The privatizations that were undertaken, like those of the previous military government, simply returned to the private sector firms that had formerly been private and had been taken over by the government when they failed. The uncertainties of a soft, inflationary macroeconomic environment as well as opposition to privatization by the Confederación General del Trabajo, by other political groups, by personnel of state-owned firms, and by private sector firms that benefited from commercial links with state firms helped constrain the importance of privatization as a policy stimulus to the private sector.[16] Nevertheless, the inflationary crisis of that era resulted in the heterodox Plan Austral, which in effect introduced certain economic aspects of privatization by cutting subsidies to state-owned utilities and allowing them to charge rates closer to market prices in order to survive. Moreover, public opinion polls in 1987 and 1988

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13 *Latin Finance* No. 38, June 1992, p. 86. Upward pressures on the value of the Chilean peso are likely to continue with the expected increase of foreign portfolio investment as a result of the investment grade rating (BBB) given to its government in late 1992 by Standard and Poors, the first such rating for a Latin American debtor nation. *Vd. Latin Finance* No. 40, September 1992, p. 6.

14 *Cf.* remarks by Alejandro Foxley, Kellogg Institute, 13 September 1991.

15 *Vd.* William Glade, *loc. cit.*, p. 123.

16 Javier A. González Fraga, “Argentine Privatization in Retrospect,” *Ibid.*, Ch. 5.

began to show majority popular support for privatization, despite continued opposition from labor unions.[17]

The administration of Carlos Menem has pursued a more comprehensive plan of economic liberalization and market discipline. Argentina's liberalization has included notable emphasis on integration of Argentine markets, including financial markets, into the international economy, justified by the need for competition to create the desired market efficiency and by the need for foreign exchange from export earnings and foreign capital to meet massive foreign debt service requirements and stem inflationary domestic fiscal deficits. Shortly after the inauguration of Menem, the legislation governing foreign ownership was greatly liberalized, including abolition of limits and restrictions on foreign ownership of local companies, simplification of bureaucratic procedures, unlimited repatriation of profits, and reduction of taxes on foreign investors. According to one US business source, these changes "effectively put foreign companies on equal footing with their local counterparts."[18]

In the context of economic policies that emphasize the opening of the Argentine economy and the resulting competitive pressures on domestic firms, privatization schemes have been speeded up and expanded to include state-initiated enterprises, but with a distinct priority on the objective of attracting capital from abroad. In addition, unprofitable service enterprises have been turned over to provinces and municipalities, which in turn have privatized many services, but even these sales have been directed toward foreign capital.[19] Where there has been participation by domestic firms in Argentine privatization, their role has been judged to be "relatively minor: They are usually minority capital partners."[20]

With permission for majority foreign ownership, some of the first major sales by the Menem administration of state-owned enterprises, badly in need of capital for modernization, were made to consortia dominated by foreign investors, as in the sale of ENTEL and of Aerolineas Argentinas. Furthermore, within four months of the completion of the sale of Aerolineas Argentinas to a consortium in which Iberia, the Spanish national airline, was committed to 49 percent ownership of the privatized firm, the Argentine government was forced to increase its own participation from 5 to 33 percent. This unplanned buyback resulted from the unwillingness or inability of the domestic participants in the purchase, originally committed to about 40 percent of the sale, to meet the capital requirements of the company. The domestic investors, who included a hotel owner, a rancher, and a fish processor, are reported to have lacked experience in

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[17] *Privatization in Latin America: New Competitive Opportunities and Challenges* (New York: Business International Corporation, 1990), pp. 86ff.

[18] *Latin Finance* No. 37, May 1992, p. 87.

[19] *Ibid.*, p. 90.

[20] *Ibid.*, p. 87.

the airline business.[21] Nevertheless, privatization by late 1992 had produced revenues of more than US`$5 billion for the Argentinian government and had reduced Argentinian foreign debt by US`$8 billion through use of debt-equity swaps in privatization sales with foreign participation. It is worth noting that Chilean investment in Argentinian privatization during 1992 reached about US $500 million.[22]

As part of its proposal for a Brady Plan agreement to restructure its foreign debt in 1992, Argentina included a special category of privatization bond as one of the bond conversion options for creditor banks. The privatization bond was dropped in later negotiations, but the concept remained as Argentina agreed, as a concession to the creditor banks, to make all the bonds issued in the Brady agreement eligible for debt-equity swaps in the privatization of government-owned industries during 1992. The result, in the words of one Argentine banker, is that "Argentina is for sale."[23]

Of course, it is not always possible to know whether capital from abroad is truly foreign capital or repatriated flight capital of domestic investors, so the Argentine objective of attracting foreign investment through privatization may also serve to mobilize dispersed savings of Argentine nationals. In any case, the macroeconomic stabilization policies of Finance Minister Domingo Cavallo, which were anchored to an exchange rate rigidly pegged to the dollar, have depended heavily upon foreign capital inflows to offset current account deficits and are vulnerable to balance of payments speculation.[24] Consequently, the use by Argentina of privatization as a lure to attract foreign capital inflows in its current process of comprehensive economic liberalization has implicitly discounted the dominant importance of domestic business in a market-driven development scheme and has largely ignored the distributional effects of the transfers of productive capital to the private sector.

