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DIVISION FOR PUBLIC ECONOMICS AND
PUBLIC ADMINISTRATION**

PRIVATIZATION IN LATIN AMERICA IN THE EARLY 1990S



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The term “dollar” normally refers to the United States dollar (\$).

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FOREWORD

A Regional Conference was held on Post-Privatization in Latin America in Buenos Aires, Argentina from 20 to 22 March 1995. Specialists provided papers on regulation in Argentina, the promotion of competition (with special reference to the New Zealand experience), social safety nets, the future of privatization in Latin America, eight Latin American country reviews and an overview paper. These and the proceedings of the Conference are hereby published in English under the title *Privatization in Latin America*.

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ABBREVIATIONS

ADELCO:	Liga de Acción del Consumidor (Argentinian consumer protection body)
BG:	British Gas (United Kingdom)
BOMT:	build, operate, maintain and transfer
BOO:	build, operate, own
BOT:	build, operate, transfer
CEEP:	Public Enterprise Evaluation Commission (Bolivia)
CNT:	Comisión Nacional de Telecomunicaciones (Argentinian telecom regulator)
CORNAP:	General National Public Sector Corporations Board (Nicaragua)
ECLAC:	Economic Commission for Latin America and the Caribbean
ENCOTEL:	Postal services utility (Argentina)
ENERGAS:	Gas regulatory body (Argentina)
ENRE:	National Electricity Regulatory Entity (Argentina)
ENTEL:	Telecommunications utility (Argentina, Bolivia)
ETOSS:	Ente Tripartito de Obras Sanitarias (Argentinian water/sewage regulator)
GDP:	gross domestic product
GTO:	Technical Operative Group, Directorate for Public Enterprises, Argentina
IDB:	Inter-American Development Bank
IFI:	Industrial Development Institute, Colombia
IHRE:	Institute of Water Resources and Power Supply, Panama
ILO:	International Labour Office
INTEL:	National Institute of Telecommunications, Panama
Kwh:	kilowatt-hour
MEOySP:	Ministry of Economy and Public Works and Services, Argentina
MOSP:	Ministry of Public Works and Services, Argentina
MW:	megawatt
NGO:	non-governmental organization
NORAD:	Norwegian Government aid agency
NPE:	new economic policy (Bolivia)
OAS:	Organization of American States
OECD:	Organization for Economic Cooperation and Development
OFGAS:	Office of Gas Supply (United Kingdom)

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EXECUTIVE SUMMARY

This is an overview of privatization in Latin America in the early 1990's, which has reference to the Conference on that subject held in Buenos Aires, Argentina in March 1995. It presents, in an analytical and comparative manner, the objectives of privatization as pursued in the Latin American region, the actual experience and the impacts, the continuing issues concerning regulation, competition and social safety nets.

The views of the Conference participants are mentioned, particularly where there appeared to be either consensus or obvious disagreement. The Conference consisted of experts from many countries in the Latin American region placed in varying situations of development and characterized by dissimilar privatization programmes: one could not anticipate complete uniformity of views or conclusions. A number of individual country papers are also included.

I. INTRODUCTION: AN OVERVIEW

1. The general setting

A. The objectives of privatization

Where stated, the objectives of privatization, on the whole, are multiple in nature, and it is not easy to establish the priorities among them. A close study suggests that fiscal benefits have been a driving force, for instance, in Argentina when privatization was first launched. Jamaica and Guatemala further illustrate the point. The fiscal benefit to the Government was conceived in several ways: the drain on the public exchequer caused by lossmaking public enterprises would be eliminated; the Government would gain from high tax revenues from enterprises that were rendered profitable through privatization; the Government would not have to find funds for investment in public enterprises; the Government could retire public debt, resulting in a reduction in the interest payments year after year; and the Government would begin to command resources for the sake of social expenditures. The purpose of "social investment" has been emphasized in the papers from Guatemala and Panama. In the latter case the law distinctly enjoins that the divestiture proceeds must be used for social and infrastructure projects. Similar is the law in Bolivia, with the additional qualification that the investments should be *in the regions in which the enterprises are situated*.

Efficiency enhancement has been in the minds of privatizing governments, though not distinctly emphasized as the overriding consideration. The Argentine paper suggests that allocative efficiency attracted recognition only in the second phase of privatization. One can infer that improving the efficiency of the enterprises has constantly been in the minds of the governments, faced with the alarming financial and production conditions of many public enterprises. The situation was feared to be so incorrigible that privatization was the solution. For example, Nicaragua realized that the state of financial insolvency and obsolescence of the productive equipment was one of "semi-paralysis," Argentina was not able to invest even in maintenance and Bolivian public enterprises "as a rule" operated far below their installed capacities, generating "unreal" employment.

Some governments have openly viewed privatization as a step in establishing a new regime of public-private interaction. Guatemala illustrates this best, placing as the first objective of privatization its intention of restructuring the role of the State into a "complementary" one, carrying out functions that cannot be carried out well by the private sector. The Uruguayan paper likewise places this at the head of its privatization objectives which, incidentally, do not openly underline enterprise efficiency.

A more distinctive focus on efficiency as the primary objective of privatization would offer several advantages: (a) any enterprise whose efficiency could be enhanced only through privatization can be privatized independently of overall economic policies; (b) the choice of modality of privatization—whether by divestiture or non-divestiture—can be attuned to the motivation of improving efficiency, rather than to the mere selling of the enterprise to the private sector; (c) with efficiency as the declared aim, the need for monitoring privatization and for regulation of privatized operations becomes self-evident in the process of ensuring that the aim is realized.

Implicit in the objective of efficiency is the dichotomy between internal or micro-efficiency and social or macro-efficiency. The former is easier to verify, whereas the latter calls for several assumptions at

the level of public policy objectives. However difficult, this is important, for the aim of the whole exercise is to enhance overall efficiency at the national level. In this connection, it is interesting to note that the Nicaragua paper conceives of privatization as a process, not an objective, which is one way of saying that privatization is a means and not an end. So formulated, it calls for clarity on the "end," which certainly goes beyond the profit made by the investors in privatized enterprises and raises the whole issue of what kind of public policies would be necessary to maximize the conceived "end." The Conference rightly went into some of these policies, relating to regulation, competition and social safety nets.

There was near unanimity on the proposition that the government had to be clear about its objectives of privatization and state them before it embarks on the programme. It was also agreed that the highest priority among the objectives should be given to efficiency improvement, as against the fiscal interest of the government.

B. Actual experience

In the generality of cases, privatization in the region has been a sequel to structural adjustment programmes and, in a more specific way, to the needs of technological upgradation and investment expansions. These seem to have had some influence in seeking external capital.

The pace of privatization has been uneven among the Latin American countries. Chile, an early practitioner, and Mexico have undertaken extensive privatization, followed by Argentina, which privatized 115 enterprises during 1990-1994, and Jamaica. Several countries have been behind schedule, e.g. Trinidad and Tobago. Guatemala's slow progress illustrates the determinative importance of political conditions; there has been such adamant opposition of labour organizations that it has not been found feasible to implement the privatization programme in all its aspects. The situation in Uruguay is similar. In Paraguay, privatization has a long way to go.

Many privatization measures have been undertaken with inadequate preparation, e.g. in Argentina. And there has been a general preference for selling the enterprises without proper restructuring, as illustrated by the "as is" sales in Bolivia. Such practices inherently had the potential to raise many difficult problems post-privatization.

Another aspect of the privatization techniques adopted in Latin America which deserves specific notice is that there have been many franchises or concessions, under which some kind of a public-private venture comes into being, e.g. in Panama, in Bolivia, in Colombia with a big highway concession scheme, and in Argentina in respect of railways, subways, telecommunications, water and sewerage, transportation and distribution of electricity and gas, and oil production for periods varying between 10 and 95 years. Jamaica followed the "leasehold" option of privatization extensively. A government-owned property might be given on lease to a private party; a new utility like a highway might be built and financed by a private party in the hope of realizing its financial inputs through tolls; or a build-operate-and-transfer (to government) arrangement might be introduced. Privatization achieved under this technique raises distinctive problems in the realm of regulation.

In concluding this section, mention may be made of the fact that foreign capital has played an important role in the privatization of many large enterprises in Latin America. Deserving of special notice is the ownership, full or partial, of public utilities such as telecommunications and electricity by foreign investors. It is deemed necessary because of the paucity of local resources for the expansions, if not the

upgradation of technology itself. In some cases, however, a limit on such investment is sought, e.g. 40 per cent in Brazil, since it is believed that there are reasons why one should be concerned about the proportion of foreign ownership. The government's approach on this question is not uniform in the region.

C. The impacts

The country papers referred to the impact in very general terms, e.g. in Argentina, and several did not touch this subject. Only Jamaica commissioned two studies on the impacts of privatization. Except for Chile, the early bird whose successes in privatization from the standpoint of results have been widely acknowledged, the cross-section of the Latin American countries feel that it is too early to conclude on the impacts, e.g. Bolivia, Guatemala.

Strictly it might be difficult, but never too early, to commence an analytical identification of the direction in which the impacts are shaping themselves. These cannot, surely, be separated from the general results of structural adjustment programmes which most countries in the region have undertaken, e.g. Bolivia. Yet some technical work on trends in the following directions cannot be postponed except at the risk of avoidable dissatisfaction on the part of the public.

First, there are the impacts at the enterprise level, in terms of the extent of competition that privatization has implied, the changes in cost structures, product mix, productivity and prices. Equally important are employment and investment or rate of growth. In a few cases there might even exist certain obligations implicit in the privatization agreement in these respects. The nature of technology development in the privatized sector calls for notice, the more so in circumstances where the desire for profit might dampen the interest of the investor to go in for large research and development expenditures. Where the privatized enterprises are majority-controlled by foreign capital, the nature of technology transfers is worth close scrutiny, in the national interest.

Second, there is the more difficult category of macro-impacts. Employment lay-offs, e.g. 200,000 in Argentina, are perhaps the first of these to attract public attention (The point will be picked up under the caption of "social safety nets"). The tendencies of price movements on the part of privatized industries as well as the elimination of erstwhile cross-subsidies need notice in the interest of the affected consumers, of whom many might be poor.

Of the other macro-impacts, which have not yet received systematic attention, those on the public exchequer are the most crucial. It is important to verify whether the perceived objective of privatization, namely, relief to the budget, has in fact occurred. This is a complex area, but it warrants an in-depth analysis, considering the weightage which governments have generally given to fiscal benefit as the privatization motive.

Let us start with some simplistic assumptions: (1) that privatization incomes augment the government's resources for social expenditures: correspondingly, the public debt analogous to the government's outlays on the privatized enterprises stays, involving recurring debt-servicing charges; (2) that the divestiture receipts bridge the annual fiscal deficit: this is a very short-sighted aim; (3) that the privatized enterprises fetch high tax revenues: true, but if they belong to the easily profit-making sectors, the government implicitly forgoes the opportunity of keeping to itself the whole profit—assuming, of course, that they are well managed.

Then there are the costs of privatization which have to be considered in striking a balance sheet for the exchequer. These include the costs of promotional divestiture prices, tax reliefs or concessions offered to the new investors (the more so in the case of foreign capital), the costs of regulation, a necessary function in many sectors, and the expenditures on social safety nets.

In most economies in the region where the low-income brackets are large and where the people living below the poverty line are numerous, as in Brazil, the consequences in the realm of income and wealth distribution, which privatization through ownership changes brings about, cannot be ignored. Schemes of democratizing ownership through special share offers to workers might not have the intended results, partly because they tend quickly to sell away their shares for a variety of reasons. If a large mass of divestitures leads to concentrated ownership of enterprises in certain sectors, at the minimum the government would be obliged to introduce effective laws to counter its abuse against the public interest.

Mention may be made, finally, of the impact of foreign investment. This is not an exclusive consequence of privatization but the latter offers it opportunities on a silver platter. Guyana's case before the Public Utilities Commission in the early 1990s, involving a big foreign investor in the Guyana Telephone and Telegraph company, is replete with alarming evidence of the undesirable practices that a foreign investor might indulge in. The concluding sentence in the Argentine paper, while acknowledging the good effects of foreign capital, takes note of its "potential impact on local savings, investment capacity and external balance".

The fear of impacts should not hinder privatization, but it should prompt governments to undertake a dispassionate estimate of the impacts with a view to devising remedial, if not preventive, measures.

Before we proceed to the topic of regulation, some reference may be made to the monitoring of privatization both during and after. This is neither evaluation nor regulation, though it helps in both, and it is highly purposeful in establishing the impacts. Experience in Latin America, as reflected in the material made available to the Conference, suggests that monitoring has been very rudimentary in a few countries, e.g. Argentina and Bolivia, and does not exist in the others, e.g. Guatemala, where however, it is considered to be of "critical importance". Argentina refers to monitoring which is limited to the control of the Government's stake in partially privatized enterprises. This is not the monitoring we are discussing here. Monitoring, strictly, consists of a continuous fact-finding on privatization with a purpose, as it proceeds and afterwards. The purpose is to establish accurately the facts relevant to the processes of privatization, to suggest course corrections, as may seem to be desirable, to assist in proper regulation post-privatization, and to help, eventually, in evaluation (Privatization and After: Monitoring and Regulation, Interregional Network on Privatization, United Nations Development Programme). Bolivia is the one country where questionnaires were sent to all owners of privatized enterprises for data on employment, wages, production levels, productivity and competitiveness; unfortunately the responses have not been adequate. There is a moral here concerning who should monitor and how monitoring should be carried out--not necessarily through a single and governmental agency. Since many Latin American countries have still a long way to go in privatization, it will be to their advantage to consider the importance and appropriate modalities of monitoring. Even countries which have advanced substantially should forthwith initiate monitoring the results or consequences, even if they have already missed the opportunity of monitoring during privatization.

2. The continuing issues

A. Regulation

Regulation, in the context of privatization, was one of the subjects specifically discussed at the Conference. It was agreed that regulation of privatized enterprises, where necessary, ought to be clear in its rationale of creating the conditions of competition and curbing the excesses of monopoly elements that persisted. The Conference registered its dissatisfaction that governments, in general, did not assiduously formulate proper regulatory structures while privatizing. While everyone was in favour of competition as the primary force in the development processes, including privatization, many doubted that would be possible in every sector and in small-sized markets. Hence "competition wherever possible, and regulation where necessary" was suggested as a working guideline.

It appears safe to generalize that this still remains a challenge for the future, a term repeatedly used in the country paper on Colombia. This country brings to the fore an interesting problem, namely, the rationalization of the regulatory structures to suit the aims of competition. For instance, the current system neither helps to make prices reflect costs nor makes the subsidy system transparent (in the communications sector).

It is widely recognized in the region that the regulatory processes have not kept pace with the needs of privatization, e.g. Jamaica. In some cases attempts are being made to establish a regulatory framework with such limited aims as giving guarantees to the strategic investor for example, in the water resources and power sector in Panama. Argentina already has an extensive regulatory apparatus. The issue paper on regulation in Argentina furnishes great detail on the commendable range of regulatory activity. At the same time it supports the view that there is ample room for improvement.

A major problem in the area of regulation is that some of the earliest and largest privatizations in the region were concerned with public utility sectors such as electricity, water and communications. There is a large element of natural monopoly in these cases a feature immensely intensified in the case of small-sized markets and countries. It is therefore necessary to ensure that privatization, however effected, is not a passport for the emergence of a private monopoly. Besides, these are sectors whose potential for spread effects is high. Good output and price policies on their part can help develop activities in many other sectors, whereas defective policies can hinder their progress and affect their competitiveness both within the country and internationally. Regulation should bring pressure on the enterprise to improve productivity and lower costs. There should also be adequate guarantees that such benefits are passed on to the consumers. Price discriminations that do not rest on cost differentials have to be censured, and any cross-subsidies have to be explicit, transparent and financed by some level of government. These are hard conditions, but the regulatory structures have to move in such directions.

The technique of "RPI minus X", first introduced in the United Kingdom in preference to profit control through a cost-plus formula, has been adopted in Argentina. The regulator needs to have adequate data in order to be able to adjudicate on the scope for economies or efficiency gains by the regulated enterprise. In the absence of enterprises competing directly with one another, the regulator's task would be very difficult. One strategy is to take recourse to the yardstick of "comparative competition", if a number of enterprises in a given sector exist, though in different regions. The cost or efficiency potential may be visualized from the best of the performance indices, without committing the mistake of ignoring regional and other differences among the units compared. This is not a foolproof device, but it has great merit. It can

be realized only where there is a chance of economical disintegration of an activity, regionwise or functionwise. In a large country like Argentina this is possible. But there are many small economies in Latin America where the size-of-the-market criterion destines an enterprise to operate as a monopoly. The regulatory focus on enterprise efficiency in such cases has to consist in simulating competition to the extent possible within a given enterprise by breaking it down for managerial and regulatory purposes into separable parts.

These issues call for more attention, as time passes, than the Conference was able to bestow. There was no clear convergence of views in respect of the techniques of regulation—for example, the "RPI minus X" method—partly because the Conference did not go into such technical details.

One other specific problem which calls for detailed analysis relates to the concessions, franchises, leases, etc. Whatever the legal name, they involve a private operator managing a publicly owned property. The owner's interest needs protection, especially in respect of the maintenance of the value of the assets. The short-term interest of the operator must not affect the long-term value of the property. Second, the regulator should ensure that the operator does not limit the enterprise to making a profit but undertakes expansions of the size and pattern required in the national interest. The regulatory conditions or the licence conditions have to be suitably drafted, so as to bring pressure on the operator in this direction. Third, there is the possibility of demand conditions falling short of the assumptions made at the time of building, say, a highway under franchise, as in Mexico recently. What should be the limits within which the operator's calamity needs to be subsidized? And what changes in the toll conditions are permissible under those conditions, such that we do not end up in a cost-plus syndrome? Problems such as these have to be examined intensively and solutions found which are technically correct and politically feasible in the circumstances of the country.

The institutional aspects of regulation came in for brief discussion at the Conference. Considering the diversity of political conditions among the countries in the region, one has to be careful in answering the major questions in this context. First, and perhaps the most important, the extent of autonomy and discretionary power which may be vested in the regulatory agency needs full examination. One may even raise the basic issue of whether the agency should be within a ministry or department of government or whether it should be outside it. The answer which most experts offer is in favour of an independent agency outside the government. Even the Chileans find that their regulatory bodies have too strong a dependence on the government and people with experience from that country argue in favour of conferring a more independent status on those bodies. It stands to reason that, when regulation is understood as regulation for competition or as a surrogate for competition, and when its *modus operandi* consists of the lowest cost basis of prices without cross-subsidizations, the agency entrusted with the task of regulation should be one that is technically competent as well as independent of political or bureaucratic masters. There are ways in which the government can strangle the range or depth of work that a regulatory agency undertakes, e.g. by reducing the resources available to it; but the convention or law that the resources needed for its effective work come out of the regulated enterprises should meet this danger. Even where, for some bureaucratic reason the resources are funnelled through the exchequer, the convention should be respected that the required resources are made available to the agency, and the government should not stand in the way of the agency launching its work schedule with a corresponding price tag.

But there arises a problem: would the regulatory agency be too independent or exercise too much discretion? (In fact under the British system the regulator is not obliged to explain decisions. Since the regulator is alone at the apex, the element of discretion might be very real sometimes). One may argue that

in the exercise of this function, namely, regulating an important sector of activity, a public utility at that, total freedom of the regulator from the democratic will of the nation might not be an unmixed blessing. In dealing with this argument one has to make a deeper analysis of the issues at hand. To the extent that the regulatory basket is one that is totally amenable to technical determinations, a high degree of autonomy of the regulator is justifiable. Where regulatory decisions impinge on public policy objectives, there has to be a clear means of transmitting to the regulator the thinking of the government in an effective manner. Such a need arises at least in two contexts. One is where the regulator takes decisions on the permissible level of return to the investor, which affects decisions on prices. Under the RPI minus X formula, for instance, the determination of X borders, to some extent, on his judgement on permissible profit. Returns in comparable activities, no doubt, provide him with a technical basis, but there is scope for discretion in wielding it. This, it can be argued with reason, is an area which the government cannot totally yield to the independent discretion of the regulator.

Second, certain decisions of the regulator, taken on the principle of cost-based prices, are likely to affect the interests of some consumers for whom the prices prove too high. Yet the government may think, on social grounds, that they deserve concessions. The right way of solving this issue lies in letting the regulator's prices stand, and to offer a subsidy—to the extent deemed desirable by the government—to the needy consumers. The subsidy channel should be administratively effective and free from leakage to undeserving consumers. This method relieves the other consumers from having to bear the burden of the socially determined subsidy, and preserves the definitive basis of price regulation, namely the cost.

Third, where the public policy objectives of the government imply that certain segments of demand, e.g. a newly developing industrial area or a rural locality, have to be offered low prices, irrespective of the related costs of supply, the government may communicate its determination to the regulator, so that corresponding action is taken by the enterprise concerned. Here again the difference between the price needed to interest the investor in the activity and the lower, externally determined price has to be provided from some level of government, federal, provincial or local. Thus the element of technical determination desirable in the regulatory process can be supplemented with the socio-political preferences implicit in a given case.

Variations of the preceding situation can occur in some Latin American countries, when a concession for a new highway or a "remote" railway line is offered to a private party. Where the likely returns fall far below the costs of the investment, it is not for the regulator to determine the merits of the venture. It is for the government to take a view in the matter; where it considers the project socially beneficial, it has to step in with a subsidy. Then the regulator should take over, in the sense that he or she applies the regulatory apparatus to establish the least necessary quantum of subsidy. The conditions of the franchise must be written accordingly.

One final word on the regulator's autonomy. In countries where privatization has been slow or unsteady and where the constraints have been weighty, the institutional arrangements must be particularly capable of smoothly transmitting the purport of public policies to the independent regulatory agency. The regulatory process should be free from government control but not run counter to public policy determinations. On the other hand, while the regulatory agency should be technically competent and autonomous, fears were expressed as regards the total elimination of democratic influence on the regulator. The disadvantage, some thought, might be too high a price to pay for the virtue of autonomy.

Another institutional problem which the Latin American countries have to tackle relates to the

constitution of the regulatory agency. Should it consist of one person at the top, analogous to the Director General in the United Kingdom, or should it consist of a board of, say, five members, as in Argentina? There are the usual arguments on either side, but a compelling criterion should be invulnerability to capture by the regulated enterprises or by the government. Which arrangement satisfies this criterion depends on the circumstances of the case and, indeed, on the individual concerned in the one-person choice. The method of appointing the regulatory board can be very important in shaping or qualifying the impartiality of the members. The paper on regulation in Argentina sounds a warning, namely, that the board method may lead to more complex and bureaucratic decision mechanisms than the single-regulator method. The Conference did not express a view on these institutional aspects of regulation e.g. should the agency be headed by a single person or by a board, and in the latter case how should the board be constituted? Issues concerning the capture-freedom of the agency also had no pointed answers.

The number of regulatory agencies which the government may set up is a matter of no small importance, especially in relatively small countries. There can be economies in constituting a common agency for a whole energy or transport sector, instead of establishing an agency each for electricity, gas and oil, or railways, ports, road transport and aviation. There will be advantages of coordination in the regulation of activities belonging to a broad sector, within which there can be scope for competition too. Equally importantly, the demands for high-level experts for the regulators' posts will be easier to meet than if there were a plethora of agencies.

The papers presented at the Conference do not indicate that the Latin American countries have developed the system of promoting consumers' organizations in the major regulated sectors, unlike in the United Kingdom whose price-cap technique has been adopted by Argentina. Consumer organizations exert a healthy influence on the enterprises and encourage a consumer orientation on their part. Several routine problems can be sorted out at their level, relieving the regulatory agency of detailed attention to cumbersome detail. The costs of these organizations have to be met by the regulatory agencies, that is, eventually by the regulated enterprises themselves.

B. Competition

The pre-eminent importance of a competitive environment for the success of privatization, economic reforms and structural adjustment programmes does not seem to have been fully brought out in the papers delineating the experiences of Latin American countries. The Conference, however, devoted due attention to this consideration in the course of the discussions.