Mexico

In Mexico, although modern privatization is typically assumed to have begun in the administration of Miguel de la Madrid,[25] some steps towards privatization date back to the last period of the López Portillo regime when NAFINSA, the national development bank, sought foreign buyers for minority interests in some public enterprises as the Mexican government

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[21] *Ibid.* No. 40, September 1992, p.113.

[22] *Ibid.,* p. 84.

[23] *Ibid.* No. 37, May 1992, p. 14.

[24] *Vd.* Nathaniel C. Nash, "Argentina amid Crisis over Economic Policies," *The New York Times*, 16 November 1992, p. C3.

[25] Oscar Humberto Vera Ferrer, "The Political Economy of Privatization in Mexico" in William Glade, ed., *op. cit.*, p. 42 ff.

sought to cope with the financial crisis of the early 1980s. In light of constitutional restrictions, government dominated markets, heavy regulation of private enterprise, and the deteriorating macroeconomic environment, it is not surprising that there were few takers, and by September 1982, exchange controls had been hardened, private banks had been nationalized, and capital flight had reached unprecedented levels.

Despite the reputation of the de la Madrid government as probusiness, and despite the rift that had grown between private and public sectors in the corporatist Mexican society since the Echeverría regime which had intensified with the nationalization of the banks just prior to the installation of the de la Madrid government, there was little disinvestment in public enterprises during the first years of the new government. In addition, there was a reaffirmation of the dominant role of government in the Mexican economy, while at the same time the government sought to re-establish dialogue with the private sector which, through relatively new business organizations, had been demanding a definition of the social and economic roles of public and private sectors.[26] Meanwhile, the government began vigorous pursuit of a neoliberal austerity program.

There was a subsequent increase in the official number of 'disincorporations' during the later years of the de la Madrid government, but the case can be made that these were not significant, either as stimuli to macroeconomic growth or as incentives and instruments for efficient, market-driven restructuring of the private sector. It can be argued that the number of actual divestments was overstated, that many in reality were simply liquidations of inoperative trust funds or loss-making enterprises, and that most were of too small a size to have an significant effect on the competitive efficiency of domestic markets.[27] According to one estimate, over half the state-owned enterprises scheduled to be privatized between 1982 and 1988 were in fact closed down, while those that were privatized were deliberately chosen for their insignificance by bureaucrats opposed to liberalization and trying to protect their positions of economic influence.[28] Despite official statements by the de la Madrid regime about the economic objectives of its subsequent increase in privatization initiatives, one cannot rule out the importance of ideological and political objectives, as the government sought to re-establish business confidence and cooperation with its strong interventionist role in the Mexican economy.

Although it can be argued that both de la Madrid and his successor, Carlos Salinas de Gotari, were following the same trajectory of gradual restructuring of a state-led corporatist economy with the latter building upon the initial steps of the former, it was Carlos Salinas who

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26 *Ibid.*, p. 53.
27 *Ibid.*, pp. 44-49.
28 *Privatization in Latin America, op. cit.*, p. 44.

articulated an economic and social case for privatization that was more coherently integrated into a comprehensive scheme of liberalization of the corporatist Mexican economy but that appears to have little to do with improving the productive efficiency of domestic business. The argument used echoes traditional textbook arguments about comparative advantage and 'guns and butter': the state can't afford both to run enterprises and to provide social services, so it should reallocate resources from the administration of property to its primary mission, the provision of services to satisfy social needs. Under the Salinas government the pace and magnitude of privatizations has accelerated rapidly, so that by 1991 37 percent of all Mexican state-owned enterprises had been privatized, representing the transfer to the private sector of US $8.3 billion, more than the total combined value of assets privatized by Argentina, Brazil, and Chile.[29] By June 1992 the privatization of Mexican banks, 17 in all, had been completed, and the government had announced the privatization of two television channels and the possible privatization of its airports.[30]