Everyone endorsed that the promotion of competition was basic to, if not more important than, privatization. That would guarantee that every enterprise endeavoured towards efficiency.

The Conference recognized that most countries launched privatization without adequate preparation, in particular without the necessary restructuring of the sectors or enterprises concerned and without ensuring that competition was going to be in place. The many serious problems that have arisen in the wake of privatization would not have been there, had these prior steps been taken and wisely.

Many of the major public enterprises in the region have been operating as monopolies, or with significant control of the market. Uruguay, for example, has a few extremely large and monopolistic public enterprises, and Nicaragua's public enterprises operate with captive markets. All efforts at improving efficiency require, first of all, the elimination of the monopoly powers which enterprises in the public sector

have generally enjoyed. This is a requirement whether the government undertakes a distinct privatization programme or not. The methods of introducing competition range over: (a) deregulation and guarantee of free entry, which permits new units to enter the sector and compete with the incumbent public enterprises, as envisaged in the Guatemalan paper; (b) promotion of competition among incumbent public enterprises, where more than one exist; (c) the disaggregation, horizontal or vertical, of excessively large incumbent units into a number of smaller but optimal units; and (d) the simulation of market conditions within the operating regime of every public enterprise through the effective creation of cost and profit centres and the application of across-the-market principles in the transfer of the output of a section of the enterprise as an input to another. Additionally, techniques such as contracting-out encourage the managers to look for the lowest cost structures, which the market can make possible.

These devices are independent of divestiture. In fact they represent the marketization of the enterprise, which privatization intrinsically entails. The tendency to assume that privatization means selling a public enterprise has helped to weaken the basic requirement of promoting competition for the sake of maximum efficiency in a given sector. That privatization through an ownership change does not necessarily bring about efficiency is shown by enterprises which have been transferred virtually as private monopolies. The problem can be addressed by regulation, no doubt, but a lot of it might have been unnecessary if, in the first place, all competition that was possible in the sector was promoted prior to privatization. It is interesting to find that Paraguay, at the minimum, believes that enterprises which could be competitive but for State ownership would be among the best candidates for privatization.

Some unbundling of activities was undertaken in Argentina during its second phase of privatization, though, during the first phase, the market power that the enterprises on the block had possessed was left undisturbed. The way in which the enterprises sold or franchised were disaggregated, partly into provincial units, and partly as functionally separate units, merits careful examination. One obvious advantage that flows from such measures is that they represent a situation of comparative competition an advantage to the regulating agency, as mentioned in the previous section.

The Conference took particular note of the New Zealand example of privatization. Basically the Government depended on the 1986 Commerce Act and all restrictive practices were strictly regulated. The most valuable inference from that country's experience is that there ought to be a competition policy, independently of and apart from privatization. The United Kingdom has an Office of Fair Trading. Besides that, there is a strong Monopolies and Mergers Commission. There is a public policy determination that all restriction on competition which is against the public interest, should be censured and remedial judgements enforced. Some industry developments, which the regulating agency by itself might not be empowered to deal with effectively, could be subject to scrutiny by public agencies set up in consonance with the nation's emphasis on the promotion of competition wherever possible. For example, mergers among the regulated units, which reduce competition in the sector, might be outside the regulating agency *per se*, though they add to monopoly in the sector. The Water Regulator in the United Kingdom had to refer a recent merger between two water companies to the Monopolies and Mergers Commission on the ground that it affected his ability to wield the tool of comparative competition in the performance of his duties.

As per the Conference material, no Latin American country appears to have a Fair Competition Act (such as Jamaica has). The importance attached to competition gets a boost with such specific legislation. It may also assist the government in preventing such flaws in privatization as: the transfer of a large monopoly in an unstructured or disintegrated manner; trade sales which might have the effect of adding to the market power of the new owner; and divestitures focused on maximizing revenue to the public

exchequer. In some cases, the buyers of enterprises might successfully exert pressure on the government for concessions and reliefs which tend to have the eventual effect of enhancing their control of the market. Countries which desperately seek foreign capital have to be particularly cautious in not compromising with the ideal of competition. They face a paradox: they need foreign capital but do not want it to enjoy market control. The more competition that the country has in mind, the less the profit motivation for the (foreign) investor.

There is a political angle to the competition issue. Where privatizations are undertaken without promoting competition, the whole programme gets into disrepute on the ground that prices are high, perhaps higher than in the former times. One cannot object to the level of prices when they are based on costs in a situation of competition. Where the prices and high profits are known to be earned in a non-competitive situation, the consumers and the public at large have a legitimate cause for complaint. This can take a political colour and the so-called liberalization and free-market approach of the government might be brought into serious question. Countries which have already undertaken privatizations without much regard for promoting the maximum possible competition in the sectors concerned need to take note of the political dangers involved. Countries which are in the process of privatizing will benefit from introducing all possible techniques of encouraging competition in the sectors to which privatization applies.

C. Social safety nets

Very few of the country papers made direct references to issues relating to social safety nets. The reason is not that these have been unimportant but that the governments have not so far undertaken a systematic estimate of the impacts of privatization. Attention has had to be paid to one major impact, however, namely labour lay-offs, and the remedies have been ad hoc in nature.

Argentina implemented some golden hand-shakes, and Bolivia adopted the method of dismissing the workers and paying them in full prior to the transfer of enterprises to private owners. Jamaica's labour markets were such that it did not face the problem of a rise in unemployment; its approach included employee share ownership schemes in some cases and offering land for housing the sugar workers at well below the market prices. Guyana is one of the few other countries in the region which did not experience unemployment when privatizations took place.

The first step in a scientific approach to the problem of safety nets is an identification of the groups that are exposed to some degree of "unsafety" as a result of privatization. Labour is the most commonly recognized group, as the country material submitted to the Conference suggests. Several devices are adopted in providing safety nets for the workers affected by privatization or, more strictly, by a restructuring of enterprises with the objective of attaining the lowest cost possible and, correspondingly, improved productivity. In other words, even where a public enterprise is not sold away, reforms intended to marketize it—for example, through a properly formulated performance contract—would have an impact on labour and might call for safety nets.

The most common net has consisted of golden handshakes and schemes of voluntary retirement. These have for one result the exit of the relatively more competent employees. The others stay on. This is not really an advantage to the enterprise, though the numbers decline. Unemployment reliefs under the ordinary laws of the land should help, perhaps not adequately where privatization leads to a sudden large-scale addition to the number of unemployed. Hence the need for some specific measures of safety nets.

Some of these can be built into the very process of privatization. For instance, the divestiture agreement could stipulate that the new owner of the enterprise should not retrench labour at all or beyond an agreed figure for a specified period after the enterprise comes under his management. While protecting employment, this runs counter to the very objective of efficiency on the part of the privatized enterprise. To some extent it might obligate the government to permit the enterprise to enjoy an element of market control in order for it to survive despite its excessive labour load.

Offering the laid-off workers easy credit for their start-up of small-scale enterprises on their own is a fruitful measure, provided, firstly, that the new businesses so promoted have a market and, secondly, that the workers have the required managerial ability to stay in business in a situation of competitive markets. Where these two conditions are not satisfied, the worker-managers will be in need for further safety nets in order to avoid bankruptcy.

One solution frequently mentioned at the Conference, beginning with the lead paper on social safety nets and mentioned in the Proceedings, is the informal sector. Diverse views were expressed on the informal sector as a way out in the context of safety nets. Doubts were expressed on the viability of several pockets of that sector, and references were made to unsung bankruptcies. Those laid off could engage themselves in this sector, with a fairly small start-up capital. Even for this, some channel of public assistance, not necessarily a dole, may be necessary. This is a tempting solution, but its utility is subject to the condition that the products or services which the informal sector makes available are marketable at profit-fetching prices and that the returns approximate at least to the wage incomes that those engaged in it are entitled to expect. This is an area which calls for detailed grass-root study in the precise circumstances of a given country.

A similar device which is generally canvassed is the retraining of the workers exposed to lay-off. This may be done by the enterprise concerned or by outsiders. The idea implicit in this plan of action is that, while the workers are found to be redundant in the activity in which they have been employed, they can be turned into usefully productive workers in some other activities. Here again the caveat, a heavy one, is that there are jobs in which they can fit after retraining. It would be too much to expect the retraining institutions themselves to establish where and what new job opportunities exist. There ought to be a systematic survey of such openings under public funding.

The best safety net, which does not appear to be one, is a programme of technological and market restructuring prior to privatization, as a result of which the enterprise would be able to market its entire output profitably. Then it would not have to undertake labour lay-offs. This technique has to be pursued with care and is to be limited to cases where the restructuring programme is certain to enable the enterprise to market its outputs profitably. Here the investments in restructuring do not represent throwing good money after bad.

Let us turn to groups other than workers who also deserve consideration. Consumers might suffer a disadvantage for example, (a) when the enterprises begin to operate at "economic" prices, as opposed to the subsidized prices of the pre-privatization era; (b) when some consumers lose the price preferences they enjoyed in the former times; (c) when certain consumers or regions are denied the supply of an output on the ground that it is uneconomical for the privatized enterprise to maintain such a supply; and (d) when privatized enterprises have a market control that enables them to announce high prices. The economic rationale of these effects on the consumers require careful understanding before one proceeds to launch safety nets. For instance, the first is an unobjectionable development to which the consumers have to get

used, though they might need some immediate cushion while adjusting themselves to the new situation. The second is again an admissible change in the sense that cross-subsidies at the discretion of enterprise managers are unacceptable and, in any case, cannot exist under conditions of competition. However, at least some of the affected consumers might deserve some price advantage or subsidy. They might need it for a short time or over a long period. In the third case, the enterprise is right in its output policies, though on grounds of public policy the government might decide that the affected groups deserve the supply. Since, by hypothesis, the enterprise is unable to supply at the price that the consumers concerned can pay, a compensation from outside, i.e. from a governmental authority would be necessary if it should be persuaded to maintain the supply. In the last case, the most appropriate public policy response has to take the shape of regulation as discussed in a the section on regulation.

To summarize: some kind of a safety net is necessary in the first three cases. The first has to be very temporary and applicable probably to all the consumers. Barring some extraordinary circumstance, a whole sector cannot permanently be allowed to work on flagrant cost-price distortions. The second calls for a safety net closely targeted to the deserving group for just as long as that group is determined to deserve the public subsidy. The third is similar to the second, but the government should be watchful in detecting a possible improvement in the ability of the consumers or regions concerned to bear progressively higher prices as time passes. No safety net is required in the last case. In fact the pressure should be for a reduction in prices.

There are other claimants for safety nets too. Two categories may be highlighted. The first is composed of the small scale units which might have been surviving under some *de jure* or *de facto* arrangement that offered them price preferences from the public enterprises which bought inputs from them. This is sometimes reckoned as an advantage of ancillarization. This might be lost when privatized enterprises rightly decide to procure their inputs across the free market. The other category consists of the privatized units—the small ones in particular and those encouraged on grounds of employee ownership—which might fail in the not-too-distant future. It will be politically too difficult for the government to dig its faith deep in the maxim of the survival of the fittest, which is right in theory.

Since many Latin American countries have not yet approached the question of social safety nets in a systematic manner, it might be useful to mention the most desirable components of policy in this direction.

First, the groups that call for safety nets should be dispassionately identified. Political considerations must be set aside as far as is feasible.

Second, the size of the problem in each category e.g. workers, consumers, and hard-hit enterprises should be estimated reasonably well, in physical as well as financial terms.

Third, a decision should be taken on the capacity of the public exchequer to shoulder the aggregate cost responsibility for a comprehensive spread of safety nets. In this process, the government should explore workable ways of spreading the cost onto others, including enterprises in general and sub-national levels of government, and produce a well-coordinated plan of resource mobilization for a given structure of safety nets. While on the question of financing the safety nets, one should not overlook the fact that most governments have already borne some costs during the privatization process itself e.g. when they opted for a lower-than-possible divestiture price in the interest of giving the employees the benefit of proprietorship at below-market share prices, or when they imposed no-retrenchment conditions on the buyers of the enterprise, as a result of which the divestiture price must have been lower than was otherwise possible.

Fourth, there ought to be periodic revisions in the composition of the beneficiaries under each safety net: the main idea is to provide a temporary cushion to the most needy.

Fifth, all programmes under the head of social safety nets should be coordinated with the government's more general programmes of public assistance, in particular those aimed at poverty alleviation. The problem of large numbers below the poverty line is very serious in most Latin American countries.

While being concerned with safety nets which are occasioned by privatization, we should not overlook the more fundamental problem of poverty, which the government has to tackle. Privatization might make some who are below the poverty line poorer than before, or add to the numbers below that line. Where the majority of those affected by privatization do not belong to the category below the poverty line, the government indeed faces tough problems of decision: how far should its scarce resources be utilized for social expenditures, which significantly include poverty-alleviation programmes, as against safety-net expenditures for those affected by privatization? The former is a more fundamental requirement, while the latter carries the weight of political immediacy. To some extent there might be overlaps—for example, where the consumers affected by high energy prices already belong to the poorest brackets of society.

There was an obvious consensus among Conference participants in favour of social safety nets being established so that the groups that suffered in the process of privatization might be offered a temporary cushion of assistance. While the interests of labour came uppermost, those of the consumers and others that might face difficulties as a result of privatization were also recognized as deserving of consideration. Public assistance to needy consumers should be through an open subsidy from a governmental source, and not through concealed cross-subsidies in the pricing structures.

The discussants were clearly of the view that the costs of safety nets might be very high indeed and doubted if the governments, in their financial stringency, had the necessary resource base.

While considering safety nets, the Conference agreed, attention should be given to the more fundamental programmes of poverty alleviation which the government meant to undertake, so that the required degree of coordination might be effected.

One concluding word. The social impacts of privatization represent, over time, problems inherent in the transformation of society into a relatively free market economy. Effective care should be taken in dealing with them, so that public confidence in the soundness of the market economy does not get rudely shaken.

On the whole there was an undoubted consensus on the desirability of privatization in the Latin American region and on the need for caution in implementation so that unintended and undesirable impacts were promptly tackled.

While there was all-sided welcome for foreign capital in the context of privatization, several points of apprehension were aired. Risks of foreign control over major sectors of activity and of unpredictable decisions of repatriation, not to speak of dubious practices in transfer pricing, had to be guarded against.

On the whole the Conference addressed a few selected topics in the area of privatization. Considering the fact that the discussants came from wide backgrounds of socio-economic development,

some lack of convergence in views and conclusions had to be expected. However, the extent of agreement, especially on the basics, was impressive. It is not certain, though, whether more detailed and longer discussions would have brought out acute differences. For privatization is one of those areas of policy and implementation where it is easy to agree at the overall level and perhaps equally easy to disagree at the detailed level.

II. REGULATION IN ARGENTINA: DESIGN AND IMPLEMENTATION

During recent years, Argentina undertook a massive, rapid and far-reaching privatization of its infrastructure public service enterprises (PEs). This transformation has changed the role of the State from entrepreneurial to regulatory, given the public service character, the natural monopoly elements involved in these basic industries or parts of them, and other market failures which merit the intervention of government in markets. Due to this, since 1991 eleven regulatory/control agencies were established or are being set up, disregarding the National Directorate for Control of Agricultural Services, as well as other public control or representative institutions of various interest groups and constituencies. This has drawn a new and complex institutional network with different monitoring and control mechanisms.

This paper is based on the recent Argentine regulatory design and implementation experience and consists of the following parts. This first part provides the privatization background. The second part analyzes the regulatory environment--the need, role and functions of regulatory agencies. The third provides an overview of regulatory techniques and institutional aspects related to implementation. The fourth refers to the legislative and judicial environment, while the fifth part deals with recourse and penalties. The final part draws some conclusions and recommendations. The annex gives some key indicators of personnel and budget allocations for each regulatory agency.

1. Background

Since the mid-1970s, the Argentine Government enacted liberalization and stabilization policies, which deteriorated severely in the early 1980s. Later, in the mid-1980s, there were successive stabilization and adjustment episodes, which led finally to structural reforms with profound changes in the prevailing accumulation model.

Argentine PEs were inserted in a complex institutional and regulatory network with diverse and usually inconsistent policies and objectives that normally were dealt with through the agency analytical framework. They were subject to political and sectoral vested interests from both labour and business that led to redundant labour, revenue and expenditure leakages, non-transparent procurement policies and cross-subsidies. Tariff levels and structures as well as prices were related to macroeconomic objectives and not aligned with costs. Financial and debt policies were independent of management operational and investment decisions and led to high levels of debt stock. Also corruption, fraud, free riding, and obsolete invoicing and control mechanisms eroded current revenues and the company asset bases.

Under these circumstances, the quality of assets and technological capacities of PEs deteriorated rapidly, together with the quality, coverage and reliability of goods and services rendered. This situation led to low operative efficiency and management levels, as well as allocative inefficiencies, which contributed to the rising fiscal deficit and complaints from public service consumers and the population in general. Finally this led to popular support and consensus for the privatization policy.

Thus, the gradual step-by-step PE reform policy which had started in 1985-1989 led, after the 1989 hyperinflationary episode with its fiscal, social and political consequences, to a massive and overriding privatization process undertaken by the incoming administration that took advantage of the political backing and consensus provided to this policy. Its stated objective was to increase fiscal revenues to service foreign debt, to contribute to stabilization and improve the quality and coverage of public services.

These changes were implemented by the incoming administration, which took office late in 1989, by establishing the State Economic Emergency Law, which eliminated or suspended all subsidies and transfers towards the private sector, and the State Reform Law, which established the rules and procedures for privatization of public enterprises.

The first privatization stage started in 1990 and was headed by the Ministry of Public Works and Services. It was implemented amidst an unstable macroeconomic environment, policy gyrations and shifts, and was characterized by arbitrariness, accusations of lack of transparency and other controversies. During this period Entel, Argentine Airlines, the main highway network, television channels and some petrochemical plants were privatized.

The restructuring activity was mainly concerned with changes in legal status, transfer of liabilities to the public sector and horizontal unbundling, as in the case of Entel. In this period, regulation had a lower legal status, since it was enacted through decrees following the establishment of regulatory bodies, as in the case of CNT, with controversies about concession contracts, tariff levels and structures.

The present stage started with the Convertibility Plan implemented in 1991 by the Ministry of Economy, Public Works and Services. This became more coherent when State reform, liberalization, privatization and deregulation policies were systematically articulated as part of a stabilization-cum-reform process.

Thus, the stabilization and reform plan made privatization the cornerstone to increase fiscal revenues and obtain the required political backing, as well as to increase economic competitiveness.

Each privatization was moulded according to its peculiarities, sector interests and available technical capacities. However, not only fiscal revenue was enhanced, but also the quality and coverage of services together with the introduction of competition when this was feasible.

The process was characterized by the outright sale of control stake rather than by widespread share distribution. This was due to the small size of the capital market, the possible increase in fiscal revenues and improvements in operative efficiency and management. However, these advantages have tradeoffs: (1) economic concentration reduces the possibility of being curbed by market forces, through takeovers, when there is mismanagement, and (2) due to the large foreign investment, a government may be subject to external political pressures and negative current account effects, due to capital outflows when dividends are repatriated.

During this stage, different aspects of the earlier privatizations were renegotiated, such as: telephone tariffs and the extension of value added services in the concession contract; the financial commitments, investments and operative plan for Argentine Airlines and its fusion with the local airline Austral; and the investment commitments, terms, toll rates and the change from fee to a subsidy for the highway concessions. All these changes had consequences on the franchise contracts and the regulatory and control frameworks.

This process had technical assistance, financing and administrative facilities provided by the World Bank and UNDP, through different loans and projects, that enabled the design and implementation of global and sectoral privatization strategies and policies, as well as the establishment and operation of some of the regulatory agencies.

Between 1989 and 1993 all large infrastructural services were privatized. The latter privatizations from the second stage were implemented amidst increasing economic stability, transparency, restructuring of different

sectors through horizontal and vertical unbundling to enhance competition or facilitate privatizations, such as railways and other sectors, partial sale of assets, more elaborate bidding conditions, concession contracts and regulatory frameworks. When politically feasible or necessary, regulatory frameworks were enacted by laws.

The estimated revenues up to 1994 were US\$ 16.3 billion, of which approximately US\$ 9.5 billion was in cash and US\$ 13.8 billion in debt papers—equivalent to US\$ 4.9 billion in cash—and liabilities for US\$ 1.9 billion transferred to licensees.

Because of the pace and size of the privatization process, the important fiscal needs, and the sale of control stakes, all aspects of the privatization policy and strategy were difficult. Sometimes the regulatory capacity was lagging or the burden was too heavy, creating serious challenges to the regulatory agencies.

2. Regulatory environment

The reduction of fiscal deficit, the improvement of operative efficiency and expansion of services were objectives that justified privatization. However, success depends on the regulatory and competitive environment in which these enterprises operate. Thus, it is important to have institutions capable of objective administration, avoiding opportunistic behaviour that will prejudice the credibility of the system.

The public service infrastructure utilities can be characterized by their specific technology and sunk or non-reversible costs; they are natural monopolies that face economies of scale, scope and density in the provision of basic goods and services. Also their products are consumed widely by consumers in captive markets with low demand elasticities. These traits of infrastructure services are at the root of the contracting problem which justifies their regulation by the State.

Notwithstanding the fiscal priorities and the massive and overriding Argentine privatization process which led to high levels of economic concentration, it is possible to observe an active interest in pro-competitive regulation, reducing entry barriers, establishing open access and interconnection rights with regulated tariffs or price caps, and in the vertical and horizontal separation or unbundling of activities to curb non-competitive and predatory actions.

Given the size of the country and its infrastructure networks, there are economies of density which are related to the relative costs of provision of services through networks, according to their relative distance to service consumers. In this case, pro-competitive policies encounter problems due to the physical characteristics of networks. Incumbent enterprises face the risk of "cream-skimming" of the most attractive parts of their market by newcomers that have access through interconnection, without sunk costs, to high demand levels from large consumers, while they do not have to commit to provide universal services and expansion of these within the incumbent firm's regulated market. By the same token, monopolistic producers will try to extend their market power toward competitive sectors through predatory actions, being able to sustain these policies while they oust competitors.

The above-mentioned reasons justify sector-specific regulation in concentrated markets. Hence, the regulator's activity will be oriented towards non-competitive markets. However, for these markets to operate there is the need to develop a transportation network which supports the integration of its different segments in order to allow the market to operate as such.

In such cases, regulation will be biased towards compensating market failures so that different actors

in the market will behave as though they were facing competitive situations in which they have incentives to improve productive and economic efficiency. Thus, natural monopolies set potential conflicts that can be reduced by using different regulatory policy tools. Finally, it is important to stress that, apart from regulatory functions, the regulator will also be charged with supervising the concession contract between the awarding power and the concessionary.

This situation may be understood better when one analyzes some of the regulations of public services. Since most of these sectors were previously restructured by market separations or segmentation, these cases will be described before referring to the key issues of market regulation and control.

Electricity

The features of the restructured electricity sector were: (a) the introduction of competition through the market; (b) vertical separation of the industry into three parts for its privatization: generation, transmission and distribution; (c) making the consumer the final beneficiary of reform; and (d) establishment of a regulatory agency responsible for the application of the law. For thermal generation, which was declared to be of public interest, the market was deregulated and the assets were sold to allow for unrestricted market entry. This market operates under rules that are set by the Secretariat of Energy through the economic load dispatch.

For the distribution and transmission sectors which are natural monopolies, concession contracts were awarded in a market where prices are regulated by price caps, in which discrimination is curbed and there is open access to the networks. The bulk carriers have to limit their activity to transmission and cannot buy or sell electricity. The large consumers, whose purchase threshold was reduced from 5 MW to 1 MW and later to 100 KW, can purchase and sell energy under competitive conditions.

The National Electricity Regulatory Body, ENRE, was created to protect consumers' rights while considering the characteristics of a regulated market. Based on this model, controls on prices, quality of services, obligation to provide service and free access to third parties were established. The ENRE's functions are: to apply the regulatory framework and ensure compliance with the concession contracts; establish regulations related to security, rules and technical procedures; metering and billing; meter use and control; service interruption and connection; quality standards; prevent anticompetitive, monopolistic and discriminatory practices; set the tariff basis and its implementation; implement the public hearing system; protect property, environment and security while building and operating the system; apply sanctions and penalties; publish information and provide advice to all actors in the system; and ensure publicity of its acts. Thus, it has regulatory, inspection and first-level judicial functions.

Gas

The vertical and horizontal separation of gas set a regulated open access system with eight distributors and two bulk carriers, which are the service licencees, and large consumers, with a deregulated gas production market. Carriers are not authorized to purchase or sell gas, except for their own use. The carriers have to provide service at a regulated price (price cap) if they have capacity to do so and in a non-discriminatory manner. Distributors sell gas under price caps regulated for consumers, with gas that was previously bought from producers with toll prices set for carriers. This model obliges ENER GAS to control prices, quality, third party free access and investment commitments. ENER GAS also has regulatory, inspection and judicial functions.

Water and sewerage

The water and sewerage services for the city of Buenos Aires and 13 districts of the province of Buenos Aires were awarded through a franchise to the lowest tariff--a k tariff discount factor. The main purpose of this franchise is that the private operator should develop a large predetermined capital investment programme based on achieving performance targets for parameters such as percentage of population covered by water and sewerage services, percentage of renewal of the water and sewerage networks and a maximum percentage of non-registered water that has to be reduced from 50 per cent to 25 per cent. This will result in the connection of approximately 1 million people during the first part of the franchise, with an estimated contract performance target that will require an investment of US\$ 3 billion for the 30 years of the concession, which is about US\$ 100 million per year, compared with the US\$ 10 million annual investment during the Obras Sanitarias de la Nacion's administration. The performance parameters that will be monitored relate to water pressure, continuity of supply, quality of water and effluents, sample frequency, consumer complaints, as well as the number of meters installed.

The regulated area has a population of 8.8 million, of which 70 per cent receive drinking water and 58 per cent have sewerage systems. The objective is that when the concession is finished, through six quinquennial investment plans, service will be extended to provide water to 100 per cent of the population and sewerage to 90 per cent, with secondary treatment for 93 per cent of effluents, renewal of 45 per cent of the water network and 5 per cent of sewers, preserving water reception systems and the environment.

The regulatory framework that is applied by the Ente Tripartito de Obras Sanitarias (ETOSS) covers the franchisee and other providers of service within the regulated area, and emphasizes that the service has to be provided under conditions that ensure its continuity, regularity, quality, and efficiency for consumers, while protecting the environment.

ETOSS has to enforce the regulatory framework and franchise contract of service; it reports and advises consumers about their rights, publishes its decisions and other useful information about the sector. It monitors quality standards of service provided to the public, as well as the improvement and investment plans, and operation and maintenance developed by the franchisee to comply with its contractual performance targets. It controls compliance with the tariff system, analyzes quinquennial reviews of the tariff structure and level and authorized inflation adjustments; receives consumer complaints and reports for deficient provision of services as well as billing problems that have not been solved by the franchisee and applies penalties established in the contract. It requests from the firm the information necessary to control the concession and analyzes and approves its annual report. ETOSS's main functions are regulation, inspection and first level arbitration.

Telecommunications

The telecommunications network was divided into four separate enterprises in which two concessionaires have participated: two that provide local and interurban services (one in the northern region and the other in the southern region), and two firms equally owned by these same enterprises to provide international long-distance service and the other value-added services under competition. For basic telephone, interurban and international services, the concession is exclusive for seven years with possibilities of being extended for another three years if the set goals are attained or surpassed. The concessionaires have to comply with the expansion plans, provide continuity, regularity and equity, and generalize the services and promote the universal character

of basic telephone services at fair and reasonable prices.

The tariff system is a price-cap one, for a basket of services that includes international long distance, and is administered by the political authority, the Secretariat of Public Works and Communications. Interconnections to the network to develop new service providers are contemplated and these interconnection prices have to be public and non-discriminatory; cross-subsidies to competitive services are prohibited. The functions of the Comisión Nacional de Telecomunicaciones (CNT) are the technical and administrative regulation, control, supervision and administrative recourse for complaints from users or other parties for telecommunication services. CNT has the capacity to apply penalties.

Consumers

Given that one of the main functions of regulation is to protect consumer rights, privatized companies as well as regulators have developed information and advisory programmes for consumers with mixed records of success. There are telephone complaint systems through toll free numbers and personal or mail complaint systems. Normally every complaint has to be initiated with the firm that provides the service, according to the set guidelines.

There are also consumer associations such as the Asociación de Defensa del Consumidor (ADELCO). Consumer satisfaction surveys are also conducted frequently by both enterprises and regulators. Since not all regulatory frameworks and concession contracts had consumer guidelines, work has started to try to develop some kind of general framework or pattern. Also, some service providers have started to notify consumer rights and guidelines with their invoices. Most utilities have recognized the need to streamline procedures to improve attention to consumer complaints and claims.

Preliminary outcomes

The outcome of this first stage of provision of privatized services has had a delayed effect on operative efficiency because of the start-up conditions. Most enterprises continued with their personnel retrenchment policy, implemented through voluntary retirement plans and other mechanisms which have improved labour productivity in most cases. Technical and management capacity has increased, improving the operation and coverage of services.

Even though climatic conditions were mild and water capacity in the basins was high, most systems reacted well when they faced peak demands and emergencies without the risk of collapse that existed before. The quality of products and services has improved, although they started from very low levels. Consumer claims, complaints and protection are being processed and service is improving. However, there still are non-programmed service interruptions and disconnections, low quality standards and investments below contract commitments, because some enterprises have preferred to reap profits and improve cash flows before increasing their investments to comply with their expansion plans. Because of the present external financial conditions, compliance with contractual conditions might be even more difficult to meet. During this first stage, the development of the regulatory capacity has been diverse and the relations between regulator and regulatees have been tense and adversarial. Most regulatory problems have been related to quality control and expansion of services, tariff adjustment and rebalancing and network interconnection.

3. Regulatory techniques

The different regulatory policies are related to the objectives and resources of each regulator, the institutions of the jurisdiction in which regulation is imposed, and the characteristics of the industry for which regulation is designed.

To enable the analysis of alternative regulatory policies, one should consider the form of regulation, which encompasses the procedures employed to design and enforce regulatory rules, the nature of these rules and the style of decision-making authority in the regulatory framework; the function and main objectives of regulation; and the scope of regulation and control.

Regulation covers diverse aspects, such as price, quality, service, information and others which are specific to each sector. These are derived from the objectives of regulation. In Argentina, regulation is geared towards improvement of managerial efficiency through market signals, reducing its interference with day-to-day management of business, which restricts the regulator's task. Because of this, price-cap regulation subject to reasonable review periods was chosen, together with long concession periods that would allow improvement in operative efficiency and expansion of service, starting with 10 years for transport and reaching 95 years for electricity. Also, for those services where it was possible, preference was given to controlling the quality of service rather than controlling investment.

Tariffs and prices

When the tariff level is applied, given the fact that one is dealing with natural monopolies that produce multiple goods or services and the inherent problem of separating joint costs, the price cap is set for a basket of services. This situation generally leads to the need to rebalance tariffs and to problems of balancing efficiency and distributional equity.

Although it is possible to set multiple price-caps or individual caps, this disregards some goods for which there is demand elasticity. Also there is the problem of implicit cross-subsidies in networks that have economies of density and, thus, higher costs in low density areas. These cannot be recovered by increases in standing charges, as this would affect low income groups or other political considerations. The practice of regulation requires a very careful balance between technical and political factors that have to be appropriately considered. There are different constituencies and interest groups behind each of these decisions, e.g. in the present situation with the telecommunication tariff rebalancing, and the restructuring of the water and sewerage tariff.

Even though it might sound like a paradox amidst a liberalization and privatization process, price-cap regulation has been chosen rather than rate-of-return regulation, together with quality and investment control when necessary, to ensure that cost reductions derive from efficiency and not from quality of service. The non-regulated costs such as the cost of electricity and gas that are produced in competitive markets are passed directly (pass-through) to the final cost of service. This also entails risks when dealing with very concentrated sectors downstream in the industry, that might have effects on the prices of fuel for both gas and electricity services. However, so far the market has reacted favourably, and private investors are starting new supply projects that will raise capacity.

The water and sewerage franchise was awarded with an adjustment factor (k) on the present tariff, which reduced the tariff by 27 per cent. However the tariff was increased later by 13.5 per cent in order to

advance investment plans. The freight railways have a tariff ceiling beneath which cargo operators set their prices, since they compete with road haulage. This was a very interesting case in which the sector had to recover credibility and compete with a system that had benefited from railway's inefficiency for more than 40 years. This transport mode has so far increased its cargo by more than 20 per cent.

The metropolitan passenger railway and subway system has a tariff set by the regulatory authority which includes a sliding-scale subsidy component for operation and investment which depends on improvement of quality of service and on demand. The concession of the trunk highway system spans a network of over 9,000 km, formed by various roads. This network and the metropolitan access system operate under a toll concession régime. The trunk network receives a subsidy, while the access system will pay an annual fee with a sliding scale that depends on traffic growth. Part of the surplus can either be returned by paying a higher fee or invested in road improvement. This is related to the fact that all concessionaires are construction firms.

Because of the convertibility plan, most tariffs have been pegged to the dollar, with price adjustments related to the United States retail price index. There are other productivity adjustment factors such as the X factor for telecommunications and decreasing standing charges with set review periods. These review periods are crucial for the concession and will require intense research and analysis from the regulator and regulatee. The concession contracts are not subject to review by the regulator as in the UK. However, one might expect that, as part of the adjustment process, some contract reviews will be made.

Market structure and promotion of competition

Another aspect of regulation is related to the industrial structure, which refers to the market that will be regulated, its technological evolution and the linkage among the different parts when determining the cause of failure in service delivery. The market entry and discriminatory practice provisions, which may enhance or deter competition, have been considered in the design of regulation to promote competition. Markets have been ring-fenced to restrict predatory behaviour when setting restraints on transmission vis-à-vis generation. Cross-subsidies may deter competition within market boundaries between telephone operators, cable TV and telecommunications value-added services. Restructuring through separation of parts of the industry while allowing open access and interconnection to network systems has occurred in both electricity and gas. The latter also developed yardstick competition among the eight regional gas distributors.

The regulatory function and activity

The maintenance and condition of infrastructure towards the end of a concession period is also a problem that has not been appropriately dealt with in the current literature or by practitioners, given the natural trend to run down the quality of assets just before expiration dates or reviews. This requires intense monitoring and control by the regulator, which may be reduced by yardstick competition or by the consumer's control of quality of services.

Regulation is a dynamic activity which changes with technological, political and social changes. Thus, it is sequential and allows for tradeoffs between short- and medium-term goals. In Argentina, the stated objective for this first stage is to restore efficiency in the operation of public services, which were very deteriorated. In the second stage, regulation will probably try to increase the diffusion and distribution of these services. An important related aspect is the credibility of regulation and the regulator, since regulatees and investors will always be second-guessing their regulator. This is because of the relationship that exists between the long-term performance of the firm and its financial capacity.

A credible and stable institutional environment, with set objectives and goals instead of moving goal posts, is relevant for the sustainability of privatizations and reduction of the risk of reversion.

This situation has been subject to intense debate in the United Kingdom, where there has been frequent talk (with a touch of irony) about “regulating the regulator”. Although it went through protracted periods of restructuring, the British privatization process was not based on unbundling industries and in some cases included the provision of consumer durables under regulated markets such as telecommunications and gas. This provided the utilities with high market power. Also, the initial set of price-caps led to high rates of return and frequent tariff reviews during the early privatization years. This situation, together with the ability of the United Kingdom regulators to review concession terms and tariffs, permits one to understand the reasons for such a strong debate and permanent confrontation. Some of these situations, referred to the Argentine experience, will be considered in the next section.

The information and participation of consumers are elements which significantly facilitate the task of the regulator. However, the cost involved in collecting information is important and information asymmetries between regulator and regulatee do exist and make the task more costly. Structural changes, such as yardstick competition, separation of sectors and other such policies can play a facilitating role. It may also be useful to use expatriate sources and international agencies for twinning, shortcuts or other forms of overcoming these problems.

The regulatory framework, whatever its legal status, spells out clearly the regulatory environment. It identifies regulated and non-regulated markets, as in electricity and gas production, value-added phone services and consumer durable goods. It also determines who are the actors in the market that are subject to regulation. Even in cases where separation is intense, what the regulator regulates is the market and the industry. Within each market, each enterprise is subject to regulation and control, according to the regulatory framework and the concession contract.

Organization and institutional capacity of the regulatory agencies

The agencies that regulate public service utilities have autarchy or autonomy and have their own resources, which are provided by rates, inspection fees and other sources. Their annual budgets have to be included in the national budget and their management is subject to internal audit of operations, administration, accounting and finance. The annual budget for 1995 for nine regulatory/control agencies, out of a total number of eleven, was US\$ 117.6 million for a total of 904 employees and a planned total of 1,119 employees.

This amount cannot be analyzed without relating it to starting cost, the complexity of the sectors to be regulated and controlled and the reactive or pro-active role that is expected from each agency. The annual turnover from the sectors subject to regulation is about US\$ 7.3 billion.

In Argentina, regulators are appointed by the National Executive Power (PEN) with approval of Congress and can only be removed with just cause and with Congress review. Appointments are made by PEN through the Ministry of Economy, Public Works and Services. Each agency generally has directorates formed by a president, vice president and directors who have different contract periods, which may or may not be extended, according to each particular framework. Some have provincial directors appointed by the provinces or the federal sectoral council. They can also have regional representatives when the activity requires such participation, and representatives from consumers and the sector, as in the case of the Ad-Honorem Committee formed by ETOSS. The selection process for authorities is based on competence, background, and technical

capacity. The directorate decision mechanism can restrain arbitrary behaviour of the regulator, although it may lead to more complex and bureaucratic decision mechanisms.

The regulatory bodies are subject to operative, accounting, administrative and financial oversight by the Sindicatura General de la Nación (SIGEN) and Auditoría General de la Nación.

Based on recent experience, the selection and appointment criteria used when forming the boards of the regulatory agencies have been varied. There were cases in which there were frequent changes of directors and presidents, as at the CNT, and others where provincial directors had not yet been appointed; lack of political independence was noted in some cases. The mandate periods are of different durations, although there is a case where they rotate on a yearly basis, which can affect policy credibility and stability.

They are organized with structures that have a technical, economic and legal department, and a section that provides administrative and computer support. Depending on the structure of the industry, there may be a greater break-down along special technical areas. The linear design of most structures introduces the possibility of being subject to capture or bureaucratic procedures due to sequential work-flow rather than integrated or matrix type work-flow. Some bodies have established personnel selection and promotion procedures and salary scales which are similar to those in the private sector, although subject to public sector rules. There are also training courses and new computing skills provided in most cases.

Regarding rules and procedures, there is a need to streamline, order, simplify and update mechanisms. Given the task performed by these bodies, building an institutional memory will provide sustainability and speed the decision-making process.

Political authority and oversight over regulatory agencies

The division of roles between the functional political authorities (Secretariats) and these new agencies has not yet been clearly established. Hence there is an overlap or gap in areas such as design of sectoral policy or strategy, and intra- or inter-sectoral coordination. A specific issue is that of coordination of intra- and inter-sectoral investment in the regional integration process that has strategic implications for Argentina.

General economic and social regulatory legislation such as anti-monopoly, fair trade, consumer protection and others which facilitate the task of the regulator and reduce the regulatory burden have not yet been correctly addressed. The present legislation in this field is insufficient, weak and lacks a proper institutional framework.

The ombudsman has been established in the new Constitution and the first one was appointed for a five-year term by Congress. He institutes inquiries on his own initiative or based on complaints and presents annual reports on the results of his inquiries to Congress. Consumers are represented by the Liga de Acción del Consumidor (ADELCO) which receives complaints, either directly or on behalf of the regulatory agencies. The new consumer protection law includes the possibility of creating more consumer protection bodies.

4. Judicial and legislative environment

The design and implementation of regulation is made by considering the political and institutional context in which regulation is managed and the detailed engineering that allow its implementation and control.

There have to be mechanisms by which societies create substantive or procedural constraints on regulatory discretion, and resolve the problems that arise from the exercise of these constraints. There also have to be rules governing utility pricing, cross or direct subsidies, entry, interconnection and other aspects needed to compensate for market failures. These were addressed above.

A country's institutional and administrative endowments consist of its legislative and executive institutions, the judicial institutions, broadly accepted informal norms that constrain the actions of individuals or government institutions, the nation's administrative capabilities and society's contending social interests and the balance between them.

Legal status, competence and contracts

There are different types of regulatory instruments—specific laws, decrees, contracts and administrative procedures. Given their different legal status and stability, each has diverse implications both for regulator and regulatee. Although enactment of specific laws takes more time because of the legislative procedures and consensus building, it has the advantage of discretionary implementation and, because of this, provides more security to investors.

In most cases the sector laws were not reformed and the task was postponed. Regarding the legal status of regulatory frameworks, except for electricity and gas that were enacted by laws, the rest were established by decrees. This choice depended on the amount of revenue and investment expected, the privatization terms, and the relative experience and political consensus regarding each particular privatization.

The telecommunications sector was privatized with a regulatory framework that was enacted by decree and with many fuzzy areas which are still being discussed. In most cases, regulatory bodies started to operate simultaneously or after the transfer to the private sector.

Provincial and municipal competencies regarding public services were not coordinated, perhaps because this would have delayed the privatization process. However, this will demand a greater effort when conflicts arise or provincial privatization advances.

The other main regulatory tool is the concession contract which is an operative licence in which the regulatory framework is specified. Its advantage is that, since it is a contract between two parties, the awarding agency and the concessionary, any change requires agreement by the enterprise.

Legislative

Argentina created a Privatization Monitoring Bi-Chamber Commission, providing the legislative competence to supervise all processes. There were also sectoral commissions that participated in their specific sectors. Participation was very limited, given the speed with which decisions were taken and the technical weakness on very specific issues. The country's political system can be characterized by its fragmented pluralism that has allowed, since the resumption of democracy, concentration of power in each of the major two political parties, and rapid enactment of some initiatives. However, short-term political interests of some legislators in relation to their constituencies, conflicts between national and provincial objectives and other aspects can condition legislation for regulation in many cases. Nevertheless, legislating through presidential decrees affects institutional credibility and gives negative signals to private investors.

Judiciary

Judges are appointed by the Executive Branch and confirmed by the Senate for life, which allows a lot of formal detachment from each administration. With the approval of Congress, the Government recently changed the number of justices sitting in the Supreme Court. Nevertheless, there has generally been adequate treatment of cases that have gone to appeal. Recent conflicts of power between branches of government that affect their independence have created unrest and led to political and public debates on the issues. This rising public debate can contribute to transparency, and is a significant step towards accountability.

Regulation and control

There are two kinds of intervention by the regulator: those which the regulator should address due to market failure, and those that arise with each particular regulatee. These can be derived from regulatory activities such as control. The regulatory activity is supposed to defend the market. To be effective, regulation has to be unconstrained except by the regulatory framework itself. The defence of the market supposes that the regulator arbitrates at the right moment and solves conflicts by considering not only the interests of the parties involved but also the public interest. This activity is not an event but a dynamic and continuing process that reduces its activity when competition develops.

The best defence for consumers is through the development of competitive markets and providing for present and future needs.

Moreover, when control tasks have to be enforced, the regulator's activity has to follow a path that is determined by the concession contracts. The regulator has to supervise and control an agreement between two different parties separated from the regulator. The function is to supervise and control compliance of the contract, arbitrate in many cases and set penalties for non-compliance, according to what was established in the contract. This is a difficult task, because given its first level judicial responsibility, due process principles have to be observed, defence rights have to be allowed and all other procedures that are the base of a society that has Constitutional roots.

However, there might be cases in which circumstances that were not considered in the contract can be conflict with the regulatory objectives. This is a very difficult situation because, if the profitability of the enterprise is affected, it might demand compensation to overcome this conflict of interests.

The above-mentioned aspects justify the care needed when concession contracts are drafted and the importance of the level or legal status of the regulatory framework to avoid adjustment or appeals which might prejudice the credibility and stability conditions for the operation and expansion of service.

Information

Information asymmetry is an issue that has been largely dealt with in the regulation literature. During this short period, regulators have been dependent on the enterprises for information, which creates problems of transparency and objectivity when decisions are taken. It is expected that, once the regulatory management systems are in place, this situation will improve and requests for information will be more selective and supervision mechanisms will be more appropriate.

According to present legislation, privatized firms are subject to stock corporation law, and their

disclosure responsibilities are those set by law. However, enterprises that become public and are listed in the Argentine stock market—Bolsa de Comercio—are subject to rules set by the Comisión Nacional de Valores (Securities and Exchange Commission), which is the local regulator for the Argentine capital market. These include annual reports and balance sheets. The present foreign investment legislation gives foreign investors the same rights and responsibilities as those given to local investors.

Regulated enterprises, according to their concession contracts, are obliged to provide information—accounting, financial, ownership, investments, participation of controlling shareholders—to the regulator, who publishes what can be made public in his annual report.

If a controlling shareholding is sold, the contract requires the enterprise to inform the regulator of any change in the composition of the shareholders. Also, ring fencing and restrictions within and across markets were set up to control monopolistic and discriminatory behaviour in these markets.

5. Recourse and penalties

When a concession is awarded it is through a contract that sets all the rights and obligations of the concessionary. Depending on each case, concession contracts have clauses regarding quality of product, service, coverage, security and expansion, as well as investment goals. In railway concessions, the State has obligations to provide infrastructure and rolling stock; in other cases, the State provides rights of way, etc.

There were different privatization strategies according to the peculiarities of each sector. In some cases, such as water and sewerage, the franchise was awarded to the firm making the lowest tariff proposal, together with service and investment commitments; in other cases, the selection criteria were based on the lowest requested subsidy or fee together with commitments on investment, service and personnel retention, as in the case of metropolitan passenger railways and subway and freight railway; or prices with commitments on product quality, service and/or investment, as with telecommunications, gas and electricity. In each case the concessionary or licensee made his business plan and determined his economic and financial equation when preparing the bid. This was part of the concession or licence contract and part of the regulatory framework.

Concession terms and goals

Given the particularities of each sector, the condition of its infrastructure and the different privatization strategies, individual goals and obligations were established for each concession. In electricity, assets of generation plants were sold and concessions for distribution and transmission were given for 95 years. The commitments were related to quality of product and service and not to investment. They have given reasonable results so far. However, in almost all the other sectors, investment commitments were set together with quality and service conditions.

Thus, for telecommunications there were quality and expansion goals for the exclusivity period (seven years) and the extension period (3 years). For water and sewerage, quality goals were set—quality of water, pressure and treatment of effluents, which lead to a 30 year investment programme, with quinquennial investment plans. For gas, the 35-year licence included quality of service and investment goals.

The highway toll concession for the trunk network, given for 12 years, has a subsidy that allows for different investments to increase security and quality of service. The metropolitan highway access network toll concession, which was given for 10 years, has investment, security and quality commitments. The 30-year

freight railway concessions have investment and maintenance goals for infrastructure, rolling stock and communications and security systems. The 10-year concessions for the metropolitan railways were awarded at regulated tariffs and subsidy with investment, quality, security and reliability goals that can be rewarded with tariff increases.

Consumer rights

Some concession contracts and regulatory frameworks have consumer rules that have been better than others. This is probably because some enterprises had previously been private and brought these rules with them. Also, in some cases, contracts establish terms and conditions for compliance with obligations and penalties. These instruments provide more transparency for enforcement of regulation, protect consumer rights and give the concessionary an adequate framework for his activity.