Proceeds from the large number of privatizations initiated since 1988 have, in fact, financed the new Solidarity program, which funds social services and infrastructural projects at regional and local levels. But again, the objectives may be more than economic. By mid-1992, it was widely believed that the linking of privatization with Solidarity was contributing to the resurgence of the political hegemony of the PRI party, which during the 1980s appeared to be threatened from parties on both the Left and the Right. By ideologically appealing to business supporters of the traditionally conservative PAN party with measures to reduce the role of government in economic life while channeling Solidarity funds to areas where the leftist PRD party is strongest and appointing traditional critics from the Left to positions of responsibility in the Solidarity program, Salinas might succeed in reasserting the dominance of a PRI party weakened by the failure of its traditional interventionist economic policies and their bureaucratic administration.[31]

The speed and magnitude of the Salinas phase of Mexican privatization would not have been possible without strong participation by domestic business, and the recent reverse flow of Mexican financial capital privately held overseas and estimated at over US $40 billion is commonly attributed in large measure to privatization. However, domestic capital markets alone could not have absorbed the rapid pace of divestiture without substantial foreign participation. As in Argentina, many of the largest recent Mexican sales have been made to foreign investors and to consortia with dominant foreign participation. Moreover, privatization has also had an easily

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[29] S. Kikeri, J. Nellis, M. Shirley, *et al.*, *Privatization: The Lessons of Experience* (Washington: The World Bank, Country Economics Department, 1992), pp. 8, 12.

[30] *Latin Finance* No. 40, September 1992, p. 122.

[31] *Vd. The Economist*, 18-24 July 1992, p. 40 and *Newsweek*, 27 July 1992.

overlooked indirect stimulus on foreign investment in Mexico because of the scarcity of domestic capital available to local business. It appears that privately held Mexican assets sold by domestic investors to mobilize financial capital for participation in the purchase of privatized public assets have in some cases been purchased by foreign investors. Union Carbide, for example, was able to regain majority ownership of its Mexican subsidiary in this manner.[32] Furthermore, the Mexican government has been aggressive in circumventing legal restrictions and political opposition to foreign investment by permitting the use of licenses, leases, service contracts for technical assistance, and other "creative relationships"[33] to engage foreign firms in the provision of domestic basic services and physical infrastructure, such as toll roads, water systems, bridges, and electric facilities. As a result of all the opportunities for foreign capital in Mexico, private foreign investment there in all forms reached US $16 billion in 1991.[34] Moreover, in the 1992 negotiations for the North American Free Trade Agreement, Mexico agreed for the first time to open to both US and Canadian companies Mexican banking, securities, and insurance business, a combination of financial activities that the United States does not allow, even to American financial institutions.[35] Meanwhile, the popularity among US investors of shares in the increasing number of private Mexican companies is apparent in the report by the US Securities Industry Association that US investors placed more funds in Mexican equities than in those of any other country during the first quarter of 1992.[36]

Given that traditional rent-seeking relationships between domestic business and public enterprises are destroyed, it is not clear that the significant restructuring of the Mexican private sector as a result of privatization programs will in the long run greatly enhance the economic welfare of domestic businesspeople. At the same time that they may be deprived of the traditional unearned rents made available through clientelist relationships with public enterprises, the opportunities opened to foreign capital by the magnitude and rapid pace of the current privatization effort may leave domestic businesspeople, even the efficient ones, in the position of secondary players in the exploitation of opportunities in a growing Mexican economy. Optimists will argue that access to international markets for capital, goods, and services will make even the position of the smaller fish in the big pond superior to that of their monopolistic predecessors in the small, protected domestic pond.

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32 *Privatization in Latin America, op. cit.*, p. 45.
33 *Ibid.*, p. 47.
34 *Latin Finance* No. 38, June 1992, p. 86.
35 *Ibid.* No. 39, July/August 1992, p. 17.
36 *Ibid.*, p. 6.

Brazil

In Brazil privatization has been named as an objective for public policy since before the debt crisis of the 1980s, and for over 20 years governments have been announcing their intentions to privatize state-owned industrial firms, e.g. Mafersa (vehicles) and Cosim (steel). However, nowhere among the major industrial countries of Latin America has the gap between the rhetoric and the reality been as great. Despite periodic legislation, public announcements and the creation of commissions and councils for privatization since 1979, only about US $200 million of assets were privatized prior to the transition to democracy during the 1980s, and most of these were reprivatizations of small and medium-size private firms that had been taken over by the federal government to avoid bankruptcy and were resold to the domestic private sector.[37] By 1991, none of the major public enterprises, about 200 in total, had been privatized by the federal government and only one state, São Paulo, had made a significant divestiture through the sale of a controlling interest in Brazil's second largest airline, VASP, "the most indebted company in Brazil"[38] to a consortium of 16 Brazilian firms and some of the airline's employees.

Continuing political uncertainty, an irregular pattern of shifting macroeconomic policies in an economy with high levels of government intervention and protective trade barriers, along with the inherent complexity of the largest and most diverse economy in Latin America help to explain and demonstrate the impotence of privatization as a major autonomous tool for reforming and restructuring the private sector into a dynamic agent of economic growth. Moreover, the long tradition of corporatism in Brazilian society with its highly developed set of clientelistic economic relations among politicians, bureaucrats, organized labor, and domestic businesspeople makes understandable the lack of enthusiasm and outright opposition among major segments of both public and private sectors to new economic relations based on competitive market efficiency, despite political and business rhetoric to the contrary. The complex and diversified private sector in Brazil has for some time been characterized by enclaves of efficient, competitive, and export-oriented firms, e.g., in auto parts and finished wearing apparel, amid relatively inefficient, highly protected oligopolistic industries, frequently dominated by a public enterprise.[39]

Nevertheless, in the face of foreign and domestic debt crises along with a lack of resources for investment in essential infrastructure and services, opposition to privatization began to fade during the government of José Sarney and some concrete steps were taken, including

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37 Rogério L. F. Werneck, "The Uneasy Steps toward Privatization in Brazil" in William Glade, ed., *op. cit.*, pp. 64-66.

38 *Privatization in Latin America, op. cit.*, p. 113.

39 *Vd.* Caren Addis, "The Revanche," Ch. 4, Kellogg Institute, unpublished, 1992; and Ernest Bartell, "Business Perceptions and the Transition to Democracy in Chile," Kellogg Institute Working Paper #184, December 1992.

the sale of steel, copper, and textile firms and the opening of some public utilities, e.g., power and railroads, to private investment. Much of the credit for these sales is given to the national development bank, Banco Nacional de Desenvolvimento Econômico e Social (BNDES,) which for some time had been pressing for reprivatization of firms it had bailed out and for divestiture of firms in need of large amounts of capital that the government could no longer provide because of the escalating interest burden on both its foreign and domestic debts.[40] In 1991, the pace of privatization in Brazil began to pick up as the government of Fernando Collor de Mello appeared to support a more comprehensive and coherent program of structural adjustment and economic liberalization following several cabinet reshufflings.

It is widely assumed that the chronically high rates of inflation in Brazil, which reached an all time monthly high of 84 percent just before the inauguration of Collor, are in large part the result of massive deficits in government budgets at all levels, to which the deficits of public enterprises are estimated to contribute US $60 billion. Consequently, the Collor government took a number of steps to stimulate greater efficiency in state sectors of production, such as opening some sectors as well as specific services within public sectors to private firms, e.g., in public utilities, establishing joint ventures between public and private firms, and contracting with private sector companies to manage public-sector operations.

Since 1991, four publicly owned industrial firms, Usiminas and Companhia Siderúrgica de Tubarão, the nation's two largest steel mills, Petroflex, a producer of synthetic rubber, and Copesul, a petrochemical company, together worth close to US $2 billion, have been sold, despite some public opposition. At the same time, the Brazilian Congress is considering a constitutional amendment that would permit private sector operations in telecommunications. Meanwhile, both domestic and foreign investors are permitted to invest in cellular telephone networks and, as a part of its restructuring, Telebras, the state-owned telecommunications monopoly, is accepting bids for private participation from consortia of both domestic and foreign investors, with the restriction that foreign capital may not constitute more than 49 percent of each group bid.

In fact, over 98 percent of the private funds invested in the four recently privatized firms has come from domestic sources, mostly consortia, which suggests strong interest among some domestic investors. The high level of domestic participation cannot, however, be interpreted as a deliberate effort by the government to favor domestic business, despite somewhat more restrictive limits on foreign participation than in Argentina. In fact, domestic business is confronted with valuation and bidding procedures designed to safeguard against clientelist preferentialism

[40] *Cf.* Ben Ross Schneider, "The Politics of Privatization in Brazil and Mexico: Variations on a Statist Theme" in Ezra N. Suleiman, ed., *The Political Economy of Public Sector Reform and Privatization* (New York: Westview Press, 1990), pp. 325-327.

and corruption.[41] In addition, the Brazilian government has apparently been disappointed at the low level of foreign interest thus far in its privatization offers. BNDES, which organized and managed the privatization sales, has expanded a multimedia advertising campaign previously directed at reducing opposition to privatization among domestic audiences to include campaigns targeting potential foreign investors in the United States, Germany, France, Japan, Italy, and Spain.[42] Moreover, the agreement reached in principle during mid-1992 between the government of Brazil and the committee representing its foreign creditor banks on a "Brady Plan" reduction package for its US $44 billion of medium- and long-term foreign commercial bank debt provides that any of the seven conversion instruments offered to the foreign creditor banks will be eligible for participation in Brazil's privatization program.[43] In general, the conversion options provide for swaps of debt instruments at a discount of approximately 35 percent, which represents the approximate discount on Brazilian foreign debt in secondary markets at the time of the agreement.[44]