Sanctions

Regulatory agencies in Argentina have been given authority to apply sanctions and this has been applied after the initial start-up period. The most interesting case has been the fine of approximately US\$ 9 million paid by the metropolitan area electricity distributors for quality failures. The fines were paid first and appealed later. This fine was returned to all consumers through discounts on future billing. There are also individual penalties and compensations. So far, regulators have been lenient when considering penalties.

Any action or claim started by a regulatee has to be initiated with his regulator. This is because the regulator is the first level specialized judicial authority. Consumers can present complaints directly to the concessionary or to any other level.

Employees

In some cases, the award process considered personnel retention conditions. However, after transfer, workers are subject to present labour legislation and their specific collective agreements. In most cases, there have been labour retrenchment policies, through voluntary retirement plans and other mechanisms. The most dramatic reduction has been in the railway sector that had 92,000 employees in 1989 and approximately 15,000 in 1994. Also, as part of the employee share ownership plans for workers, cooperatives and consumers, workers are allowed to appoint one director when equity has been subscribed or may supervise management while equity conditions are still pending.

Investment and quality-of-service compliance

In most cases, except where investment has been totally recovered as with telecommunications, quality of service and investment are lagging and, in some cases, contracts are facing termination. In this situation, the regulator needs to keep a careful balance between confrontation and negotiation. There are also some situations in which there are rewards, in terms of tariff hikes, for overshooting targets, as is contemplated for metropolitan railways.

As already mentioned, the price-cap and quality regulation provides more incentives for the concessionary and reduces the burden on the regulator. However, this is not always so; the regulatee might decide it is worth his while to pay the fine and reduce his investment commitments.

In general, there has been an increase in operative efficiency. This is related to the redundant labour and internal corruption that existed during the previous period, which were subjects of top priority and have been slowly dealt with, and the management improvements brought in by the new operators.

The dividend policy that was adopted by the enterprises that operate in the most profitable sectors—telecommunications, gas, generation and transmission of electricity—has been to distribute dividends and later increase their debt exposure to comply with investment commitments. The changing conditions in the international and domestic markets will probably affect this policy, given the new requirements that financial institutions will probably set. Concessionaires might start looking for new financial mechanisms, including consumer financing and share distribution.

Regulatory discretion

It is convenient that the regulator has discretion to arbitrate, while observing due process and diligence, based on his role as first-level specialized judicial authority. This does not mean that the enterprise cannot appeal to the sectoral political power or judiciary when it believes that some administrative procedures have not been followed or that some decision may affect its economic equation. Since the contract conditions cannot be changed and review procedures are set, the margin for discretion is quite small.

It is important to keep an adequate balance with all sectors affected by regulation. The dilatory manoeuvres by regulatees and potential competitors finally affect consumers who should be the main beneficiaries of the system. Moreover, the excessive exercise of discretion can affect the regulator's credibility and, consequently, expansion and the financial costs faced by the industry.

Public hearings

Public hearings have been established in most regulatory frameworks as a very complex mechanism that can arbitrate conflicts. This is a public and oral participation procedure, where all parties have the right to make their presentations, before any decision that might affect their rights and interests is taken. This procedure gives a guarantee of reasonableness to consumers, an appropriate mechanism for consensus building of public opinion and for objectivity and transparency of procedures, together with an element that democratizes power.

In the judicial function, a regulator may call public hearings to solve differences on his own initiative or on a request by a third party, which provides publicity for the mediation role that guides his procedures. Recently, the public hearing on the telecommunication tariff rebalancing showed how the system works when it lacks transparency. Finally, the new Constitution, which was reformed in 1994, provided legal status to consumers and raised the possibility that consumer organizations could act to control public services.

6. Conclusions and recommendations

The stabilization and reform plan established privatization as the cornerstone of the Argentinean transformation process. It had the purpose of raising fiscal revenues and getting the required political backing, as well as creating competitive conditions in the economy. Towards this purpose, the Government has tried to improve the quality and coverage of services, introducing competition whenever possible.

This reform has changed the role of the State from entrepreneur to that of a regulator, given the character of public service and natural monopoly elements that characterize most basic industries.

In this context, departing from the principle "competition when possible and regulation when necessary", structural and institutional conditions for the new stage were established.

The size of the process, the characteristics of the markets and the policy objectives demanded the development of a strong sectoral regulatory capacity. Also, it is important to note that, apart from his regulatory functions, the regulator is responsible for overseeing the concession contract between the awarding authority and concessionary. The intensity and complexity of this task will rely on the quality, coverage and provisions embedded in the contracts.

However, because of the massive, overriding and concentrated economic power involved in the privatization policy, sometimes the regulatory capacity was lagging or was inappropriate, creating initial management problems. Because of this, it is important that the regulator should be established prior to the transfer of the enterprises.

The preliminary results of this post-privatization stage have been problems due to the starting conditions and the search for "quick fix" solutions. Most enterprises continued with personnel retrenchment programmes and an increase in their technical and management capacity, required to improve operations and extend services. The main source of operational efficiency during this stage has been personnel retrenchment, reduction of corruption and development of new operational and managerial capacities.

The system has reacted relatively well to changes of climate and various emergencies. The quality and coverage of services, which were initially at very low levels, have improved permanently, although not reaching contractual standards. So far the access to financial and capital markets has been favourable. However, due to changes in external and domestic market conditions, the enterprises may face some problems that will have consequences on their investment commitments.

The biggest problems that regulation has confronted so far have been related to the quality and expansion of service, tariff rebalancing and restructuring and promotion of competition through interconnection, reduction of the consumption threshold for large consumers and other instruments. As expected at this stage, the relationship between regulators and regulatees is tense and with conflicts.

The policy has been to regulate for efficiency, reducing any intervention in enterprise management. This required a price-cap regulation system, quality control and reasonable review periods. The pro-competitive strategy involved in the structural changes and regulatory framework design was also geared towards this purpose. However, "regulation with a light rein" is not always feasible when the regulator is bound by the objectives and functions set by legislation.

Thus, the role of the regulator is to regulate and control the concession contracts, while being regulator, supervisor and first-level judicial authority. This leads rapidly into discussion about the relative autonomy and discretion granted to the regulator to ensure credibility and confidence to all parties, including the financial and capital markets. The answer to this discussion is not easy nor trivial, but it seems as though, having certain autonomy, appropriate institutional capacity to develop their functions and discretionary powers that do not affect the rules, due process and diligence can be sought as adequate conditions.

The political and institutional environment in which regulation operates is complex and has not been adapted to the State's new role. There are overlapping competencies with different levels and jurisdictions that have to be sorted out. The legal status of regulation could become a problem for credibility and confidence. Also,

overall economic and social regulation is lacking, weak or lacks enforcement capacity.

The institutional organization of the regulatory agencies has been complex, demanding more time than expected. Traditional linear organization structures, which suppose sequential processing of problems, should be reviewed or modified for more flexible structures along modern managerial patterns that allow integrated work and deter risk of capture by interest groups.

Consumer participation, attention and protection has improved in quality and effectiveness and both regulators and regulated enterprises have established consumer complaint and service systems. However, coordination and streamlining could still improve their efficiency and effectiveness. Some of the start-up problems could have been reduced if they had been appropriately considered during the privatization process.

The recourse and penalty system is operating well and is an important tool for the regulator. The other compensation and participation institutions such as public hearings and the judiciary are operating reasonably well and are useful.

Based on the previous conclusions, the main recommendations are:

(a) in the design of a regulatory framework, pay due attention to the institutional endowment and political environment in which regulation will operate;

(b) set boundaries and competencies within and among jurisdictions;

(c) try to update and get consensus from the provincial powers to draft new sectoral legislation and the regulatory frameworks, which should be enacted by law;

(d) coordinate and streamline administrative procedures, consumer guidelines and penalties;

(e) establish technical assistance and cooperation agreements with other countries and institutions on regulatory frameworks, instruments and information systems, with particular emphasis on tariff setting and control, service quality, current cost accounting, investments, reasonable and fair rates of return for utilities, technological change for sectors, interconnection and expansion of services and other key regulatory issues;

(f) design, enact and implement overall economic and social regulation; and

(g) give adequate attention to the institutional organization, institutional memory and administrative and management procedures of regulatory agencies.

Personnel employed and budgets of the regulatory/control agencies
1995

Agency	Personnel	(US\$mn)	Budget
Comisión Nacional de Telecomunicaciones -CNT-		22.1	400
Comisión Nacional de Correos y Telégrafos -CNCT-		8.8	6
Ente Tripartito de Obras y Servicios Sanitarios -E		15.7	72
Comisión Nacional de Transporte Ferroviario -CNTF-		9.4	74
Comisión Nacional de Transporte Automotor -CONTA-		18.8	165
Organo de Control de la Red de Accesos a la Ciudad de Buenos Aires -OCRABA-		3.0	6
Ente Nacional Regulador del Gas-ENARGAS		22.6	86
Ente Nacional Regulador de la Energía-ENRE-		15.6	85
Organo Regulador de Seguridad de Presas -ORSEP-		1.7	11
Unidad de Coordinación del Programa de Coordinación Ferroviaria -ATAM- *	s/d	s/d	
Organo de Control de Concesiones Viales		s/d	s/d
Totals		=====	=====
		117.6	904

* Not enacted

Source: Sigen

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Memoria del Organo de Control de las Concesiones Viales

III. PROMOTION OF COMPETITION - THE NEW ZEALAND EXPERIENCE

1. Deregulation and competition

The New Zealand experience is that there are no post-privatization issues. Post-privatization issues are pre-privatization issues that have not been resolved.

One of the key pre-privatization issues is an effective competition policy. An effective competition policy is more important and has a greater effect on the economy than privatization. The benefits of privatization will be largely lost if there is no effective competition policy. Neither privatization nor a competition policy work well unless they are part of a sound framework of economic and fiscal policies.

But first, why is the New Zealand experience relevant to Latin America? There are strong similarities between countries in South America and New Zealand. The New Zealand economy was built around exporting primary products to the British market. At the time that Argentina had a very high standard of living so did New Zealand. Just as the agricultural policies of the European Community have been disastrous for Latin America, they have been disastrous also for New Zealand.

The parallels continue. Just as Latin American governments sought to improve their local industries with protectionism so did New Zealand with high tariffs and import quotas. New Zealand went the whole way with fixed exchange rates, licensing industries, centralized wage fixing, price controls, interest rate controls and exchange controls.

Of course the policies failed. So New Zealand Governments subsidized the export sector and tried to stimulate growth with huge Government-funded energy projects. All the energy projects failed and we ended by subsidizing the world to eat our meat.

As the economy stagnated, State industries were featherbedded with employees and the Government's deficit grew to 6.3 per cent of GDP. New Zealand had a growing balance-of-payments problem. The Government's solution was to borrow. By 1984, New Zealand's per capita debt was higher than any country in Latin America. I am sure all this sounds familiar.

Why New Zealand is of interest is because all that was in 1984. Today inflation is less than 2 per cent, growth is 7 per cent, exports are up and the country has a favourable trade balance, the Government is running fiscal surpluses and is repaying debt, unemployment is down to less than 8 per cent and there is a record number of jobs. If there is a single reason for New Zealand's success, it is because we recognized that there is no single cure. I am sorry to tell you but, for success, you have to do the lot. The Government, of which I was an associate Finance Minister and the Minister in charge of privatization, was elected in 1984 and introduced the following policies:

- A programme for dismantling import licensing controls (now all abolished), reducing tariffs and phasing out export assistance;
- Financial markets were comprehensively deregulated, exchange controls were removed, and the exchange rate was floated;
- The Government moved to fully finance its deficit by bond sales and open market operations, and

monetary policy was targeted at reducing inflation;

- A comprehensive reform of the taxation system was implemented, involving broadening the income tax base by removing many tax concessions, lowering personal and company tax rates and introducing a goods and service tax; and
- The Reserve Bank was given statutory independence and the single target of price stability.

The National Government elected in 1990 has introduced labour market reforms based on freedom of association and freedom of contract that have resulted in very significant productivity improvements.

According to an article in the Economist Magazine, New Zealand has privatized more than any other country, as a percentage of GDP. The problems being discussed at this conference were issues in New Zealand. We faced the same problems but we resolved them prior to privatizing. The good news is that the problems can be successfully resolved. I think it is important to recognize that the problems are not the result of privatization. The problems being discussed at this conference are the results of economic and social policies that privatization has just exposed.

We resolved not to sell any industry that had a statutory monopoly. All regulations giving State business favourite treatment were repealed prior to sale. A good illustration of this policy is our State airline, Air New Zealand. The Government was advised that the real value of the airline was its monopoly right to fly on the main trunk routes. The removal of the airline's exclusive landing rights lowered its value on sale by 70 per cent. So why did I, as Minister of Civil of Aviation, not only remove the monopoly but also granted a foreign airline a domestic licence to compete? New Zealand is a long thin country. Aviation links to provincial cities are vital. Every month the Minister would receive a delegation asking for better air services. Many small towns had just one service a day. Flights were late. Tickets were expensive. Service was extended by air hostesses who I am convinced were too rough to be prison wardens. The airline acted in the manner predicted by the text book for a monopoly. Maximum monopoly profits are reached when the monopoly provides services that are just short of the market demand. The airline never provided enough capacity. You had to book popular flights weeks ahead.

There was just one exception. In my constituency there was an offshore island with a small population. As my electorate was an opposition stronghold, to punish my voters the Government refused to extend State airline services. It was open skies. To my and my opponents' surprise this policy did not result in no service. It resulted in competition: three airlines provided daily scheduled services and two more provided charter flights. We had the best air service in the country. The monopoly profits were captured not by the State but by the staff.

When we came to sell Air New Zealand, our consultant said that, while he was not sure what the King of Jordan was paying his pilots, it was his view that for hours flown, Air New Zealand pilots were the highest paid in the world. Indeed they flew so infrequently, I thought they should be retrained between flights.

The management bitterly opposed deregulation. The airline argued that not only would the State get a better price from the sale of a monopoly but that it was in the public interest. Management argued that the main trunk routes subsidized the provincial routes. Competition would result in the main routes being profit-skimmed and provincial routes being axed. Standards and safety would be compromised. I am sure this sounds familiar. The same arguments were used by the State telephone company, the State railways and the power company to oppose deregulation.

Based on my experience in my electorate, I deregulated aviation and the direct opposite of what was predicted by management has occurred. Air fares are lower. Service is now the best in the world. Frequency of flights is up. Those delegations from provincial Mayors have stopped because most provincial towns get many flights a day from up to five different airlines.

The same thing happened with the privatized and deregulated railways. No branch line has been closed. Services have increased and rail now receives no protection or subsidy. It is the same happy story after deregulating telephones and electricity.

Why? It is the effect of two principles. The first is competition. At this gathering I am sure I don't have to establish that open competition results in efficiency, enterprise, innovation, growth and customer service. Over time, an open competitive system will outperform all others.

The second principle is the law of network economies. The law of network economies states that if competition is introduced to a network, then the predominant supplier's competitive advantage is its larger network. It will never be economic for new entrants to duplicate the whole network.

So provincial air routes are not Air New Zealand's handicap but their competitive advantage. So it proved in practice. While Air New Zealand thought its provincial routes lost money they have now realized that these routes make a positive contribution. A passenger will join an Air New Zealand flight in a provincial town and will stay on the airline all the way to Europe. Over the total distance travelled the airline makes a profit.

There are a number of telephone companies now operating in New Zealand. Telecom, the former State monopoly, is extending its network to compete. Big corporate clients want to be able to telephone rural subscribers. Its larger network is Telecoms biggest competitive advantage.

2. Regulation

New Zealand has proved that all network monopolies can and should be deregulated, including the postal service. Most so-called post-privatization issues are attributable to the failure to deregulate network monopolies. The answer is simple, deregulate.

If the government made a profit from selling State assets as a monopoly, than it was a false profit made at the expense of the economy, business and the people. It should be deregulated. If legal guarantees were given to the monopoly, they should be bought back. Other speakers will tell you that they are natural monopolies. I do not agree. Speakers will say that you can set up regulatory regimes to effectively control monopolies. They are mistaken.

New Zealand has an honest, well-educated, non-political civil service. For fifty years the civil service tried to run a variety of regulatory regimes to control the so-called natural monopolies. They failed. A good international example is cement. As delegates will know, the world market is dominated by just two manufacturers, both of whom owned two plants each in New Zealand. Just as they have divided the world market they certainly did not compete in New Zealand. Cement was subject to price control for fifty years. The policy failed.

All that price control can achieve is to control profits. In effect price control guarantees profits. Price control cannot control costs. A manufacture cannot be ordered to purchase inputs at below cost. I know, because

one New Zealand Government issued such controls. The products stopped being produced. The economy came to a halt. The regulation had to be repealed.

Costs in a monopoly industry will continue to rise. For example, despite having wage controls, labour costs in the twenty sectors covered by price control were higher than in the deregulated economy. Price control failed to regulate prices.

Regulating profits may be politically popular but it makes no economic sense. High profits are an important market signal. High profits attract competitors. Competitors result in lower margins, innovation, better service and lower profits. So why control profits? New Zealand had on its statute book for forty years a law outlawing profiteering. My colleague, the Minister of Commerce in the Labour government, the Honorable David Caygill, who is the architect of our competition policy, objected to the profiteering law on two grounds. It did not make economic sense and it was bad law. We have repealed the law.

As Minister in charge of all State enterprises, I had many consultants come calling with their new sophisticated regulatory models. They do not achieve the results claimed. They are snake oil. The British regulators saw me and boasted that they had reduced telephone charges in real terms. New Zealand telecoms reduced toll calls by 40 per cent and a basket of charges by 21 per cent in two years. New Zealand Telecoms has reduced its charges by more than British Telecom and in half the time. The British telephone service in 1984 was by any measure better than New Zealand's: now it is worse. In 1988 only 30 per cent of New Zealand exchanges were digital. Now it is 93 per cent, and 100 per cent in the cities. Last year the TMD Group in Switzerland published their World Competitiveness Report. New Zealand telecommunications were ranked third behind Hong Kong and Singapore.

Instead of a regulator, we have competition. Telecom competes in the toll market with Clear, a consortium of local companies and MCI and Bell Canada. It competes in cellular telephony with Bell South, with 17 companies in telephone instruments, with 10 companies in telepaging, with 22 companies in cellular mobile telephone and, at the last count, with 78 companies in non-voice equipment.

To promote competition, New Zealand relies on the Commerce Act 1986. This law is general. It applies a general prohibition against restrictive trade practices. It is illegal for a dominant firm to act to prevent another firm from competing. The law is enforced two ways. There is a Commerce Commission to which appeals can be made. The Commission can hold hearings and make orders.

Business people have a second remedy—the courts. The Commerce Act gives the courts the power to award damages to a person deliberately affected by anti-competitive behaviour. There have not been many complaints to the Commerce Commission and fewer to the Courts. This is to be expected. If the law is sound, most people will obey the law. Our law is not structurally based. It is not illegal to be a monopoly. It is just illegal to behave anti-competitively. There are no price controls on anything.

As New Zealand is a small country, there is only one white-ware manufacture. The courts have ruled that, provided the company is not anti-competitive in its behaviour, its monopoly is not unlawful.

A competition policy by itself is not a cure-all. It has to be part of a framework of consistent policies to promote an open competitive economy. In 1984 New Zealand had the most protected economy in the OECD, with high tariffs and import quotas. Today there are no quotas, and tariffs have been substantially reduced.

To use our white-ware example. The New Zealand manufacturer knows that anyone is free to import Simpson white-ware from Australia or a shipload from Italy. The New Zealand manufacturer has responded by vigorously reducing costs, improving quality and offering very good after sales service. Simpson has captured some market share but the New Zealand manufacturer is now so competitive that the firm has a good export market, to more than compensate for lost domestic sales.

In 1984, New Zealand's manufacturing exports were negligible. As a result of opening up the New Zealand market, New Zealand manufactures have become world-competitive, to the astonishment of everyone, and exports are growing rapidly.

How does a country move to an effective competition policy? Let us take the example of cement because it has monopoly behaviour in most countries. In 1984 New Zealand cement prices were high by world standards despite price controls. Industries under price control tend to stagnate. The cement industry wanted to be free of price control. Government agreed to lift price controls but also to remove import quotas and tariffs. Government said to the industry that it would watch their behaviour and "if we see anti-competitive behaviour we will impose price control". The unions opposed the deregulation. Government said to their unions and to the construction industry "Monitor the cement industry and report any anti-competitive behaviour". The Minister told me when I was researching this paper that there have been no complaints from anyone. An importer did bring in one trial shipment but New Zealand cement is now at the world price, quality is up and the cement plants compete.

Our experience is that it is not necessary to have competition to have competitive behaviour. What is necessary is to have the possibility of competition. The cement industry knows that the construction industry can import cement, so industry competes with the possibility of competition.

New Zealand has deregulated the oil industry. There are now no controls. No new oil company has been set up. The cost of entry is high because of the need to set up tank farms and distribution networks. But the real reason is that New Zealand petroleum prices are now equal to the world price plus the margin for the distance. I am on the Board of the country's largest road construction company. We use a lot of asphalt—a petroleum product. We regularly investigate the economics of importing our asphalt from Singapore. The answer is always the same. The local industry is cheaper. It sells at the world price. Under price control we paid more for asphalt than we do now.

It was against this framework of policies that New Zealand privatized. No special regulations were needed and we have had no so-called post-privatization issues. The example of the United Kingdom is often given to justify special regulations as a consequence of privatization. This is not so. Regulations were a result of how industries were privatized in Britain. For political reasons the British government decided to use privatization to create widespread share ownership. It was populist politics. There is no economic reason for creating widespread share ownerships. The policy would only be achieved by selling the shares cheaply and then guaranteeing profitability. So the British Government sold monopolies and did not fully deregulate prior to sale. Having sold privileges they had to regulate. This was bureaucratic nonsense. This is why privatization in Britain has only marginally improved the British economy.

The future is a global economy. Countries that want improved standards of living for their people have to be globally competitive. Most privatization issues are the pre-privatization issues that were avoided. The longer you wait the harder it gets. Deregulation is the key. In New Zealand, opening up monopolies to competition resulted in bigger benefits than privatization. It was the threat of competition that led Telecoms to improve its services and lower its prices. It was competition that led Air New Zealand to improve its

productivity. While privatization resulted in some further improvement it was not as great as the introduction of competition.

The old State monopolies were so inefficient that they paid little tax and often needed tax handouts. Railways lost one million dollars a week. New Zealand Rail is now making a profit of one million a week. The company taxes which are being paid, not just by the privatized industries but also by the new industries created by deregulation, are very significant.

It is true that the old State industries employed many more people than they do today. Telecom employed 24,000 in 1984 and 9,000 today. But the ninety new firms created by deregulation are employing thousands of New Zealanders and telecommunications has become a significant export industry. Reducing the cost of telephones, the cost of electricity, energy and transport has made New Zealand industry world-competitive and created thousands of jobs, so solving many social problems.

Post-privatization problems are not the result of privatization. They are the result of poor economic, fiscal and social policies. The problems are solvable and I commend the New Zealand model to you.

IV. SOCIAL SAFETY NETS IN LATIN AMERICA

1. Privatization and social safety nets

After more than a decade of development as a generalized regional phenomenon, privatization in Latin America can be finally evaluated from a "social" angle. The "social evaluation of privatization" risks being limited to its direct effects on employment, prices, the quality of goods supplied by the new enterprises, etc. While these markers are important, a wider vision places them in a more complex context closer to reality. Hopefully this will lead to the successful implementation of a strategy to correct negative effects such as unemployment and greater poverty.

The establishment of "social safety nets" in the era of "post-privatization", as suggested in the title of this conference, forces a new examination of the phenomena of poverty and marginality. This is no longer the old debate on the "dual society" of Latin America, although some authors still try to maintain this argument as the principal support of such examination (Jaguaribe E. 1993, pg. 91). In fact it is necessary to understand the globalization movement and all of its implications (acceleration of technological change, rapid emergence and decline of productive systems, the retreat of governmental power, the sequence and overlap of financial, social, political, military and other turbulence, etc.).

During the last two decades, in countries in different stages of development, distinct experiences of privatization have been followed by the spectre of unemployment and political and unionized resistance. In numerous cases, privatizations have continued existing processes of restructuring.

In the United Kingdom, for example, since the late 1970s, restructuring and privatization had a negative impact on employment. Between 1978-1979 and 1982-1983 the number of individuals employed in the steel industry declined from 186,000 to 81,000. In British Leyland, employment fell from 177,000 to 107,000, and in British Airways from 56,000 to 35,000 (Domingues R.M., 1988, pg. 52). The movement towards privatization was extended during the 1980's to other Western European countries such as France and Italy.

Later, in Argentina, the restructuring process started in 1990 when the 13 largest public enterprises underwent a reduction in employment from 222,000 to 42,000 by the end of 1993. Under such reduction, 66,000 employees were expected to transfer to the new privatized companies, 10,000 were forced to retire and 95,000 took early voluntary retirement (through indemnities and compensations). When considering all public firms during the same period, the number of individuals employed fell from 250,000 to approximately 60,000.

The privatization of the "Sociedad Mixta Siderurgica Argentina (SOMISA)" is a case in point. In 1991 the firm, located in San Nicholas and being the chief employer in the city, employed 12,000. In slightly over 4 months, 6,200 employees, in addition to 1,700 from its subsidiaries, accepted voluntary early retirement packages.

During the six months that followed, SOMISA disbursed approximately US\$ 100 million in compensation as part of those packages. During that period, the ex-employees used the compensation packages to maintain and frequently increase their level of expenditures (purchases of appliances, automobiles, home repairs, etc.) and to start small enterprises with little previous research, such as market research. Thus, San Nicolas experienced an explosive surge of "micro-businesses" (kiosks, paddle ball courts, etc.) which in less than a year went from 9 to 120, but finally ended massively bankrupt.

The level of disappointment was such that the municipal authorities started a project financed by UNDP under the advice of ILO (PREALC). The project consisted in the establishment of a technical unit within the local municipality aimed at training workers for the creation of new enterprises, using existing infrastructure and technical and financial support from the programme (di Rocco E.L., 1993, pg. 203). The naive expectation of a spontaneous and improvised conversion of employees into entrepreneurs, without prior market evaluations or specific technical training, was considered the most critical error of that experience, which might have been avoided if a programme of social conversion had been in place beforehand.

2. The crisis within the State

The SOMISA case questions the level of efficiency available within the State to resolve the problems of social reintegration caused by its own conversion. This leads us to the subject of the crisis within the State in Latin America and its relationship with the privatizations of the 1980's and 1990's. In this sense, the Latin American case must be considered within the widespread decline of statist economies in their different versions, viz. Keynesian in developed countries, socialist in the ex-Soviet States, protectionist in developing countries).

This decline is partially due to globalization. The development of extensive global economic networks implies the emergence of systems highly autonomous from national powers, not only at the financial or commercial level but also at the technological, cultural and political levels.

Nevertheless, the Latin American experience of crisis within the State and of privatization is clearly different, particularly in its social implications, from the experiences of Western Europe in the 1980's (which were relatively "orderly and soft", and stimulated a certain renewal of the capitalist culture) and Eastern Europe (particularly in the ex-USSR, which were generally chaotic, catastrophic and plagued with the emergence of organized crime). In Latin America, the developing mixed economies followed a different road.

The statism which originated in the 1930's and was aggravated in the 1940's through large-scale nationalizations and the creation of parastatal enterprises caused the degeneration of the State apparatus into hypertrophied structures overwhelmed by inefficient bureaucracies. In many cases, the State became a hospital or junkyard of enterprises. For example, by the mid-1980's, Argentina had 527 State-owned enterprises and Mexico had 1155, in an environment in which irrelevant companies such as manufacturers of tortillas, gym shoes, hotels and hostels, coexisted with important firms in the mining, steel and energy sectors (Minsburg N., 1993, pg. 1061).

A perverse and mutually parasitic relationship developed between State bureaucracies and private firms which engaged in a predatorial attack on the public sector through arbitrarily priced contracts to supply goods and services, disputable financial operations, etc. Thus, the analysis of the decadence of the State should be included in the context of the culture of underdevelopment, which includes both corrupt bureaucrats and entrepreneurs, both parties showing a poor level of professional responsibility.

The debt crisis was not the only stimulus of change. The financial impasse triggered a situation of evident decadence highlighted by technological retardation, organizational irrationality, overexpenditure, etc. In all their different national manifestations, privatizations took place within a situation of State crisis.

3. Privatization, unemployment, poverty

Latin American privatization should be placed within the context of a social landscape seriously worsened by the economic recession of the 1980's and its impact on a structurally weak productive apparatus. This explains the multiplied negative effect on employment caused by the conversion of State enterprises into private firms. Between 1981 and 1990, regional per capita GDP declined at an average annual rate of 1.2 per cent (from US\$2,188 to US\$1,946). On the other hand, according to ECLAC, poverty and destitution affected approximately 110 million Latin Americans in 1970, 135 million in 1980 and 195 million in 1990 (Minsburg N., op.cit., pg. 1064).

In other words, privatization took place in impoverished societies, with increasing social marginalization. The dis-industrialization of the 1980's seriously affected the productive culture and, in addition to the deterioration of the State, operated as a brake on the process of labour reconversion.

Evolution of Minimum Urban Wages, 1984-1990				
Average annual indices (1980 = 100)				
	1984	1986	1988	1990
Argentina	167.5	110.0	93.5	40.2
Brazil	87.4	89.0	68.7	53.4
Colombia	113.5	114.2	109.9	107.9
Costa Rica	104.4	118.7	114.6	120.5
Chile	80.7	73.6	73.9	87.5
Ecuador	62.8	65.0	53.4	36.2
Mexico	72.3	64.9	54.2	45.5
Peru	62.3	56.4	52.0	23.4
Uruguay	88.0	88.5	84.5	69.1
Venezuela	66.5	90.4	89.5	59.3

Source: ECLAC, 1992

The exclusive nature of the global technological environment contributed to the negative legacy of the 1980's. Computerization, biotechnology, new materials, reduction in energy consumption and other components of the technological revolution tend to reduce employment, chiefly through the introduction of systems which increase quality while reducing the imperfections of direct human participation (computerization, etc.) or by simply displacing traditional productive structures (e.g. introduction of isoglucose, which marginalized the production of sugar cane).

Globalization and the development of labour-saving (mostly unskilled) technologies are virtually inseparable. Furthermore, the problem goes beyond skilled and unskilled labour, involving an acceleration of the rate of emergence and obsolescence of skills. The flexibility and adaptability of systems of professional

training becomes a decisive factor.

Thus, in the era of globalization, development is differentiated from underdevelopment not only by a superior accumulation of wealth but also to a large degree by the ability to adapt to technological change. The chronic technological unemployment prevailing in industrialized countries is worse in developing nations. The entrepreneurial, labour and State structures of Latin America, with a weak potential for productive adaptation, bear the consequences of globalization through unemployment and marginalization.

This does not imply that the creation of highly technological employment is the only valid response to compete in a global economy. Labour alternatives should be available for varied market places, whether local or international, whether demanding high- or low-technology goods. It is essential to find alternative survival and development mechanisms, associating specific niches with feasible products and technologies appropriate to precise commercial objectives.

The establishment of projects of social development at the labour or entrepreneurial level must be based on rigorous interrelationships between markets, products and technologies. In this sense, the organization of social promotion projects based on local economic realities could constitute an appropriate response in developing countries.

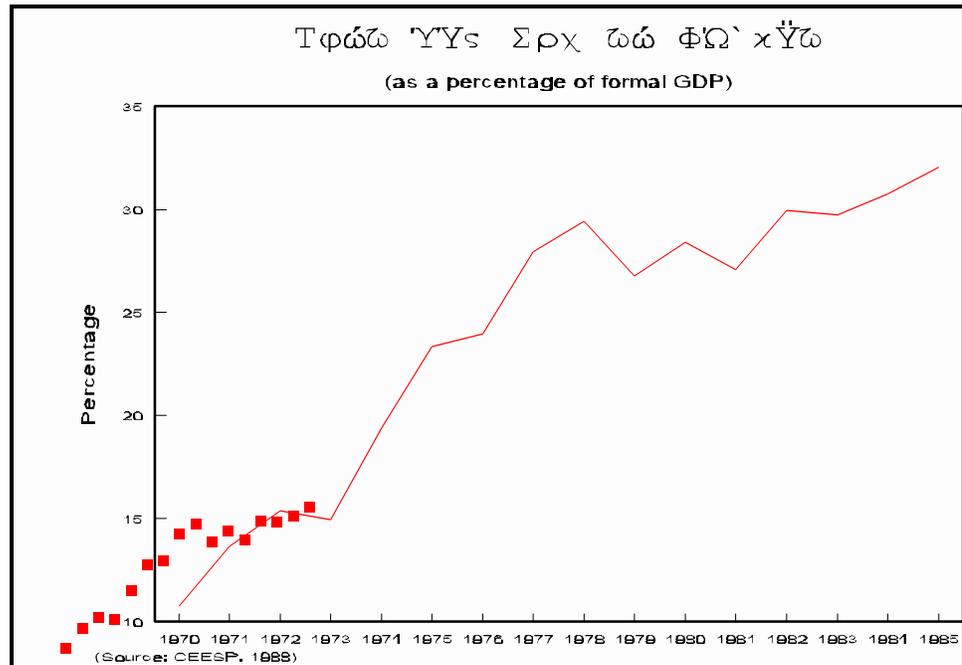
4. Informal economy

The crisis within the State can be explained by globalization, the decadence of State bureaucracies and the acceleration of the technological revolution. The examination of the expansion of the informal sector is also very useful in the development of social safety nets. The informal sector appears as an expression of autonomy and social discontent in the face of the State, and has been in continuous expansion for the last twenty years to the point of becoming a significant global phenomenon.

Informal economic activities are defined as those not registered in official statistics and thus marginalized from the State. They cover legal and illegal activities, range from the technically rudimentary and of very limited geographical reach (food production in areas of extreme poverty) to highly technological sophistication (software production) and with international projection (financial flows). Informal activities run parallel to globalization and are an irresistible socio-economic tide in both developed and developing countries, enjoying in the latter higher relative weight in the overall economy. These activities are independent of deteriorated statal machinery and employ a significant proportion of low-income urban populations.

In Latin America by the mid-1980's, the informal sector was responsible for a significant portion of the national economy. In Mexico, Argentina and Colombia the informal sector represents approximately 25 per cent of all economic activity, reaching 30 per cent in Peru and 50 per cent in Bolivia. In Mexico alone, informal GDP increased from 10 per cent of total GDP in 1970 to 32 per cent in 1985. Projections in Peru point to an increase of up to 60 per cent by the year 2000 (Frediani O.R., 1988, pg. 62).

1970	10.73
1971	13.66
1972	15.37
1973	14.96
1974	19.39
1975	23.34
1976	23.95
1977	27.93
1978	29.45
1979	26.77
1980	28.42
1981	27.09
1982	29.96
1983	29.75
1984	30.74
1985	32.06



The recent history of Latin America shows the joint emergence of globalization (and the rapid dissemination of technological innovations that it generates), together with the deterioration of the State, widespread privatizations and the extension of the informal economy. The establishment of social development networks in poor areas must take into consideration not only the generally low level of efficiency of the State apparatus but also the existence of widely extended mechanisms of survival and entrepreneurial development, beyond State control and at the level of the lower-income sectors of medium and large urban centres. These sectors grow following economic parameters which are different from those found in more advanced systems (in terms of rate of return, commercial activity, innovation, etc.) and which should be rigorously examined as a base for future strategies of support to that segment of the economy.

How to get full use of the creative forces in the informal sector is a mystery, since neither conventional macroeconomic approaches nor the managerial models based on the "excellence" of global high-technology firms have managed to fully explain this amazing micro-economy. Its current importance, which will be even greater in the coming years, demands the development of a specialized kind of management which will be essential to the success of social development projects.

Curiously, the Latin American privatizations, especially those of very large enterprises (steel, telecommunications, airlines, railroads, etc.) appear as the consummate expression of globalization, combining technological and managerial modernization with their integration into transnational enterprises, and definitely in sharp contrast with the gray universe of the urban informal sector. However, both processes share the same origin: the decline of the modern underdeveloped State. Many ex-employees of the privatized public enterprises survive and in some cases prosper as small entrepreneurs when they are left to their own initiative, without official programmes of labour conversion. In general, they have managed to find and exploit concrete commercial opportunities re-utilizing and/or re-tooling their own technical expertise. These experiences

constitute an invaluable source to be taken into consideration in the formulation and implementation of micro-strategies of social development.

5. Management of microsystems of social development

It is normally held that there is a need to relate economic growth to social investment as a means of overcoming poverty. This equation is usually completed with proposals for programmes of social development focused on well-delimited population groups, in order to avoid the dispersion common in over-generalized initiatives. The need to focus social policy appears as a major obligation of the State after the crisis of the 1980's and the subsequent wave of privatizations (Infante T., 1992 and Aedo C., 1993). This type of approach merits three observations.

In the first place, economic growth within the context of globalization appears as a necessary but not sufficient condition of social development. Furthermore, recent experiences show us that entrepreneurial modernization is indivisible from advanced technologies which generally reduce the need of unskilled or obsolete labour. On the other hand, those social groups (particularly urban) which are left outside the modern (globalized) entrepreneurial systems do not remain outside the culture of globalization: they participate in it mostly as spectators, unemployed and/or underemployed producers in informal survival structures. The media and other urban networks inform everybody of the changes and novelties and nobody can escape from the spectacle of cultural globalization, or take refuge in a separate autonomous space.

The general lack of economic growth produces a drastic increase of unemployment (as in the 1980's), but growth is also often followed by a significant increase in unemployment, especially in the case of rapid global integration. Privatizations fall within this logic.

Secondly, social investments, even those focused on the neediest, are a necessary complement to growth but also insufficient for poverty eradication.

Finally, the State can be reformed, adapting it to the new era. However, even such a necessary achievement is insufficient from the point of social development. Growth is a potential basis of resources for governmental and non-governmental organizations, and focused social investments carried out by an efficient State can create a good support base, but both become pointless without opportunities available to the majority.

These three observations compel us to pay attention to the concept of social development powered by small innovative projects based on a combination of surveyed niche markets, goods specifically designed for those niches, and labour and entrepreneurial training aimed towards those commercial opportunities.

The management of micro-systems is closely related to the development of social, labour and commercial projections. Training of managers of micro-enterprises of a diverse technological range (from artisans to internationally competitive initiatives) appears to be an essential component of social development. From a macro-economic perspective, productive systems are needed in which interacting sub-systems coexist. At one extreme are those globalized firms which need to constantly renew their technological base, while at the other end of the spectrum are firms generating a sufficient return for their survival. There is ample scope between these extremes for the development of interrelated initiatives through markets, cultural exchanges, etc.

V. LOOKING AHEAD: PRIVATIZATION AND THE FUTURE OF LATIN AMERICA

1. Introduction

Economic reform in Latin America is a work in progress—and a work under assault. From President Caldera's departure from orthodoxy to the collapse of the Mexican peso to the dramatic reversal of capital flows that is affecting the whole region, there is a sense that the reforms of the recent past are at risk. The hemispheric outlook has gone almost overnight from white to black or, at least, to grey. Investors, national and international, who only months ago were prepared to commit an ever larger share of their portfolios to the region are cancelling new investments and re-evaluating those which had already been made; the general perception in the investment community is that risk has risen dramatically while returns have fallen equally fast. The resulting shift in capital flows has caused a dramatic retrenchment of economic policies, whether in reaction to crisis (Mexico) or in order to forestall one (Argentina). Growth is slowing in all countries and actual declines in output are likely in some.

The obvious question is whether the region's apparent recovery from the growth-numbing debt crisis of the 1980's was ephemeral; whether the economic growth model was somehow fatally flawed. Central to that model, of course, has been privatization—defined not just as the sale of State-owned assets, but as a profound shift of the boundary between the public and private sectors in favour of the latter. This shift, financed by private capital flows and assuming the continuous availability of new flows, was designed to move the fulcrum of economic activity to the private sector. The result was intended not only to get governments out of the business of making steel or generating electricity or flying airplanes, but to change how growth was generated and financed. Private savings and investment, supplemented by private foreign capital flows, would replace the old process of governmental borrowing to finance public-sector economic, industrial and perhaps even social investments.

It is the thesis of this paper, first, that the privatization-based model of economic reform remains viable and, second, that in the absence of a continuing move toward greater private ownership and policies to support the private sector, the countries of Latin America will once again be caught up in a vicious circle of inflation, recession, and financial market crises. The challenge to policy makers is to persevere in strategies which rely on private sector investment and entrepreneurship, resisting the knee jerk reaction to frustrate market forces or to return to the bankrupt model of State intervention and ownership. The further challenge is to continue to create conditions which maximize the possibility of private sector success—including continued privatization—even when it would be easier (at least in the short run) and more natural for the State to resume a leading role in the economy.

Arguably, the governments and countries which survive the current crisis most successfully will be those which most aggressively reinforce the strategies of the recent past; more privatization, more tax reform, more incentives to invest and save, more transparent capital market conditions, more efforts to liberalize labour markets, more predictable policy environments, and more competition. The countries which continue to move in such a direction, rather than ones which either retreat toward the statist past or even ones which pursue orthodox stabilization programmes to an extreme which debilitate the private sector, are likely to prosper.

2. Privatization

The world-wide rush to privatization over the past decade has changed the economic landscape not just

of Latin America, but of many countries around the world. Airlines, hotels, banks, telephone and electrical utilities, newspapers, and innumerable other companies have been sold by governments eager to redefine how they intervene in the day-to-day functioning of their economies. When the dust from all this activity finally settles, the result will be a dramatic transformation in how these economies work, in the fabric of international commercial and financial relations, and in the very distribution of economic and, consequently, political power within and between countries.

Whether motivated by pragmatism or ideology—or simply because the owners were broke and needed money—there has been, and continues to be, a global fire sale of assets. Some of these sales were unqualified successes with immediate financial, commercial and economic benefits. And some of these sales did not attract qualified buyers or sufficient finance or were badly structured or lacked the proper macroeconomic or regulatory framework. But both failure and success have had important economic and political consequences.

Indeed, in most so-called emerging markets, particularly in this hemisphere privatization has been not only an essential part of practically every government's economic strategy, but a key measure of their leaders' commitment to political and economic reform. Just as the debt crisis and the initial wave of democratization defined Latin America in the 1980's, the sale of State-owned enterprises has been the most consequential characteristic of Latin governments (and countries) in the 1990's.

Privatization, at least as it has been conducted in Latin America, needs to be understood first in a political context and—more particularly—in the political context which existed at the start of the post-debt crisis reform process. At that point, most reform proposals enjoyed little inherent political support and excited fierce opposition. Neither Presidents Menem nor Salinas were elected with much of a mandate to undertake the sort of profound structural changes which became their governments' trademarks. Entrenched interests, including unions, consumers, suppliers, bureaucrats and politicians had long benefited from government control of important parts of the countries' industrial and service infrastructures, even if, in broad terms, the whole country had suffered from public stewardship. Sustained economic reform requires new political constituencies with stakes in the reformed economic system; privatization was one of the few ways in which such political constituencies could be quickly created.

But Latin American economic history meant that privatization played a second important political role. Governments and their leaders had often proclaimed commitments to reform. However, traditionally, Latin presidents proved their patriotism, if not their economic good sense, by nationalizing investments in oil, banking and other sectors; politicians sustained their political machines by creating jobs in State-owned enterprises and built their fortunes through the contracts those companies controlled. Throughout the hemisphere, monuments abounded to these heroes of statism in the form of overmanned, inefficient, often corrupt State companies; as in the Soviet Union and Eastern Europe, not until those statues were torn down would long-suffering people and hesitant investors believe that a new era had really dawned.

In addition, there were also important economic considerations which made privatization a central part of post-debt era economic strategies. The most obvious is that State ownership was not working anywhere in Latin America. This is an empirical, not an ideological observation, which is as true in this hemisphere as elsewhere in the world. For example, an analysis of the 500 largest non-U.S. mining and manufacturing companies in 1983 concluded that private corporations are substantially more profitable and more efficient than State-owned companies (see Anthony Boardman and Adrian Vining, 1989, "Ownership and performance in competitive environments", *Journal of Law and Economics* 32, 1-33). In Latin America most State-owned enterprises were inefficient, overmanned, undercapitalized, without adequate access to modern technology,

unable to compete without government subsidy, and generally without defenders among the public once the possibility of divestiture began to be discussed. If nothing else, the popularity of privatization, demonstrated in poll after poll in country after country, suggested that consumers of the output of these government-owned companies recognized that private owners could do better.

Moreover, most of these companies were significant drains on already overburdened government budgets. Regardless of how proceeds were used, the need for deficit reduction demanded privatization, if only to remove operating losses from the governments' books.

Most importantly, privatization offered the opportunity to attract new investors, new capital, new technology, and new management skills, as well as the chance to become integrated into the world economy. At a time when governments were largely unable to raise money in international markets, asset sales became the vehicle which not only provoked the return of massive amounts of flight capital, but stimulated new investors to invest in local stock and bond markets. Without these inflows, the region would have become an economic backwater, moving toward African rather than Asian economic conditions. Indeed, the core challenge facing policy makers in the mid-1980's was to design a new engine of growth, replacing Prebisch's statism with Adam Smith's reliance on markets. Privatization was a necessary element of that effort.

However, privatization alone could not accomplish the profound transformation of Latin America's economies which was needed after the debt crisis—although that transformation could not have been achieved without privatization. And, more obviously after the onset of the recent Mexican financial crisis, a fully articulated economic modernization strategy built around privatization could not eliminate the possibility either of policy failures or of swings between periods of growth and periods of recession. But the shift in the boundary between the public and private sectors opened up new possibilities of growth which neither existed nor seemed to be in prospect ten years ago, when commentators routinely worried about the Africanization of Latin America.

It is not necessary to recap the spectacular recovery of the Latin economy after 1988 or to make a resume of the liberal economic and financial strategy which to a greater or lesser degree was adopted throughout the hemisphere. Trade liberalization, fiscal reform, implementation of conservative monetary policy, debt renegotiation, regulatory reform, labour law reform, de-indexation, improvements in capital market and banking oversight as well as privatization were common elements of that strategy. Naturally, there were important differences—Argentina's convertibility law versus Mexico's crawling peg, Uruguay's rejection of privatization versus Chile's aggressive embrace—but the similarities defined a clearly recognizable "Latin American model" whose core was constructed upon the development of the private sector as the leading edge of economic growth and development.

How necessary was—and is—privatization to the success and prospects of this model? There is a growing body of empirical evidence that privatization played a central role. A recent study of 61 companies from 18 countries (including several Latin countries) in 32 industries shows that privatization significantly increased profitability, productivity, efficiency and, most surprisingly, total employment. (See William Megginson, Robert Nash and Matthias von Randenborg, 1994, "The Financial and Operating Performance of Newly Privatized Firms", *Journal of Finance*). Another study, by a team of World Bank economists (Ahmed Galal, Leroy Jones, Pankaj Tandon and Ingo Vogelsang, 1992, *Welfare Consequences of Selling Public Enterprises*. The World Bank, Washington, D.C.) looked at twelve privatizations in four countries (including Mexico) and concluded that in eleven of the twelve case studies there were positive welfare gains for society as a whole. Again, the biggest surprise in the study was that workers as a whole were not disadvantaged by privatization and in some

cases that they gained, largely because of higher wages and appreciation of shares granted to or purchased in the privatization process as well as because of substantial severance payments for those whose jobs disappeared. The table below summarizes the study's conclusions. Evidence from particular privatizations in Brazil, Mexico, Argentina and Chile closely track the conclusions of these international studies.