The future of the privatization program and of foreign participation in it, along with realization of the Brady agreement, were cast into doubt by the political upheaval culminating in the impeachment of President Collor in 1992. Vice President Itamar Franco, who succeeded Collor at the time of the latter's impeachment, has been perceived in the foreign business press as "antireform and decidedly against the country's still nascent privatization program."[45]

Responses by Business

Rhetorical support for the principle of privatization by business individuals and groups can be very different from behavioral responses to specific privatization projects and their market effects. Rhetorical enthusiasm, as typically conveyed by business associations, is perhaps best understood as ideological affirmation of the larger liberalization process as well as an expression of either entrepreneurial or rent-seeking conduct. The behavioral response of domestic business to specific privatization projects and proposals as expressed in plans and decisions governing spending, savings, and investment will depend upon changes in market opportunities created by privatizing actions of government as perceived by investors in light of their time horizons and financial and economic objectives as well as their preferences for risk. Consequently, different

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41 David Felix, *Reflections on Privatizing and Rolling Back the Latin American State*, Washington University Department of Economics Working Paper #162, September 1991, p. 24.

42 *Latin Finance* No. 38, June 1992, p. 97.

43 *Ibid.* No. 39, July/August 1992, pp. 7-8.

44 *Ibid.*, pp. 8, 11.

45 *Ibid.* No. 40, September 1992, p. 17.

segments of domestic business can also be expected to respond differently to the same programs. Entrepreneurs and managers producing for export can be expected to respond differently from those producing for a protected domestic market,[46] and both may respond differently from investors managing financial portfolios.

Participation by domestic business in the purchase of privatized public assets has undoubtedly been responsible for bringing home domestic flight capital. However, the return of flight capital to Latin America, estimated at US $35 billion in 1991 alone,[47] obviously cannot be explained solely by the proceeds of privatization sales, especially in countries like Argentina and Brazil where domestic purchases have constituted only a minority stake of privatized assets. It is rather more likely that privatization, when it is a part of a coherent scheme of market liberalization, simply contributes to the economic and political confidence that is a prerequisite for the return of flight capital.

In this respect it must be noted that a high percentage of the reverse flight capital in the recently privatizing Latin American economies, such as Argentina and Mexico, has returned as portfolio capital rather than as direct investment, helping to drive the rapid rise in share values on the stock exchanges of those countries.[48] Financial assets in the expanding securities markets of Latin America are, of course, more readily marketable than fixed physical assets, so there is no assurance that the reverse capital flight will not do another about-face. Privatization in the form of portfolio assets will not alone keep within the country the returned capital of domestic investors experienced in assessing political and economic risks according to their own traditional criteria and previous investment experience in global financial markets.

Moreover, global investment in financial assets is especially responsive to international currency risks in addition to internal political and economic hazards. The currencies of both Argentina and Mexico were judged by many analysts to be significantly overvalued in 1992.[49] The substantial inflows of capital from abroad that have been inflated by the proceeds from sales of privatized public assets in both countries have allowed them to maintain deficits in their balances of trade and current accounts, which otherwise would have provoked devaluations. Since the number of public assets available for privatization is obviously limited, pressure for

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46 David Felix, *op. cit.*, p. 7.

47 *Private Banking in Latin America*, June 1992, p. 21.

48 It is estimated that in 1991 alone US $6.6 billion entered Latin America as portfolio investments, most of it foreign capital. The Mexican Bolsa price index tripled in its US dollar value during the twelve month period ending March 1992, while prices on the Argentine stock exchange rose 350 percent and those on the Brazilian stock market rose 257 percent during 1991. *Vd*. *Latin Finance* No. 38, June 1992, pp. 81, 85.

49 *Cf.* Juan Carlos Moreno Brid, “Macroeconomic Policy Responses to External Shocks,” lecture, Kellogg Institute, 17 March 1992; “Currency Concerns,” *Latin Finance* No. 37, May 1992, pp. 57-58.

equilibrium in the balance of payments could provoke serious depreciation in the value of national currencies as the inflow of foreign exchange from the sale of public assets dwindles. Signals of such depreciation, or even the threat of it, could spark an exodus of financial capital by domestic and foreign investors alike.