Winners and Losers: New Welfare Changes

Workers:	Not worse off; sometimes clear winners.	
Consumers:	Lose in a number of cases as prices rise to an economically efficient level with larger societal benefits.	
Governments:	Immediate fiscal effect usually positive.	
Competitors:	When relevant (i.e. non-monopoly situations)	clear gains.
Foreigners vs. Nationals:	When foreigners are involved, they generally do quite well but nationals do even better.	

Source: Galal, Jones, Tandon and Vogelsang, Welfare Consequences of Selling Public Enterprises.

These improvements in efficiency and productivity have been important contributors to the economic successes of the past few years. And there was, at least until recently, every reason to believe that the positive effects on privatization would continue. Indeed, the World Bank study cited above concluded that for a typical developing economy, privatization, if embedded in a broader market-oriented economic reform strategy, would have continuing benefits:

- "(a) ... capable of producing annual welfare gains of around 5 to 10 per cent of predivestiture annual sales;
- (b) if half the public enterprise sector were to be divested, the annual gains would be about 1 per cent of GDP, and
- (c) additional benefits might follow from such indirect effects as unleashed private entrepreneurial activity and accelerated capital market development."

3. What's next?

Nevertheless, the Mexican financial crisis and consequent flight of capital from Latin America have raised new questions about the viability of the hemisphere's reliance on portfolio capital flows to finance growth. Commentators from President Zedillo to The New York Times have opined that reliance on speculative capital—so-called "hot money"—puts the fate of great nations in the hands of 28-year-old traders with no commitment beyond the next trade and no horizon beyond the news flash on a computer screen. It is a short leap from this criticism to an argument that the hemisphere has been too dependent on foreign capital (i.e. current account deficits have been too high and savings rates too low), to an argument that the private capital flows are unstable and private investment unreliable as a linchpin of economic growth, to questions about whether the private sector is the right platform on which to base a sustainable economic strategy. This somewhat tortuous chain of logic could become more persuasive, or at least more popular, if private capital flows (which have overwhelmingly gone to private sector addresses over the past five years) dry up, if recently privatized companies fail in Mexico or elsewhere and are rescued (that is, re-nationalized) by governments, or if the economic growth does not quickly revive.

The immediate issue, then, is not whether to continue to privatize or whether privatization has

worked. Privatization has produced sufficient tangible economic and financial benefits to make the case that private ownership is usually preferable to public ownership. The question, rather, is how to sustain the momentum toward a private-sector driven economy—including continuing privatization where the process is as yet immature—in the face of adverse changes in international and regional conditions. The answer lies partly in an examination of some of the lessons of the Latin privatization experience and partly in a discussion of future policies which governments should consider.

It is possible to cull a number of lessons from the Latin experience with privatization, some of which address future privatizations, some of which concern the viability of past privatizations.

First, governments typically face a buyers', not a sellers', market, although they just as typically fail to recognize this. The consequence may be lower prices and less restrictive conditions than expected when domestic political circumstance and national pride may demand higher prices and more restrictions. There is always severe competition for scarce capital and scarcer technical expertise. As a result, some privatizations will fail and, as a result, some loss-making enterprises will (or should) simply disappear. For example, there may not be a market for all of the airlines now owned by Latin governments, when there is an obvious excess supply of airline services internationally. This does not mean that the State-run airlines should be kept flying; the public welfare may be best served by permanently grounding some of them.

Second, privatization is an intensely political process. This does not mean it is corrupt, but rather that the government has to cope with important domestic forces whose aim is to frustrate or pervert the process. The government can be caught between the demands of entrenched interests and those of the potential investors; too often the result of trying to please both simply produces bad policy. The rule should be: when in doubt, favour the investors.

Third, privatization should be defined primarily in industrial rather than financial terms. Asset sales can raise money and extinguish debts. But the long-run success of these sales depends on the injection of new management, capital and technology. Thus, the organizing principles should be to improve economic efficiency, promote technological development, and provide enhanced services rather than to maximize receipts. To the extent that privatization is seen primarily as a way to raise revenues for the government or an alternative to debt strategy, it will ultimately fail, even if, along the way, individual deals are completed. The sale of banks in Mexico to the highest bidders rather than to the most qualified may have helped produce the solvency problems which are increasingly evident.

Fourth, the sale of a public-sector monopoly to the private sector requires the careful elaboration of a new regulatory framework. Private-sector owners and investors are inherently more likely to manage more efficiently to introduce new technologies, and to allocate capital on economic rather than political criteria, if only to maximize profit. Monopoly powers can be abused, however, and the dilemma is how to give the new owner enough protection to earn a fair return, especially in the early post-privatization period, while protecting the public interest.

However, private monopolies pose their own problems. Different governments have approached the problem differently. In Argentina, the telephone monopoly was divided into two regional, but not competing companies; in Mexico, the company was sold intact with a national concession. In both cases, however, competition has subsequently been introduced by allowing new entrants to offer services based on new (wireless) technologies. Moreover, Mexico, like Chile before it, will soon open even basic local and long

distance services to direct competition.

The growing reality is that the evolution of technology is transforming the nature of what traditionally were considered to be natural monopolies. In almost all industrial and service activities competition can and should be introduced to maximize the public welfare.

Fifth, it is a general rule of thumb that the success of privatization depends on the ultimate distance from the political process of the privatized entity. The more the post-privatization decision-making process in an entity is depoliticized, the more likely the company is to make economically based decisions. This is true, for example, in the case of electricity or telephone companies; if privatized utilities have to bargain with politicians over each price increase, their independence (and their profitability) will inevitably suffer.

Sixth, governments often have a hard time understanding the difference between their roles as owners or as regulators. It is essential that the post-privatization regulatory environment be specified prior to sale, not only to maximize revenues from the privatization but to maximize the likelihood that the privatized company will be able to operate successfully. But it is also important that governments recognize that they need to let private companies operate freely, succeeding or failing on their own. For example, in technology-intensive businesses—like telecommunications—the government should regulate services, not pick technologies. There is a critical difference between defining the framework and managing a business and, in a privatized world, only the former is within the appropriate purview of the government. But many governments, out of habit or conviction, too readily interfere in what should be operational decisions.

4. Promoting privatization

What can governments do to assure the continued success of privatization and of privatized companies even as the Mexican induced financial crisis threatens to curtail capital flows to the whole region? The basic answer is to sustain a stable growth-oriented macroeconomic framework which recognizes the priority of maintaining the viability and competitiveness of the private sector. The crucial modification to the economic strategy of the recent past should be a greater emphasis on measures to promote domestic savings, to improve the transparency and efficiency of capital markets and to raise the quality of local financial institutions; one element of such an approach should be the rapid privatization of social security systems, as pioneered by Chile. This would reduce dependence on external portfolio capital flows. At the same time, countries should look at measures which reduce the velocity of cross-border capital flows, carefully balancing the liquidity needs of investors against the stability needs of the users of capital. The risk, of course, is that the distance between such measures as minimum investment periods and capital controls may be too short in the minds of some investors (and, indeed, some politicians).

One of the present dilemmas facing several countries in the region, particularly Mexico, is that the sort of orthodox adjustment programmes mandated by official lenders as well as by conventional wisdom require dramatic fiscal and monetary tightening. Positive real interest rates and budget surpluses are appropriate to certain situations, but could transform a recession into a depression if too much damage is done to private financial and non-financial companies. There is a real, urgent need for new thinking about how to stabilize financial markets when government finances are basically sound and when the growth strategy is predicated on continuing private sector credit flows to private sector addresses.

Even in the midst of financial crisis, governments should seek to reinforce the privatization processes which they have launched. Indeed, it is possible that just as the early Chilean, Argentinean and Mexican

privatizations captured the imaginations of investors, a new wave of privatizations now could entice owners of capital to resume much needed flows. This suggests several observations:

First, it is essential that contractual commitments made to privatized firms are rigorously observed. Venezuela's harassment of CANTV has done almost as much damage to the market's perception of the country's investment climate as any of its other policies.

Second, the economic rationale underlying the decision to privatize should not be lost when fiscal pressures suddenly balloon. Just as privatization should not be a substitute for debt policy, it should not be a substitute for fiscal policy or the long-run commercial consequences may not be viable. Rushed, badly designed, unprofessional privatizations will not work.

Third, governments should be prepared to let privatized companies fail. The absence of market discipline was a principal source of the inefficiency of State-owned companies and would have a similar corrosive effect on private ones. Saving privatized companies will do little to impress potential investors and will do nothing to improve the viability of the economy.

Fourth, perhaps the single greatest mistake in the early wave of Latin privatizations was the failure by some governments to create full blown post-privatization regulatory environments before divestiture. Success in the future requires the establishment of a known, predictable policy framework. This is even truer in the midst of crisis conditions when investors are being asked to undertake long-term commitments, than it was when conditions were more positive.

Fifth, as little distinction as possible should be made between foreign and domestic capital. There is no economic case for such distinctions—indeed, there is a strong case in favour of allowing unfettered foreign investments—and the political case is usually exaggerated. Where outright asset sales to foreigners are thought to be too sensitive, more subtle methods of incorporating foreign capital and technology—joint ventures between private and public firms, concessions to operate, etc.—can come close to approximating privatization.

Sixth, for privatization to flourish, indeed, for private sector to fulfil its leading economic role, there must be profound judicial and legal reform throughout the hemisphere.

From today's vantage point it seems likely that privatization will remain an essential element of the Latin American economic strategy. In a world where wealth is primarily created in the private sector, government's role will increasingly be limited to one of setting and maintaining the rules within which private forces interact. This requires a profound change in how politicians and bureaucrats think about economics. For example, there is little in the administrative tradition of most Latin countries which is consistent with the exercise of open, impartial regulatory processes; Latin bureaucrats are typically more comfortable mandating activities rather than in simply establishing and administering parameters within which companies are allowed wide latitude to operate.

The companion to this observation is that most Latin American governments and bureaucracies do not seem to have yet embraced the full implications of market-driven economics. For example, in discussions about the framework for the post-Telmex telephone liberalization, Mexican government officials have worried aloud that too many market entrants will lead to over-investment and that the country can ill afford such waste. Similar examples of a reluctance to give up the vestiges of dirigiste thinking abound and

will only disappear if leaders insist that market forces predominate.

Finally, the governments of Latin America have little choice but to reinforce the strategies which produced success during recent years. There are no substantial pools of capital outside the private sector and there is no willingness on the part of the leading industrial countries to finance alternative models of development. Indeed, there is no credible alternative model.

The opportunity—and the challenge—is to consolidate the gains of past privatizations and to promote new ones. After all, what would be a more spectacular affirmation of continuing commitment to radical economic change than the privatization of PEMEX or Petrobras?

VI. COUNTRY PAPERS

1. PRIVATIZATION IN ARGENTINA

1. Background

Before privatization, public enterprises (PEs) in Argentina had a significant and growing economic and political role. Their share in the economy did not differ significantly from the average country, in which PEs contribute 16.5 per cent of capital formation and 9.5 per cent of gross domestic product (GDP).

Argentina had approximately 300 public financial and nonfinancial enterprises in 1982. These usually took the form of public corporations. They supposedly combined managerial autonomy of operations with political control and oversight. The overall share of the Argentine PE sector before the long privatization process, which started in 1989, was approximately 7 per cent of GDP, 30 per cent of gross fixed investment, 56 per cent of the public sector deficit, 26 per cent of external debt (\$58.5 billion) and 2.8 per cent of the total labour force (290,000 employees).

These enterprises were principally public utilities—energy, transport, telecommunications and water resources (90 per cent of the overall sector), and industries—mainly Ministry of Defence productive enterprises, which were about 10 per cent of the total sector, mainly in steel, metalworking, chemicals and petrochemicals. There were also some productive and service enterprises which were rescued by the State and later liquidated or returned to the private sector. Employment was concentrated heavily in the railways (FA), telecommunications (ENTEL) and postal services (ENCOTEL), which provided about 60 per cent of total sectoral employment.

Although their evolution and origins were diverse, one can usually trace some of the following motives: ideological, market, national security, industrial development strategy, nationalization, employment and distributive factors. Each one had a different weight and depended on the particular political, social and economic setting. However, the recent period witnessed a major shift in many of the driving forces backing the public enterprise sector.

Since the debt crisis started in the early 1980's, Argentina's investment capacity was reduced to a level that did not allow even the maintenance of its capital stock, both public and private. Investment dropped from 20 per cent of GDP during the 1970's to 10 per cent in the 1980's. This led to a short-sighted lack of investment in maintenance and improving the productivity of existent operations, because of overall cuts in current expenditures. Although this was the turning-point which made privatization the only possible outcome, it also worsened institutional investment programming, policy-making and planning process at the sectoral level.

Ideological changes stressed the need for liberalization, "market-friendly" policies and the "subsidiary State", and the perceived limitations of bureaucratic management. New contestable markets and technological changes also affected market structures and shifted borders while management capacity matured and indigenous entrepreneurs got better access to capital markets. Thus, when the debt crisis erupted in the early 1980's, the overall financial performance of PEs imposed a burden on the fiscal accounts. The consequent adjustment process seriously eroded the quality of services, productive performance and the capital base in many sectors, contributing to the popular endorsement of privatization policies.

The above-mentioned changes and limitations created the conditions to start profound stabilization and reform processes of which privatization was a part.

Therefore, Argentina began an overriding, rapid and widespread "sell first" policy without extended restructuring, which took into account its fiscal restraints and temporary political capital, sectoral support and weak opposition, which would have vanished if a more gradual step-by-step approach had been adopted.

To understand this overall and speedy privatization process, the policy has to be analyzed in its particular setting. Argentina confronted at least two hyperinflationary episodes in mid-1989, with a second one early in March 1990. This situation caused serious fiscal problems, due to adjustment fatigue and the lag in counter-inflationary interventions. This exhausted public policy tools and access to public sector borrowing. The main source of funds was privatization through outright sale of public assets or of long-term concessions.

2. Former institutional structures

Argentine PEs operated amidst a complex institutional and regulatory network with multiple and inconsistent objectives and policies. The Ministry of Public Works and Services (MOSP) was responsible for the main service PEs through its four sectoral Secretariats that were held directly accountable for each area. The productive enterprises were under the aegis of the Ministry of Defence. The rescued PEs were under the charge of the National Development Bank (BANADE). In 1985, a Secretariat of Growth Promotion was established to increase divestiture options, but was eliminated in 1986 due to its negligible effect. During the same year, the Secretariat of Control of Public Enterprises (SECONEP) was created to advise the Government on PE policies and control: this was also soon dissolved.

The Directorate of Public Enterprises (DEP) was instituted in 1986. At first, it tried to promote the institutional reform of PEs by means of decentralization management contracts, restructuring and privatization. Later, it centralized power and decision-making in the DEP and MOSP and appointed directors and management staff in PEs. It tried to implement deregulation and demonopolization policies, but with limited success, and was abolished in 1989.

The Sindicatura General de Empresas Publicas (SIGEP) became the oversight body for PEs. It audited legal compliance, accounting and management (operational) procedures by participating in PE board meetings. However, most audits were ex post and formal, given the lack of clear ex ante management objectives and policies for most PEs.

The first phase of privatization started in 1985 and was able to privatize only a few public enterprises that had been rescued from bankruptcy and some others in which the State had a minority stake.

The new administration, which took office in July 1989, emphasized the need to advance towards State reform and presented an ambitious legislative package to Congress for its enactment and implementation. As mentioned above, the initial political thrust, the overall social and political impact that the recent hyperinflationary process had, and the diverse political base and constituency, gave the Government the support it needed to start this policy.

The second privatization phase had two parts. The first, between July 1989 and February 1991, was conducted by the Ministry of Public Works and Services (MOSP), during which controlling shareholdings of Argentine Airlines and ENTEL (telecommunications) were sold. Minor stakes in petrochemical firms, television

stations and highway concessions were awarded. The second part began in 1991 amidst a successful stabilization package (the Convertibility Plan) and was managed by the Ministry of Economy and Public Works and Services (MEOySP), which shared the responsibility for enterprises belonging to the Ministry of Defence.

This was part of a learning process for both the public and private sectors. It used the existing monitoring capacity as a stepstone for its success.

Between 1990 and 1994, after legal changes and break up into independent business units, approximately 115 enterprises were privatized through outright sale of assets, concessions and franchises. Also public offerings of YPF shares and concessions for primary and secondary oil production areas were made. Total sale proceeds were \$16.3 billion. During this period there was an overall personnel reduction in most sectors leaving about 100,000 employees in the privatized firms after retrenchments.

The dimension, diversity, complexity and time constraints of the privatization process required appropriate coordination, coherence and sequencing to allow the attainment of its different objectives and goals.

3. Privatization process

(a) Objectives

The policy statement on privatization declared that "anything that the private sector can undertake itself will not be done by the national State; that everything that the provinces can do autonomously will not be done by the national State; and that all that can be done by the municipalities will not be done by the national State" (Presidential Message to Congress, July 1989).

The objective of this policy was to increase fiscal revenues to service foreign debt, to contribute to stabilization and to improve the quality and coverage of public services. This process had support and assistance from the World Bank and UNDP through the sectoral Public Enterprise Reform Adjustment Loan and a Technical Assistance PE Reform Loan as well as other sector loans and projects. These provided the necessary funding for both sectoral adjustments and tailor-made privatization plans.

Because of the pace and size of the privatization process, the important fiscal needs, the sale of control stake—all aspects of the privatization policy and strategy, there was a lag in the development of relative regulatory capacity, or the burden was too heavy, which created serious challenges to the regulatory agencies.

(b) Modalities

The choice of modality of privatization was based on market structure, required period for investment recovery, competitive conditions and the amount of the State's stake. Modalities were: (a) outright sale of asset for firms that operated in competitive markets, such as in electricity generation, YPF peripheral activities and most productive PEs; (b) share offerings, as with YPF and most residual stakes; (c) concessions, franchises and licences, for periods that varied between 10 and 95 years for roads, railways, subways, telecommunication networks, water and sewerage infrastructure, and facilities for transportation and distribution of electricity and gas and oil production.

(c) Macroeconomic conditions

The so-called Technical Operative Group, which was set up within the Secretariat of Finance, conducted the financial, fiscal, price and tariff monitoring of all PEs during the whole process. This task was useful to determine the overall cash and debt requirements and sector goals and to build different scenarios for privatization. It also analyzed the possible inflationary and fiscal impacts of changes in tariff levels and structures and tax cuts in the stabilization and deregulation process, and the external balance and debt impact of different privatization strategies. During this phase, due to the improvement in fiscal conditions, Argentina got an IMF Extended Fund Facility and later started negotiations to be eligible for the Brady Plan, which allowed rescheduling of foreign debt that was carefully monitored by the IMF, World Bank and commercial banks. Therefore, waivers and other conditions had to be met before privatization of PEs. These accounted for about 26 per cent of the external debt.

The strict and widespread current and capital financial constraints, set by the Secretariat of Finance, caused deviations which led to an increase of liabilities during the privatization and transfer process. This could have been avoided with a more flexible and piecemeal approach towards control of revenues and expenditures.

The aforementioned information was used mainly by the Secretariat of Finance, but could have had a more extended use in the Undersecretariat of Privatization, the ad hoc Privatization Commissions and other sectors.

(d) Techniques and procedures

Other preparations included transfers of rights, statutory reforms based on privileges, attention to competitive and market conditions, and necessary regulations, with preference given to partial owners, employees (Programme for Participated Property (PPPs or ESOPs), users and consumers or producers of inputs (cooperatives).

In many cases there was business unbundling through horizontal restructuring, such as in freight and passenger railways and highway toll networks, or vertical restructuring, such as with gas and electricity transport and distribution. This was intended to reduce the firm's market power, introduce competition or facilitate privatization, through break up of networks. The task entailed identifying business units, separating infrastructure and assets, administrative and accounting information, allocating personnel and other operational aspects as well as establishing boundaries and contractual forms of access and integration.

Preparation also involved statutory, legal and institutional reforms of PEs which were restructured to facilitate divestiture. After these transformations, public corporations became stock corporations. This facilitated later sales of equity.

The sales were made through assignment of control stakes to groups which were formed by a sectoral operator with confirmed experience of running utilities of significant size. Formal guarantees were obtained for investment commitments, quality of service and maintenance, and safeguards for public service assets, according to the conditions of each particular business.

Golden shares were not retained by the public sector. The only contractual condition related to share ownership and foreign investors (who have the same rights as domestic investors) was the obligation to inform the Government of any change in the control group. The firms were subject to concession contracts and

regulatory framework conditions set for public services in terms of service standards, investment commitments, consumer rights, monitoring and information disclosure, access conditions, review periods and other key issues. The selection procedures included public bidding, public contests and auctions—with or without baseline prices, share offerings in different markets and direct contracts.

(e) Valuations

Appraisals by national, provincial or municipal public agencies were required. International and national professional appraisers were hired when valuation by the public sector was not feasible.

In most cases, there were asset valuations at the net present values of businesses, based on their discounted projected cash flows. From this information, baseline prices were set for each bidding process. Depending on the outcome, this threshold could be lowered or removed. Since values changed with macroeconomic conditions, this also affected the acceptable mix between cash, debt and transfer of liabilities. Public offerings were based on reasonable price-earnings ratios for similar firms, adjusted by the rated country risk.

(f) Administrative arrangements

The "sell first" and comprehensive privatization strategy required strong political commitment, centralization, coordination, monitoring and control to proceed without affecting transparency, accountability, competition and other aspects.

Debt-equity swaps could be used for partial payment to reduce the debt load and also provide external backing. There were also provisions for protecting employment conditions and social security to mitigate negative social impacts. The policies towards labour were broad and established general intentions which served to reduce employee opposition, but lacked patterns to be dealt with in the process. The Government assumed most PEs' total liabilities in order to facilitate the privatization process, although some were transferred to licensees.

During the second phase, Decree 2408/91 set the time-frame, sequence and conditions for the privatization process, which was to be terminated by the end of 1992. It set the deadlines for drafting legislation, transfer of services, bidding, tender, concession conditions and restructuring plans and programmes. It established the basis for coordination and agreement with provinces in areas of shared competence related to privatizations and concessions. Responsibility was assigned for submitting projects to the National Executive Power (PEN) with the regulatory framework and service standards, inspection and control, consumer protection and safeguards for State assets included in concessions, privatizations and decentralization, prior to issue of corresponding bidding terms and conditions. External debt conversion and capitalization could be requested by the enforcing authority and approved by PEN, after approval of the MEOySP. The discount rate of debt was set by the MEOySP and their review was shared by the Secretariat of Finance with the Central Bank (BCRA).

The MEOySP had a policy-making role. It also coordinated progress and received monthly reports from the implementation units on the fulfilment of the proposed schedules, highlighting particular issues. The Undersecretariat of Privatization became, from then on, the so-called Enforcing Entity, administering and monitoring the procedures, while the Minister of Economy (MEOySP) became the Enforcing Authority with power to contract legal, accounting and economic consultants, both domestic and international, to issue the calls to tender, approve all regulations and general and specific bidding terms and conditions, issue all administrative

acts and carry out all necessary steps for the fulfilment of the Decree.

Resolution MEOySP 4178/91 placed the rules and procedures for presentation of progress reports, monitoring and control of the privatization process with the Congressional Committee. Enforcement was by the Ministry and coordinated by the PEN. The annex specified 37 administrative acts, starting with the declaration of what was "subject to privatization". It also instituted a Privatization Commission, and dealt with selection and contracting of technical, financial and legal consulting firms (with or without external control), approval of the regulatory framework, restructuring, appraisal procedure, sale conditions, pre-qualification and award commissions, bidding process and consultations, pre-qualification and award, appointment and establishment of the directorates of regulatory bodies, performance guarantees, the signing of contracts and transfers. For each step there were specific mechanisms which were pre-determined. Centralized decision-making and decentralized implementation allowed a strong rhythm to comply with the set schedule.

The Privatization Commissions contracted extensive legal, technical, financial and economic consulting capacity. This was used to prepare specific privatization strategies and policies, draft the institutional, legal and statutory changes, set the employment and investment conditions, make appraisals of enterprises and business units, set bidding, award, contract and transfer conditions, design regulatory frameworks and other necessary aspects. There were many problems concerning personnel, inventories, assets, billing and infrastructure information update which had consequences on the bidding and transfer procedures, when defining business units, conditions and residual revenues. The Employee Property Shared Programmes have not been totally implemented to date, mostly because they were used to avoid trade union opposition, but did not fully solve the equity and other implementation problems. In many cases trade unions seriously affected operations and controlled information flow.

Present monitoring of privatization is related to control of the State's residual stake since, after the sale of control packages, the State still has significant participation in many enterprises, amounting to between 10 per cent and 49 per cent including shares held by the Employee Share Ownership Plans. There is also a need for control of the transfer process until all assets and liabilities are totally settled. Here again, there is plenty of room for improvement during the preparatory phase in order to simplify this activity. The experience with transfer of liabilities, retroactive billing, etc., has been quite complicated. It seems that improving reviews and drafting specific contract conditions can avoid future adjustments.

(g) Monitoring

The State Reform Law 23.696, enacted in August 1989, set the rules and procedures for privatization and declared the Administrative Emergency of Public Services and the State. This authorized the appointment by Ministers and sectoral Secretaries of Intervenors in PEs for limited periods (180 days, renewable), and determined their functions and responsibilities. The execution of the programme was supported by sectoral ministries and audited by the regular oversight agencies in their areas of competence, that is, Tribunal de Cuentas for the nonproductive public sector APN, and SIGEP for PEs, to provide external supervision of the process. A Congressional Committee formed by 6 Senators and 6 Representatives was coordinated internally with sectoral Commissions and with the PEN, and was charged with supervision and follow up of procedures. In cases where provincial jurisdictions were affected, the Law required their consent.

For divestiture and participation of private capital, PEs had to be declared "subject to privatization", total or partial, except for minority stakes, which were governed by their own statutory provisions. Inclusion of any enterprise other than those listed in the annex to the Law had to be dictated by the PEN, with approval of

Congress.

Immediately thereafter, Decree 1105/89 set the rules derived from the Law. During the same year, various sectoral decrees were enacted to establish the basis for railway concessions, deregulate and demonopolize telecommunication services and deregulate the oil sector. The Directorate for Public Enterprises (DEP) was dissolved and the existing monitoring capacity was transferred to the Ministry of Public Works and Services (MOSP). MOSP created an Executive Reform Committee, responsible for the process at this initial stage. As the reform progressed, Decree 2074/90 added ports, water and sewerage, gas, shipping, electricity, coal production and postal and telegraph services to the original list of sectors and firms.

After years of trying to establish appropriate, reliable, consistent and timely information systems for PEs, a Technical Operative Group (GTO) was set up at the DEP in 1987. This maintained information on all relevant PEs—service and productive—on labour contracts, employment, productivity and personnel management, financial and fiscal data, prices and tariffs, cost structures, some performance indicators and procurement. This unit was able to succeed in its job because it had acquired expertise in the PE budget monitoring process in the Undersecretariat of Budgeting within the Secretariat of Finance and because it started with a tailor-made financial information system implemented at the enterprise level. The system was transferred to the MOSP when the DEP was abolished, and was used to monitor key macroeconomic, labour and microeconomic issues related to the privatization objectives and sectoral process, including direct control of PE cash flows since 1990.

It was subsequently transferred to the Under-Secretariat of Privatizations and finally to the Secretariat of Finance, where it is charged with financial monitoring and tracking the State's residual stake and liabilities in divested enterprises. SIGEP, the audit body for PEs, also maintained and published economic and financial information and performance indicators from the MOSP enterprises, but was interrupted in 1991. The report and audit function are still carried on by its successor SIGEN.

A general overview of each particular divestiture strategy and outcome shows very different patterns which can only be explained by the particular sector circumstances in which each strategy was designed and implemented. Each sector faced different public- and private-sector technical, investment and service expertise, labour conditions and consumer demands. This quite obvious fact is often disregarded when analyzing the privatization process.

Thinned public-sector capacities, bureaucratic resistance and other factors placed a heavy burden on most privatization units, which were intensively supported by external consultants and had appropriate incentive schemes to comply with the privatization strategy. These groups generally participated in all phases of the process, beginning with the intervention of management, setting the particular privatization strategy, following the divestiture procedure and, in many cases, designing and heading the regulatory body. These very compact ad hoc units usually conducted the whole process effectively and in a timely fashion. Careful attention had to be given to transparency, accountability and autonomy when addressing the different issues.

The above-mentioned GTO collected different data which were processed to provide various short- and medium-term indicators. It was able to obtain this information because it provided PEs with systems and models which facilitated their work and it processed the crude data to obtain the key indicators requested by the policy-making authority. The information system that was built had a data base which was continuously updated. This unit could have been vulnerable if not for the fact that it only assumed a monitoring role and had no analytical and assessment capacity. This was known by those subject to monitoring. During the second phase, the World Bank and IMF started using this information for monitoring purposes and soon the authorities realized

that they had useful information for macroeconomic and external impact analysis and other aspects related to short and medium-term programming. This gave stronger backing to the task-force which enabled a wider coverage and more timely information.

The other oversight structures were Congress, which had a Bi-Chamber Committee for Supervision of Privatizations, and SIGEP, now Sindicatura General de la Nacion (SIGEN), the central Government's audit agency. They played a limited role, in terms of control and supervision of this process, probably due to their weakened institutional capacities. Recently, the Auditoria General de la Nacion, a congressional oversight body, has been established. It has control responsibilities over the regulatory agencies.

(h) Constraints

PEs in Argentina were of two very distinct types: (a) public service infrastructure firms, which operate in nontradable and, mostly, noncompetitive markets, appropriate for rent-seekers, and are thus subject to regulation; and (b) industrial enterprises which are exposed to competition. In both cases, indigenous entrepreneurs associated with foreign operators and investors became interested in the prospect of restoring profitability through improved management and investment practices.

The major privatization programme started with the concession of the telecommunication public enterprise (Entel) to two major operators, providing exclusive rights to operate in the basic services during a 7-year period that could be extended, upon compliance of targets, for 3 more years. In that same year Argentine Airline's 85 per cent control stake was sold to private investors, together with the sale of petrochemical firms, award of television station concessions for 15 years, and highway toll concessions for 12 years. During the second phase, generation plants were sold, and electricity transmission and distribution networks were awarded under 95-year concessions; gas transportation and distribution networks were licensed for 35 years; YPF shares were floated in the stock market, providing revenues of \$ 3,040 million; freight and passenger railway concessions were awarded for 30 years and metropolitan road accesses were given in concession for 10 years. Furthermore, flotations of residual stakes of privatized firms such as telecommunications, generation plants and one of a gas transportation firm were successfully made in the market.

Since the privatization process started, the major constraints were macroeconomic; related to incipient capital markets; legal and institutional; structural, managerial and labour-related; political (commitment and consistency); and technical competence. These should be appropriately analyzed and addressed when deciding the strategy and policy to follow and probably explain many of the successful outcomes and shortcomings which have occurred.

However, the economic coercion of hyperinflation was a major factor which overcame resistance to privatization within civil society, particularly that of trade unions and PE management. They were overcome by attractive early retirement and employee share ownership plans (PPP) when they realized that this alternative had become inescapable.

Labour contracts, employment, personnel structures, social benefits and labour productivity were analyzed and updated to check compliance with committed goals and specific sector strategies. This information was of paramount importance in supporting negotiations with trade unions and designing the divestiture conditions. However, the quality of the information proved ex post to be partially unreliable since in one privatized enterprise alone there were still close to 900 ghost workers (out of a total estimated work force of 23,000). Corruption and fraud were common in most PEs and reached all employment levels. This was the

reason why there was ample room for raising labour productivity under new conditions.

The employee PPPs have not yet been fully implemented. Although these were a useful incentive, they can also serve the objective of worker participation. There were also some microenterprise and labour training and outplacement programmes. Fragile macroeconomic conditions and instability with high inflation created an environment adverse to investment. This raised the internal discount rate, due to the perceived country risk and deteriorating asset values. The overall and protracted fiscal restraint rapidly worsened the technological and operational conditions of most enterprises. This policy, together with cuts in recurrent costs, particularly salaries, left divestiture as the only possible option for PE reform.

Entrepreneurs who had developed their economic base as contractors to PEs, using transfer pricing practices, were aware of the limits to the previous development policy and started to consider the possibility of managing and investing in public service sectors that were subject to severe mismanagement and run-down infrastructure.

Moreover, the distributive dispute which had led to structural constraints and inflation in Argentina, changed because of the effects of adjustment fatigue and the possibility of finding new sources of profit by economic agents. However, not only were domestic conditions modified, but also external economic conditions changed favourably during this period.

Privatization was effected by sale of a controlling stakeholding due to the structural problems that most PEs confronted and the small size of the Argentine stock market when this policy started. Nevertheless, this entails that management is less subject to the discipline of takeover.

During the first privatization phase, the local capital market was small and lacked the density that was needed to absorb new equity issues or large public placements. However, during the second phase the local and international stock markets played a significant role, especially for institutional investors. Because of this, the Government strengthened the Comision Nacional de Valores (Securities and Exchange Commission), which has worked with investment bankers, brokers and other sectors, to establish the conditions for large share offerings and to design other financial instruments to raise capital for private and privatized firms which became public and listed in the stock exchange.

Following the success of the stabilization and reform policies, amidst the depressed international financial markets, the local stock market had a dramatic growth. Its equity traded value grew fivefold and daily operations grew from \$ 2-5 million or less to \$ 80-100 million at its peak, becoming one of Latin America's emerging stock markets. Capital flight reversed and became capital inflow, surpassing \$ 10 billion dollars in recent years. However, it is still an unstable market: recent volatility has had a negative effect on both small shareholders and institutional investors. Government has also tried to institute a loyalty bonus and other means to promote savings and widespread ownership.

Nevertheless, after stabilization and growth policies became effective and credibility recovered, privatized firms were able to place over \$ 1.7 billion in financial instruments in markets to finance part of their investments.

Most enterprises, particularly public service ones, faced problems related to size and relative market power which affected the possibility of transfer to the private sector. There were also legal and institutional problems that had to be sorted out to facilitate this shift.

Privatizations during the first phase left market power relatively intact, as with the telecommunications duopoly that was the outcome of splitting Entel into two basic service operators. During the second phase, most enterprises were separated into different business units, such as electricity, gas and railways, while water and sewerage had already been decentralized by creating provincial entities. Trunk highway and metropolitan access networks were given in concession through build-operate-maintenance-transfer (BOMT) or similar contracts with set fees or subsidies.

External financing provided funding for international and indigenous consultant firms and individual consultants for all technical, legal, economic and financial aspects of the process while the State was going through a profound adjustment-cum-reform process.

(i) Impact

Privatizations in Argentina have had positive effects in terms of productive efficiency, quality and coverage of service and fiscal impact, and will continue to do so.

The first privatization phase was fiscally driven and served the purpose of honouring external debt, recovering credibility and reducing country risk. This created a momentum for the overall process, but with insufficient attention given to improvement of allocative efficiency. Nevertheless, this transformation created very strong incentives for productivity and profitability improvements from cost reductions, particularly due to labour retrenchments, and to better management practices. However, incentives for economic efficiency were less than they might have been due to market power. High tariff levels, protected market conditions and a lag in regulation and enforcement capacity contributed to this outcome.

Notwithstanding this, during the second phase, further consideration was given not only to the productive impact of privatization but also, in cases like electricity and gas, the sector separation was aimed at improving allocative efficiency. The contribution of public enterprises to fiscal deficits was dramatically reduced, while tax revenues increased significantly due to high profitability of some firms—mainly in telecommunications, electricity generation and transmission and gas transportation and distribution. For some tradable sectors such as steel and hydrocarbons, liberalization was insufficient to curb monopolistic behaviour or collusion and further oversight capacity has to be established to deter non-competitive practices.

Specifically, the fiscal impact was threefold—positive cash revenues, external and domestic debt swaps, and a growing stream of tax revenues, which contrast with the former fiscal deficits and financial requirements for investment.

The outcome in terms of quality of service and investment was also favourable, when compared with past experience in which the efficiency and effectiveness of investment was very low. However, the absolute level of yearly planned investment is not that significant, only 1.5-2 per cent, compared with historical investment and the investment needed for sustained growth. However, most likely, the combination of fiscal deficit reduction and tax revenues derived from these privatized firms may provide resources to finance future infrastructure public service projects with new private participation schemes.

So far, foreign investors have a 60 per cent participation in all privatizations, of which Spain has 15 per cent, the United States 12 per cent, Italy 9 per cent, France 7 per cent, Chile 6 per cent, Canada 3 per cent and the United Kingdom 2 per cent, with minor shares for Switzerland, Belgium and others. This cross-bordering or transnationalization of non-tradable service firms has started recently and is part of the globalization and

integration processes, with balance-of-payments, technological and political implications. Also, fifteen large concentrated local economic groups have participated in most privatizations of which four—Perez Companc, Rio, Rocca-Techint, Soldati and Gruneisen-Astra—operate extensively in most sectors .

Given the monopsonist market power, inelastic consumer demand, increased concentration and environment in which these firms operate, there can be a "crowding-out" effect on tradable sectors when they compete in financial markets for scarce funding. There are also problems related to equity changes and distributional effects that have to be accounted for. All these aspects justify the presence of strong sectoral regulation and require anti-trust, trade and consumer regulation to promote competitive practices.

The transfer of enterprises free of liabilities, in generally sound financial condition, with favourable changes in tariff levels and structures and lenient service provision, had a facilitative role, given that some investors considered that their main entry cost was the up-front payment or other initial requirement.

Some economic groups have augmented their annual turnover five-fold during these last few years because of their participation in this process. Given the exposure and leveraged purchases, it will probably be necessary to make a careful scrutiny and review each concessionaire's debt structure, economic and financial performance, investment portfolio and ownership changes. Although the market may provide the solution, in case of mismanagement or default, its public service condition requires careful review by the regulators.

Privatizations also had important consequences on labour productivity in privatized firms since almost 200,000 employees were retrenched. Layoffs and retrenchment were achieved through attractive early retirement and voluntary retirement plans implemented *ex ante* by the PEs and later by the privatized firms.

There were also distribution effects, as tariff rebalancing in some cases favoured industrial consumers and enhanced sector competitiveness. This has not been appropriately coordinated at the provincial level, so there are some regional inequities which still have to be sorted out. Further attention will have to be given to environmental, technological and regional issues.

Regarding the external impact of privatizations, the outcome is still pending and will depend among other things on future profit remittance policies by foreign investors.

(j) Privatization of public services

ENTEL - National Telephone Company: The privatization of this legal monopolist telecommunications company, which had 3.5 million installed subscribers in a rapidly changing technological sector, led to the sale of 60 per cent of the State's assets to a control group headed by foreign investors—Stet, France Telecom and Telefonica Espanola—which are the service operators.

The company's basic service was split into two main areas: Telecom Argentina in the north and Telefonica Argentina in the south, which provide basic telecommunications services. Teleintar renders international services and Startel contributes with the so-called competitive services (cellular phones, data transmission, telex, etc.) They are owned equally by the two telephone companies. The licensees have monopoly rights for 7 years with an option for extension to 10 providing all basic and long-distance service commitments are met.

Gas del Estado - State Gas Company: The gas sector was broken into two basic parts: transmission

(transportation) and distribution. The transportation is being provided by two operators on an open access basis which have transported 20 billion cubic metres of 9,300 kcal gas in 1994, while the distribution is being dispensed to 4.9 million users—households, commercial, industrial, GNC, generation plants and official consumers—by eight operators who have 35 year licences.

Electric Energy Sector - SEGBA, AyEE, HIDRONOR: The electric energy sector has been divided into three segments: power plants which have an installed capacity of 15,000 MW (peak demand slightly exceeds 10,000 MW), consisting of 44.8 per cent hydro, 49.1 per cent thermal and 6.1 per cent nuclear, and operate in a competitive market; the high voltage (500 kV) 7,000 km-long bulk transmission grid is a natural monopoly that connects 80 per cent of the market; and the distribution network which covers approximately more than 5 million industrial, domestic and commercial consumers in the metropolitan area. The transmission system includes an extensive range of lower voltage subnetworks (132 KV) for interconnection between provinces.

OSN - National Water Resources Company: The regulated area has a population of 8.6 million people of which 70 per cent receive drinking water (5.9 million people) and 58 per cent (4.75 million) have sewerage systems. These cover the city of Buenos Aires and 13 districts of the province of Buenos Aires with 2.2 million customers with a 30-year plus 10-year extension concession period. The two treatment plants—Gral. San Martin and Gral. Belgrano—produce 90 per cent of the total water supply, which is estimated at 3.8 million cubic metres/day. Estimated domestic consumption is 280/430 litres per person per day.

Ferrocarriles Argentinos and Femesa - National and Metropolitan Railway Companies: The 35,000 km railway system carries 20 billion traffic units, if ton-kilometres and passenger-tons are added together. It was split into three different business units: freight, intercity passenger and suburban passenger for the Buenos Aires Metropolitan Region. The integrated restructuring programme agreed that the freight business (10.2 million tons in 1993) was financially viable. The privatization involved giving concessions for 30 years, with 10 year extensions, and splitting the network into 6 lines to make it technically and financially viable, while developing competition with road haulage. The network may also carry passengers or give access to intercity passenger railways and charge tolls for its use.

The Buenos Aires Metropolitan Region Suburban passenger services, that has a length of 900 km and carries 800,000 passengers per day, was assigned to a firm called FEMESA that was created to cover the 7 lines and the Metro (subway) which is 44 km long and carries 500,000 passengers per day. This part was offered in 5 packages with 10-year concessions and 20 years for the Urquiza and subway-linked network. Intercity linkage for passenger service for the Buenos Aires-Mar del Plata line was transferred to the Province of Buenos Aires. Other provinces are running some passenger services.

D.N.V. (National Road Directorate): The DNV has 12 concession contracts for approximately 9,000 km of roads that span over 20 corridors and carry 2,000-2,500 units per day. They are operated on a toll basis. Awards were made for operation, maintenance and improvement, with an annual subsidy that will later become a fee. The national network has 28,000 km. There is also a toll road access network being built by four metropolitan access companies which will pay a sliding scale annual fee for 22.8 year concessions.

SSP - Undersecretariat of Ports and Navigation (National Port Authority): This sector has been subject to economic and pilotage deregulation and liberalization with the transfer of minor ports to provincial authorities and operative independence given for major ports—Santa Fe, Rosario, Quequen, Buenos Aires, Bahia Blanca, Ushuahia and Rosario). The new Port Law established a regulatory framework that decentralized ports and most

port services, with wharf and dock cargo and operation services awarded through concessions of 18-25 years, with baseline prices on a guaranteed freight rate basis. Dredging and buoy maintenance, oversight of concessionaires and port administration are the responsibility of the Port Authority. Its main principles are: decentralization; operative autonomy; competition among and within ports; self-financing; legalized private ports.

ENCOTEL - National Post Office Company: The restructuring that is currently being undertaken has resulted in a new firm, ENCOTE SA, 51 per cent State-owned, 14 per cent by PPP and 35 per cent by members of the Universal Postal Union, which carried 372 million postal parcels in 1993, 70 per cent of the total market share.

(k) Regulation

The main areas of regulation are price- or tariff-setting and the expansion and improvement of quality of service, following the principle of efficiency regulation. The prices have been guided mainly by the price-cap principle—RPI minus X—for electricity, telecommunications and gas, with X being a factor reflecting the Government's or regulator's estimate of the scope for increased efficiency of the utility. However, since this ceiling can have negative effects on the quality of service, it both price and quality have to be supervised. The initial tariff has been set in the concession contracts and will be subject to long-term scheduled review periods. For the rest of the concessions the tariff is set along cost-plus lines.

In most cases, regulation covers not only tariffs and quality of service but also investment commitments and plans.

The activities and geographical areas covered by regulation will probably have to be expanded to encompass different and dynamic technical and economic frontiers. Because of different competencies, provincial frameworks and rules should be compatible with the ones established at the national level.

The privatization strategy that Argentina implemented sets a serious regulatory challenge for these new entities. This is because competition was temporarily curbed to increase revenues, attract local and international investors and advance rapidly. Concentration was allowed as there was insufficient knowledge about the real conditions of infrastructure and capital goods that will require further review.

Regardless of this, experienced investors have probably discounted further regulation when they pursued long-term investment strategies. It may be useful to differentiate investor strategies by sector—industry, service and financial—and by source of capital to understand their different strategies and reactions to diverse conditions.

Approximately 12 regulatory agencies have been established or are being created, including the Dirección Nacional de Control de Servicios Agropecuarios (National Directorate for Control of Agricultural Services). Initial privatizations were effected before regulatory and institutional capacity was in place. The legal instruments used to establish the regulatory agencies have been of different levels—some were laws and others were decrees, which implies different conditions and possibilities for adjustment and repeal.

4. Conclusions

Privatization in Argentina started in 1985 and included a few public enterprises which had been rescued from bankruptcy, some in which the State had a minority stake and others fully State-owned. The second privatization stage, which started in 1989, had two phases. The first, which took place amidst different stabilization packages, policy gyrations and shifts, was done in haste and required further adjustment. The present phase, begun in 1991 amidst a successful stabilization plan conducted by the MEOySP, will be completed shortly with privatization of the post office, nuclear plants, airports and some minor enterprises.

Major constraints were macroeconomic imbalances, unformed capital markets, legal, structural and institutional problems, and managerial and labour resistance.

This massive and impressive privatization process has involved the divestiture of almost all large utilities and service enterprises. The strategy responded to political, economic and social factors which opened a window that the Government, with its important and diverse constituency, exploited favourably.

However, this approach demanded very strong centralized policy-making and coordination together with decentralized operational capacities. Although the State's capacity had severely deteriorated, the external backing provided by the World Bank and UNDP, and particular institutional and technical arrangements, permitted the achievement of set goals with some minor deviations. This was supported by an ad hoc monitoring system which had its shortcomings but was very useful amidst the stabilization and reform programme.

Analyzed with hindsight, as is the usual case, there is always room for improvement and greater efficiency during the privatization and post-privatization processes in terms of further development of overall economic and social regulation for both competitive and monopolistic markets; strengthening of sectoral and intersectoral planning and policy-making capacities, coordination of competencies at the provincial and municipal levels; and oversight, control and enforcement capacities. Also, worker participation schemes have to be fully implemented and the State's control of residual stakes could be strengthened.

Privatization in Argentina has had immediate positive effects in terms of productive efficiency together with medium- and long-term consequences due to improvements in quality, coverage and expansion of services, and a contribution to the reduction of the fiscal deficit and increased tax revenues due to the restored profitability of privatized firms.

This swift move has its costs in terms of a complex and extended regulatory task, with respect to tariff, quality and investment controls. The autonomy and discretionary capacities of regulatory bodies deserve further attention because of their effects on credibility, efficiency and sustainability. Careful trade-offs will be required to guarantee due process and diligence together with agility, so as to deter protracted judicial processes.

Although "regulation with a light rein" is difficult during the first stage, due to immature and deteriorated public services, regulation should be considered as a dynamic process which has to be streamlined after pro-competitive and restructuring policies have taken hold, facilitating market entry and increasing productive efficiency and rational resource allocation.

The interest that foreign investors have shown has been beneficial as it reflects credibility and positive capital inflows. Nevertheless, it merits further attention in terms of market, technological and investment strategies, because of their potential impact on local savings, investment capacity and external balance.

2. PRIVATIZATION IN BOLIVIA

1. Objectives of the process

The ultimate goal of the privatization process is to promote accelerated economic growth without sacrificing stability and thus increase the economy's efficiency and competitiveness, leaving both the productive and the service sectors to private enterprise and devoting all of the public sector's effort and financial resources to infrastructure, education and public health.