The fact is that domestic investors in many Latin American countries have learned to behave as international actors after many years of capital flight that often represented rational market behavior in light of their evaluations of political uncertainty and economic risk after comparing investment opportunities in their own highly regulated, economically 'imperfect' domestic markets with more economically rational international capital markets. Even now, as domestic capital markets in Latin America are liberalized, there is evidence of movement of Latin American capital across Latin American borders, especially between Brazil and Argentina. In the words of one financial analyst, "This is fickle money, obviously; it left once and could leave again."[50] Similarly, there is no reason to expect reprivatized domestic firms that had previously been taken over by the state because of financial difficulty to perform more admirably unless the government offers subsidies, e.g., through the assumption of past debts, rationalizes prices and markets, especially for labor and other inputs that may have hampered profitable operations, and provides a healthy macroeconomic environment for private management.

Interviews with domestic business leaders in Chile and Brazil during and shortly after their transitions to democracy to ascertain perceptions about economic prospects[51] strongly suggest that privatization by itself is not a major source of entrepreneurial or investment incentive. In neither country was it raised by interviewees as a major issue of political or economic concern as domestic business faced the uncertainties generated by the very different political transitions in the two countries. At the same time privatization was also not simply an ideological rallying cry. Perhaps because it was implicitly understood that the implications and success of privatization were so intricately interwoven with the elements of macroeconomic performance and market liberalization, privatization served more as a reference to the issues considered most significant by business respondents in the open-ended interviews.

In Chile, where privatization of enterprises, banks, and social service programs was largely complete by the time of the first set of interviews in 1988-89, the issue of privatization was mostly

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[50] *Latin Finance* No. 38, June 1992, p. 86.

[51] The 1987-88 samples of 41 respondents in Santiago, Chile and 36 in São Paulo, Brazil, as well as the 1991 follow-ups in both places, were intended to represent decisionmakers identified by their peers and by academic observers either as successful and representative of significant sectors of the economy or as positive examples of modernizing behavior, especially in nontraditional and export sectors. For further description and analysis of interviews, see Ernest Bartell, *op. cit.* and Ernest Bartell, "An Entrepreneurs' Tale of Two Transitions: Business Perceptions before and after the Transitions to Democracy in Chile and Brazil" (Kellogg Institute, 1991).

subsumed under more basic concerns about the maintenance and strengthening of the comprehensive liberal economic model that was by then in place. None of the respondents, for example, raised the continued state ownership of the CODELCO copper mines as an important issue. Of fundamental concern, however, was the security of private property rights, specifically of productive assets.[52] In this respect, privatization was seen as one neoliberal strategy that, having been accomplished, would not likely be reversed by a new democratically elected government. For this purpose of solidifying a social and political consensus on the rights of private property, it was the reprivatization of agricultural land that was identified more often than the privatization of public enterprises.

There was criticism by several respondents in Chile of the potential for social and political destabilization of distributional effects of nonproductive speculative gains achieved by the economic groups who dominated the purchases of the first wave of privatized public assets in the 1970s, and there was no objection to the strategies of popular capitalism used by the government to diversify the ownership of some privatized firms. The lack of opposition by business to such diversification is understandable, since there was evidence that workers tended to sell their shares in privatized firms, just as small farmers had earlier sold their newly acquired titles.[53] At the same time the taxpayer-financed subsidies received by the reprivatized banks that had been taken over by the government to prevent their failure in the crisis of the early 1980s were criticized for the competitive advantage that the subsidized long-term, low-interest loans gave them in the financial marketplace. At the same time several favored the reduction or removal of restrictions that limited the number of companies in the private sector in which the privatized social security pension funds could invest.

The businesspeople interviewed in Chile were the survivors and beneficiaries of thirteen years of neoliberal restructuring of the Chilean economy which included two waves of bankruptcies and extensive integration of both trade and capital markets into the international economy. It is not surprising that they were confident of their own efficiency and abilities to compete. Nor is it surprising that Chilean business respondents expressed no disquiet over the purchase of domestic productive assets by foreign investors. Nor did they object to the use of discounted conversion of Chilean foreign debt instruments by foreign investors to pay for purchases of domestic assets, including ownership in privatized firms. This may be attributed to

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52 For an exposition of representative neoliberal analysis of the links between property rights and private enterprise, *vd.* Steve H. Hanke, "The Necessity of Property Rights" in Steve H. Hanke, ed., *Privatization and Development* (San Francisco: ICS Press, 1987), Ch. 6, pp. 47-52.

53 *Cf.* Paul E. Sigmund, "Chile: Privatization, Reprivatization, Hyperprivatization" in Ezra N. Suleiman, ed., *op. cit.*, p. 361. Sigmund also notes that support of upper-income people for privatization of health care could be explained by their exemption from payment for a public health care system they never used. *Ibid.*, p. 360.

the fact that in 1988 and especially after the successful transition in 1991, Chilean businesspeople not only did not fear foreign competition but were actively pursuing opportunities for joint ventures with foreign firms. There was, however, frequent criticism by domestic businesspeople of the legal limitations on their own use of debt-equity swaps for domestic asset purchases.[54]

In Brazil, privatization was also a matter of minor interest to businesspeople interviewed, but for very different reasons. In 1988 and again in 1991 it was the macroeconomic environment and the policy measures of the government to manage that environment, not the microeconomic composition of the marketplace nor the underlying principles of property ownership, that preoccupied the businesspeople interviewed. A stagnating economy and rampant inflation with high real interest rates, especially in 1991, tended to overwhelm the investment aspirations and plans of both domestic and foreign businesspeople in Brazil. Elaborate financial maneuvers to avoid the costs of currency depreciation were a daily preoccupation of decisionmakers in all segments of the private sector and dominated investment planning.

At the microeconomic level there was much more criticism expressed of the market inconsistencies introduced by the price and wage freezes of the various heterodox stabilization policies, beginning with the Cruzado Plan, than of the effects on markets of large public enterprises. While there was acknowledgment of the inefficiency of public enterprises, the criticism was not universal and several examples of public enterprises considered efficient were noted in the interviews. Indeed, several domestic businesspeople expressed their satisfaction with the predictability and absence of competitive pressure in some oligopolistic markets resulting from a presence of state enterprises that was sufficiently dominant to determine prices and market shares of individual firms. Virtually no one recommended privatization as a remedy for the destructive effects of inflation, including high real interest rates.

Foreign businesspeople and some specialized domestic industrial exporters complained more than their domestic counterparts about the undesirable effects on their costs of high protective tariffs on imports and of the market reserve regulations, which required domestic purchase of inputs if those inputs were manufactured in Brazil. Foreign businesspeople typically complained about the cost of dealing with the bureaucracy and its multitude of economic regulations, but domestic businesspeople generally did not view their relations with the regulatory bureaucracy as especially troublesome or costly. In short, in 1988 the typical domestic business respondent remained comfortable with the prospect of a large protected internal market structure dependent upon government regulation and participation, including the presence of public enterprises, which continued to ensure profitability without undue concern for competitive

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54 *Vd.* Ernest Bartell, *op. cit.*

efficiency.

In the 1991 interviews, both Brazilian and foreign businesspeople were much less concerned with investments in productive enterprises than with the erosion in value of their liquid assets, which had been frozen by the new Collor government with interest accruals that failed to cover current rates of inflation, and there were widespread rumors about machinations by domestic business elites to gain access to their frozen balances. Understandably, in 1991 there was less optimism among respondents than in 1988 about the viability of the traditional model, but there was still no buildup of enthusiasm or even consensus among those interviewed about the need to restructure and liberalize the Brazilian economy. Consequently, it is not surprising that the first privatizations of large public enterprises by the Collor government were of firms that were regarded as profitable and, in the case of Usiminas, perceived to be among the most competitively efficient.

Conclusion

There is empirical evidence from World Bank country studies that privatization improves aggregate domestic economic welfare within national economies, including those of Latin America, as measured by costs and benefits to all economic actors affected by privatization, including workers, consumers, and governments, as well as the purchasers of the privatized assets.[55] Case studies from Chile and Mexico indicate increases in productivity, investment, product diversification, and growth.

However, the record for individual firms is mixed, and the evidence suggests that benefits related to efficiency in production are positively related to the degree of competition in the markets in which the privatized firms will function. Privatization in competitive markets for tradable goods are the most likely to yield “solid and rapid economic benefits.”[56] The second major influence identified on economic benefits from privatization is a neoliberal macroeconomic policy environment conducive to the development of competitive open markets, and the third major factor identified is an effective regulatory and legal framework of the government.[57] The mixed record of individual firms and the broad scope of these three conditions for success implicitly acknowledge the secondary, albeit significant, importance of privatization as a tool for stimulating market driven economic growth.

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55 Sunita Kikeri *et al.*, *op. cit.,* pp. *v.,* 9-12; Ahmed Galal *et al.,* “The Welfare Consequences of Selling Public Enterprises: Cases from Chile Malaysia Mexico, and the UK” (papers presented at World Bank Conference on the same topic, June 1992, and forthcoming volume).

56 Sunita Kikeri *et al.*, *Ibid.*, p. vi.

57 *Ibid.,* pp. vi, vii, 18-21.

Given the fact that privatization is most effective in the context of competitive market restructuring and neoliberal macroeconomic policies and that governments have a variety of objectives when pursuing strategies of privatization, it is understandable that there is no necessary correlation between privatization and the interests of domestic business. Domestic businesspeople may well support privatization in principle because, to be effective, it must implicate many of the characteristics of neoliberal economic models, e.g., secure private property rights, flexible market prices, and access to lucrative markets, that attract private capital. And sometimes privatization offers opportunities for windfall capital gains, speculative financial gains, or economic rents, as occurred in the first phase of Chilean privatization or in cases where sales are made without competitive bid and on the basis of undervalued government assets.[58]

Some domestic businesspeople, such as those already capable of competing without government subsidy in export markets, may benefit from policies of macroeconomic and microeconomic liberalization, e.g., through lower costs of imported inputs. However, privatization can put an end to implicit subsidies of domestic business firms and individuals who, in countries like Mexico, are the principal consumers of subsidized public services, such as electric power.[59] Privatization in free markets may also diminish the comparative advantage that domestic business sometimes enjoys over its foreign competitors in maneuvering through regulatory bureaucracies, as Brazilians skilled in *jeitinho* pointed out in interviews.

When privatization occurs in monopolistic and oligopolistic markets, however, conditions for market efficiency are not fulfilled and there is no assurance that prices to consumers will not include unearned rents. In the case of monopolies, regulation can in principle enforce marginal cost pricing with resulting efficiency in resource allocation.[60] In practice, however, this reintroduces the possibility of added social costs for regulation and renews the potential for collusion and corruption between regulators and the regulated in the determination of allowable costs, fair rates of return, etc. To the extent that regulation is still essential for the achievement of efficiency in such markets, domestic businesspeople may still find opportunities to ply their traditional clientelistic skills. In oligopolistic markets the situation may be even more complex. If, for example, a subsidized government firm that dominates a given oligopolistic market has as one of its objectives the provision of services at low prices to consumers, private competitors must maintain levels of efficiency sufficient to meet those prices. When the dominant firm is privatized,

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[58] *Vd.* Mario Marcel, “Privatización y finanzas públicas: El caso de Chile, 1985-88,” *Colección Estudios CIEPLAN* No. 26, June 1989, pp. 38-44, where the author contends that normal methods of valuation indicate that sales of public assets were undervalued during the second phase of Chilean privatization.

[59] Ben Ross Schneider, *loc. cit.*, p. 324.

[60] Chile pursued this policy in conjunction with the privatization of its power companies. *Vd.* Sunita Kikeri *et al.*, *op. cit.*, pp. 21, 49, and the case of Chilgener in Ahmed Galal, *op. cit.*

however, and is free to 'compete' in the marketplace, the effects are not unambiguously predictable and may result in oligopolistic collusion to raise prices on the part of all firms in the market.[61]

Nevertheless, some domestic businesspeople and firms may find themselves at a competitive disadvantage with their foreign colleagues as tariffs and other international trade barriers are eliminated, as special concessions are offered to foreign investors in privatization sales to meet balance of payments objectives, and as the largest state firms, which account for most of the value of state enterprise production in more industrialized countries like Brazil and Mexico, are brought to a global market where only relatively capital-rich foreign firms and consortia, in which domestic elites are often minority participants, can afford to bid.

So, domestic businesspeople will in practice evaluate the benefits of investment opportunities created by privatization much as they evaluate alternative investment opportunities at home and abroad. Moreover, as managers and as shareholders in successful privatized firms, they will increasingly behave as global actors in seeking sources of funds for their expanding firms. Already some of the largest privatized and domestically managed firms in Chile and Mexico, e.g., Compañía de Teléfonos Chile and Teléfonos de México, have been significant borrowers in the growing international depository receipt (DR) markets and, along with other large borrowers among Latin American business firms, have contributed to the expansion and globalization of those markets.[62] At the same time, Latin American investors are increasingly responsive to the opportunities offered by new portfolio instruments in international markets, such as American Depository Receipts (ADR), that permit them to take advantage of domestic Latin American equity opportunities with the protection of US securities regulations.

As privatizing countries move beyond the stages of reprivatization and the sale of numerous relatively small entities, domestic businesspeople may well continue to participate, both as managers and as shareholders, in the privatization of the largest and last of the state enterprises. The era of privatization will then pass, and domestic members of the private sector, investors, entrepreneurs, managers, shareholders, and speculators, will be left, for better or worse, as global actors within increasingly open competitive economies in whose evolution privatization played an instrumental but ultimately transitory role.

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61 *Vd.* Giovanni De Fraja, "Efficiency and Privatisation in Imperfectly Competitive Industries," *The Journal of Industrial Economics* Volume XXXIX, March 1991, pp. 311-321.

62 *Cf*. "Equity Expeditions," *Latin Finance* No. 39, July/August 1992, pp. 34-37.