To do this, it is necessary to achieve some intermediate objectives, including: to develop the capital market and democratize capital; to transfer the economic risk of operating the enterprise to the private sector; to obtain the highest possible price for the public enterprises transferred; to ensure that the enterprises are transferred to the best investor, so that there is a high probability that they will be economically and financially successful; to enable workers to become shareholders of the enterprise in which they work; to reduce the public sector deficit and reassign its scarce resources to activities appropriate to the State.

2. Privatization mechanisms

The mechanisms authorized by law are the following:

National and international public bids

These are carried out through the international purchase agencies contracted by the Bolivian Government. They are responsible for invitations to bid, evaluation of the bids and the submission of appropriate recommendations to the Government;

Open bidding or auction

Carried out by the sale of assets through auctioneers responsible for carrying out the entire auction process. This process is subject to the provisions of the Commercial Code and other laws;

The sale of shares

The sale of participation rights and shares through stock exchanges. Transfers by the sale of shares are subject to the provisions of the Commercial Code, the National Securities Commission Act and other applicable legal provisions; and

Establishment of joint ventures

The establishment of joint ventures is carried out in accordance with the provisions of article 1 of Act No. 1330 and the provisions of the Commercial Code;

3. Macroeconomic conditions

In 1985, when it was realized that the State, because of its bureaucracy, inefficiency and economic interventionism, was the main enemy of the Bolivian economy, a New Economic Policy was adopted, thus initiating Bolivia into a modern market economy.

The main goal of the New Economic Policy is to achieve a change in the country's economic structure. The process of achieving monetary, exchange and price stability was initiated and the economy was completely opened and liberalized.

4. Policies adopted for the privatization process

The privatization process in Bolivia is based on the following principles:

The contracting of independent assessors is carried out through the Sales Agency and in conformity with the relevant regulations and procedures of the financing organizations.

The assessment, evaluation and sales strategies of the enterprises are carried out by independent consulting firms.

The transfers must be made by means of public bids, open auctions or bidding or through the sale of shares.

The enterprises are transferred "as is". No investment or restructuring measures are carried out.

The central Government makes bridge loans to the Regional Development Corporations, which have no resources, for the payment of social benefits to the employees.

The executive summaries of the studies of the enterprises to be privatized prepared by the consulting firms are published in the press.

Workers and employees may participate in the privatization process in accordance with the preferential terms established in each case. Access by workers to the purchase of shares in the enterprise is encouraged.

The awards are made to the highest bidder.

The form of payment is decided on in each particular case and may be by cash or with financing.

The funds obtained from the sale of enterprises are used for health, education or basic infrastructure projects in the region in which the enterprises are situated.

All the information contained in the studies is available to any interested party.

As transparency is an important aspect of the process, it has been decided that no contract or direct sale will be negotiated.

Persons connected with the State may not participate in the purchase of any enterprise.

Another principle employed is that of consensus. For the privatization of each enterprise a Resolution by the Directorate of the Regional Development Corporation is issued authorizing the sale of the enterprise. The Directorate is made up of representatives of various sectors, including, among others, labour, private organizations, private entrepreneurs and the State.

Memoranda of understanding are signed with the workers of each enterprise subject to privatization and ex gratia payments are discharged.

"A" envelopes (technical proposals) and "B" envelopes (economic proposals) are publicly opened.

In order to counteract opposition to the privatization process and strengthen public support for it, information on the methods, procedures and successes of the programme is issued regularly and public support is reinforced by a public information and awareness campaign.

As a strategy for the implementation of the privatization process, the Government has decided to start with small or medium-sized public enterprises as a first step in order to learn more about the process itself and obtain experience to be used in subsequent privatizations of large enterprises.

5. Administrative organization

Act 22407 of 11 January 1990 established a Public Enterprise Evaluation Commission (CEEP) to determine the situation and future prospects of public enterprises and to decide whether or not they should be transferred to the private sector. The CEEP is responsible for providing technical and operational support to CONEPLAN and has authority to approve the evaluation of enterprises as well as to decide on the strategies for privatization. It is chaired by the Minister of Planning and Coordination and made up of the Minister of Finance, the Minister for the sector to which the enterprise belongs and the Chairman of the Regional Development Corporation owning the enterprise to be transferred. The CEEP, which is a high-level body supported by technical staff, centralizes decision-making on privatization and is responsible for ensuring the transparency and efficiency of the process at all times.

By DS 22836 of 14 June 1991, a Public Enterprise Reorganization Executive Unit (UERE) was established within the former Ministry of Planning and Coordination, with independent administrative, technical and financial management. The UERE functions as the technical secretariat of the CEEP and is responsible for implementing public enterprise reorganization policy. Subsequently, it was provided under D.S. 23170 of 5 June 1992 that UERE should be a unit of the Subsecretariat for Economic Development of the former Ministry of Planning and Coordination. It is responsible for advising and providing technical assistance to public enterprises and the executive on all matters relating to the evaluation and privatization of public enterprises.

As Act No. 1493 of 17 September 1993 modifies the structure of the executive power and eliminates the Ministry of Planning and Coordination, it was provided under Ministerial Resolution No. 59 of 12 November 1993 that UERE should be under the direct authority of the National Secretariat for Capitalization and Investment, which is the case at present.

6. Monitoring the process

In order to obtain information on the impact of the privatization process with respect to jobs created, wage improvements, new production levels, increases in productivity and competitiveness, new investments, exports and prices, questionnaires were sent to all the owners of the privatized enterprises. Unfortunately, there have been too few responses to provide a basis for valid conclusions.

7. Specific characteristics of the privatization process

Because the enterprises so far privatized have been of small or medium size, they have almost all been sold to a single buyer. The exception has been the sale of the Guabira Sugar Refinery. In that case a joint corporation was created of which the workers acquired 40 per cent, the cane sugar suppliers also acquired 40 per cent and the remaining 20 per cent remained in the hands of the State in the form of the Santa Cruz Development Corporation.

The reason for carrying out a transaction of this kind was to avoid social conflicts, which could have been rather serious in view of the importance of the sugar refinery in its region. The system of stock participation which was adopted satisfied the parties directly concerned. However, the fact that the method of sale employed was that of direct negotiation with the buyers without a public offering of the refinery created suspicion of the privatization process among the public at large. In view of the fact that transparency is fundamental for the success of the process, it was decided not to continue this kind of operation.

8. Techniques of valuation

The valuation techniques employed have varied depending on the size, complexity and activities of the enterprises to be valued. In most of the economic units the methods of valuation have been those of discounted cash flow, depreciation of assets according to period of use and present condition, comparison with similar transactions and productive capacity on the basis of functioning machinery. The techniques of valuation have always been recommended by the consulting firms responsible for the study of each enterprise.

9. Specific aspects

As a first step, the Government identified the enterprises belonging to the public sector, 175 of which were of small and medium size. Of these, 72 were under the control of the Regional Development Corporations, 28 of the Armed Forces, 16 of the prefectures (hotels), 17 of the municipalities and 11 of the National Secretariat of Industry and Trade (silos).

Independent appraisers were then contracted to prepare studies of the viability and profitability of the enterprises and the sale strategy to be employed.

Once each study had been submitted and approved by the Government the enterprise was prepared for subsequent sale by legal restructuring. Then the benefits of the workers were paid, the agreements signed and the ex gratia payments discharged.

The enterprises or economic units to be sold were not prepared technically nor were investments made in order to sell them.

10. Impact on public finances

The income from the privatization of the 27 enterprises amounted to a sum equivalent to US\$ 18,712,154. Of this amount, US\$ 16,616,154 has been received to date, owing to the cancellation of the US\$ 2,096,000 attributable to the transfer of assets of the Guabira Sugar Refinery to the workers and cane sugar suppliers of the refinery.

Although this sum is not significant, account must be taken of the money the State ceased to lose by

privatizing the enterprises, since it subsidized their operating deficits. For example, the Rafael Deheza Olive Oil Factory had an average annual loss of US\$ 720,000 and the Bolivian Ceramics Factory one of US\$ 79,350. At the time of their privatization these two enterprises had accumulated considerable losses which were assumed by the State from 1978.

In quantifying the amount that has ceased to be lost with privatization, the chaotic management of the enterprises must not be forgotten. Few of the enterprises functioned at 50 per cent of their installed capacity. The rest did not reach even 20 per cent.

The enterprises considered large in terms of the national economy, like the refineries or the olive oil plant, supplied between two and three per cent of the national market while to be able to capture at least 10 per cent it was essential that they operate at 50 per cent of installed capacity and that investments be made in each enterprise.

It is obvious that the creation of public enterprises generates direct and indirect employment. However, from the standpoint of return on investment, it is obvious that the investments made in them were too high and disproportionate to their size in the markets in which they operated. These investments were unjustified in terms of their operation and their markets.

Another aspect which should be taken into account is that throughout the period of their functioning as public enterprises none of them paid their taxes. For example, the public enterprises belonging to the Regional Development Corporations at present owe the State approximately US\$ 100 million in taxes.

Summing up, it can be said that as a rule the public enterprises operated far below their installed capacity. They generated unreal employment, as all of them had supernumeraries. They caused the State large tax losses as they never paid their taxes and created liabilities through pension, health and insurance funds and, lastly, their goods and services were non-competitive.

11. Social aspects

In all the privatizations which have taken place in Bolivia so far the Government has dismissed all of the workers, paying all the benefits established by law as well as some additional bonuses, in order to leave the potential buyer of the enterprise complete freedom to hire the employees he needs.

The Government found itself obliged to adopt this policy in order to be able to attract private investors, in view of the condition most of the public enterprises were in. In most of the public enterprises in operation at the time of their privatization it was necessary to reduce the number of employees in order to reduce the inefficiency of the enterprises. In the past, public enterprises always served succeeding governments as a means of doing political favours by hiring employees without regard to the needs of the enterprise.

On the other hand, as a part of the process, enterprises were privatized which were in a state of paralysis. When these enterprises were privatized the owners began to reactivate them, thus generating new jobs. This has served to some extent to counterbalance the unemployment generated by the other privatizations.

12. Sectoral regulations

In 1985 Supreme Decree No. 21060 was issued, initiating the process of deregulation in the following markets:

Goods market: price controls were eliminated; the economy as a whole operates under a system of free prices which stimulates supply, making markets more competitive.

Foreign exchange market: exchange controls were eliminated, although a system of flotation is maintained through foreign exchange auctions (the curb market) in the Bolivian Central Bank.

Financial market: controls over positive and negative interest rates were eliminated and those rates are fixed by the market rather than the Central Bank.

Labour market: wages are set freely by the parties without State intervention except for the establishment of a minimum wage.

Foreign trade: opening of the economy by the reduction of tariffs.

Labour legislation: freedom to hire and fire in both the public and private sector.

Telecommunications market: transfer of urban telephone services to public service user cooperatives is authorized; prices are set freely although prior approval by local authorities is required.

Air traffic: freight and passenger traffic are deregulated as any private enterprise may operate freely over the route or network of its choice on both trunk and secondary lines.

Entry and exit of capital: entry from abroad is free, as is the transfer abroad of dividends, interest and royalties such as for the transfer of technology.

Bureaucratic and administrative deregulation: has been carried out in the national ministries through the reduction of the number of steps involved in various internal State procedures as well as those relating to the private sector and the public in general.

Tax deregulation and simplification: an array of 600 national and municipal taxes has been replaced by only 6 permanent taxes, 4 on consumption and 2 on imputed income (capital).

13. Impact of privatization

No data are available which would make possible an evaluation of the situation of privatized enterprises and the possible benefits to them of privatization. A questionnaire has been prepared requesting information on production, employment, investment, the payment of taxes and other subjects, but the privatized enterprises have not as yet provided the information requested. The one certain fact is that some of them are beginning to operate this year and others are gradually increasing their utilized capacity, generating new jobs and paying their taxes.

With respect to employment, some have rehired a certain number of employees, such as the Villamontes Oil Plant and the Bolivian Ceramics Factory, and are slowly attempting to reach 100 per cent of installed capacity, a situation which would in turn increase their labour force needs.

Article 5 of Act No. 1330 provides that the funds obtained from the sale of enterprises must be used for health, education and basic infrastructure projects in the regions in which the enterprises are situated.

From the regional point of view, privatizations represent an effort to save enterprises which would otherwise be shut down and liquidated because of the operating losses, chiefly due to bad administration, their accumulated losses and the Government's economic policy with regard to public enterprises, with the accompanying increase in unemployment.

They also mean that the regions in which the sales occur will have funds to invest in the health, education and infrastructure sectors.

Although the necessary steps are being taken to ensure that the funds are used in those areas, no more than 20 per cent of the funds obtained from the sales has so far been invested. The remainder has been deposited in the special accounts of each Regional Development Corporation with the Central Bank.

Although privatization seeks to achieve greater equity chiefly in the use of funds intended for social investment, too short a period of time has elapsed to be able to see its benefits.

A specific case that can be analyzed is the privatization of the Guabira Sugar Refinery. Guabira was privatized by the transfer of its assets to a joint venture with the following participation: 40 per cent by the refinery's workers, 40 per cent by the refinery's cane sugar suppliers and 20 per cent held by the State for a specified time after which it must be transferred to the private sector under the terms of the joint venture's articles of association. In order to democratize its capital, the Government granted the workers every facility to be able to participate in its purchase.

Assessing the situation in the year of the refinery's privatization, two specific developments are apparent, one relating to the functioning of the enterprise and the other to the behaviour of the workers as shareholders. With respect to the first, the administration of the refinery has greatly improved, having functioned efficiently throughout a harvest season. It has fulfilled its tax obligations to the State. The refinery is operating as an efficient private enterprise.

The disquieting development is that of the behaviour of the workers. In spite of the fact that the company's articles of association prohibit the sale by the workers of all or part of their shares for a specific period of time, they have already begun to sell their shares.

The positive side of this privatization is that the refinery is being well run, is complying with its tax obligations and has completed its first harvest as a joint venture with good results. From the point of view of the workers, it seems that the only benefit they have obtained which interests them is having been able to keep their source of employment, although they continue to be redundant.

14. Conclusions

The privatization process in Bolivia is one of the reforms being implemented in the country in order to liberalize the economy more completely and limit State intervention.

The principal objective of privatization is to increase growth by increasing productivity. It has been seen that in most of the enterprises privatized this goal has been attained, and in some cases expectations have been

surpassed.

There are other lesser goals. One of them is to attain greater equity in the distribution of the country's wealth through social investment of the funds obtained. The funds received through the privatization process have not been sufficient to make an impact in the social area.

Another goal is the democratization of capital. For the time being, the only mechanism employed has been to offer the workers the opportunity to participate in the purchase of the enterprise's assets with financial help from the Government. However, they have failed to respond, with some exceptions, which has not led to the desired results. The workers have been unable to assume their role as proprietors because they have been unable to change their outlook to correspond with their situation.

In any case, the Government has decided to continue with the privatization process because it is confident that its long-term results will benefit the country. It is hoped that the privatizations will succeed in creating a climate propitious for investment, both domestic and foreign. The private management associated with the new investments will increase production and productivity. That increase will be essential to improving the situation of employees and wage-earners so that the level of life of the citizens will be increased.

Described as a "brilliant plan" by many observers, "capitalization" offers itself as a novel alternative to privatization. In capitalization, unlike privatization, nothing is sold. Instead, it creates an association between the private sector and the Bolivian people.

In 1985, our country needed a complete change of direction in order to remedy an economic situation of chaos, hyperinflation and political disorder. That change was brought about during the government of Dr. Victor Paz through the application of a novel— for that time—model called the New Economic Policy (NPE). The results were admirable: the rates of inflation fell sharply, the country grew, the fiscal deficit was reduced and the foreign debt crisis was largely resolved.

However, although the NPE was successful in achieving stability, Bolivia's present economic situation undoubtedly requires an even greater transformation. There is an urgent need to redistribute wealth, create greater sources of employment and improve the standard of life for Bolivians. Hence the necessity for capitalization.

Bolivia needs a rate of investment of 20 to 25 per cent of GDP to overcome these problems and thus achieve sustainable development. For that purpose, the Bolivian Government is undertaking the capitalization reform and looking to the private sector as the motor of the country's economic growth.

15. Capitalization vs. privatization

Privatization involves operations of purchase and sale in which the State sells its assets to private investors who keep 100 per cent of the property. Unlike privatization, capitalization involves contribution: the State contributes its assets and the private investor contributes new capital equivalent to the market value of the company. In this way, the investor becomes a partner in Bolivia.

In seeking a partner for Bolivians and not a mere purchaser of enterprises, the idea of a cold process focused primarily on the economy and only afterwards on human beings changes radically.

In principle, the Treasury's vaults are not being filled but rather the wealth that is the fruit of capitalization is distributed among all adult Bolivians. This is not an act of demagoguery but a rational action: to universalize social security coverage over the long term, to generate savings, also over the long term, and to improve the current situation of the retired.

This system ensures that the strategic investor's capital remains in Bolivia—within the company—to be channelled into new investment and increased production. In this way the productive capacity and net value of the enterprise capitalized are immediately increased.

In capitalization, both contributions—that of Bolivians and that of the strategic partner—are employed to create a new company or corporation. The strategic investor, because of experience and technical knowledge, will have the right to manage it.

In this way, the six large enterprises owned by the State, the Empresa Nacional de Electricidad (ENDE) (electric power), Yacimientos Petroliferos Fiscales Bolivianos (YPFB) (petroleum), the Empresa Nacional de Ferrocarriles (ENFE) (railways), the Empresa Nacional de Telecomunicaciones (ENTEL) (telecommunications), Lloyd Aereo Boliviano (LAB) and the Empresa Minera Vinto (EMV) (mining) will be opened to private investors.

After capitalization, the State intends to dispose of the proceeds by distributing them to the almost 4 million adult Bolivians. The shares will be deposited in six or more private pension funds in order to create a universal pension system.

Once capitalization and other reforms are carried out, the Government expects an increase of 6.5 per cent in GDP. It is also hoped that private investment will reach 23 per cent of GDP within three years.

The great flow of investment that capitalization will bring to Bolivia will dynamize the whole economy. A series of new goods and services will multiply around the new capitalized enterprises. That is to say, capitalization will generate directly and indirectly a greater number of jobs.

In this way it is ensured that capitalization will bring not dismissals but jobs, since the amount to be contributed by the investor will go directly into the expansion of the enterprise and not into the national Treasury. The partner must submit a proposal for improvements to be carried out in the short term in the delivery of services and the expansion of the system.

From the first day of capitalization the strategic partner will have enough capital to expand the enterprise. To do so, not only must the present workers be kept but new ones hired.

Capitalization also makes it possible for the workers in the enterprises to transform themselves into partners. Not only will they be employed but they will become shareholders. To make all this a reality, a series of sectoral laws is being submitted. Bolivia and the investors will then have a clear set of rules which will enable them to transform the country.

16. The capitalization of public enterprises

One of the fundamental reforms undertaken by the Government of President Antonio Sanchez de Lozada is what is called the capitalization of the public enterprises. By this term is meant in Bolivia the simultaneous process of privatization and the attraction of investments to be used in the six largest State enterprises, a process which will be accompanied by the distribution of the State's share in those enterprises to all Bolivian citizens.

These enterprises are situated in very dynamic sectors of the Bolivian economy, with broad, unsatisfied markets and, in many cases, monopoly activities. The process of capitalization consists of proposing to a private investor that he invest a sum equal to the enterprise's market value in return for half the shares of the enterprise so capitalized and its management. The shares belonging to the State will subsequently be distributed freely to all Bolivian citizens through a mechanism to be explained below, so that the original public enterprise will become a wholly privately owned corporation.

In March 1994 the National Congress approved the Framework Capitalization Act establishing the legal bases on which the process was to take place. At present the economic value of the enterprises to be capitalized is being estimated with the help of international experts and the strategy to be followed in each case is being worked out. The regulatory framework within which the new enterprises will operate is also being worked out in a process of broad consultation with interested potential private partners. The Government's intention is to complete the entire process by September of this year.

In order to carry the process forward within the timetable laid down by the President of the Republic, a Ministry Without Portfolio for Capitalization was established in March 1994, with responsibility for conducting the processes of capitalization and privatization of the enterprises as well as the reformed pension system. In order to establish the legal and regulatory system required for the capitalization process, particularly with regard to the monopoly enterprises, the sectoral legislation, the Administrative Procedures Act and the Sectoral Regulatory System Act (SIRESE) have already been prepared. These provide a regulatory framework for the markets and rules governing concessions, licensing and tariffs and define the specific functions of the supervisory bodies to be established for each sector.

We present below a brief description of each of the enterprises to be capitalized:

EMPRESA NACIONAL DE ELECTRICIDAD (ENDE)

The electrical sector in Bolivia is very small, with an installed capacity of barely 750 MW, as compared with neighbouring countries like Peru, with an installed capacity of 4100 MW, and Chile, with 5150 MW. The same is true as regards per capita energy consumption, which amounts to 323 KWH/year, compared with a level of 499 for Peru and 1345 for Chile. The electrification service covers only 56 per cent of the population, with 77 per cent of the demand concentrated in the three main cities—La Paz, Cochabamba and Santa Cruz.

The projected growth in demand exceeds generating capacity for the next two years and the projected rates of increase reflect the urgent need to expand the country's generating and transmission capacity. Moreover, because of its geographical situation, Bolivia has great potential for the export of electricity to neighbouring countries. Without investing in the sector Bolivia runs the risk of being unable to grow at the rate required.

The new structure of the sector laid down in the new Electricity Act provides for the vertical separation of the sector into generating, transmitting and distributing activities. At the generating level, free competition is established, combined with free access to the national transmission network and the Interconnected System, for all generators and distributors.

The capitalization strategy for the sector proposes separation of the activities of generating, transmitting and distributing electrical energy, the rationalization of ENDE and its separation into four enterprises, three generating enterprises, Corani, Guaracachi and Valle Hermosa, to be capitalized, and a transmission enterprise. Corani is a hydroelectric plant with a capacity of 126 MW and the two others are thermoelectric plants with a capacity of 177 MW and 144 MW respectively. The transmitting activity will be capitalized six months after the capitalization of the generating enterprises.

The final timetable for the capitalization of the three generating enterprises was presented to potential strategic partners in Miami on 16 June 1995, and accepted by them. At present information on the enterprise is available to all interested investors in the "Data Rooms" opened in La Paz, New York and London. There is a short list of 31 enterprises which have indicated an interest in capitalizing ENDE, including Endesa, Destec, Enron, Iberdrola, Powergen, Liberty Power, Chilectra, National Grid, and Ontario Hydro. The strategic investors selected will take control of the generating enterprises in March 1996.

EMPRESA NACIONAL DE TELECOMUNICACIONES (ENTEL)

Bolivia's telecommunications services are operated by 18 local telephone cooperatives and the Empresa Nacional de Telecomunicaciones (ENTEL), which provide basic local telephone service to small communities and national and international long distance telephone, data transmission, telex and facsimile services.

Bolivia's telecommunications sector has an average telephone density of 3.7 lines per 100 inhabitants (1993) and 8.28 in the city of La Paz. In 1995 unsatisfied demand is projected at more than 26,000 lines, even taking into consideration all the expansion plans of the cooperatives, which to date amount to the installation of 133,000 lines.

According to recent estimates, it is entirely possible to double the national telephone density, urban and rural, in the next five years. The telecommunications act which will be approved at the end of February 1995 establishes the rules for the operation of the telecommunications services under conditions of free competition throughout the national territory, and grants the national supervisory body authority to supervise the sector. It also makes obligatory the interconnection of the public lines, free access by the public to the interconnected national telecommunications network and facilitation of service in rural areas so as to provide modern telephone service throughout the country.

Only the capitalization of ENTEL is planned, as the cooperatives are free to remain in the sector and to incorporate themselves into or form joint ventures with ENTEL. The telecommunications supervisory body will grant concessions for long-distance, local, cellular, cable, TV and other services. The telex and telegraphy services will be privatized separately.

For a period of exclusivity extending to the end of the year 2000 the regulatory body will not grant new concessions to enterprises not already in existence or designated for the capitalization of ENTEL. Subsequently, the concessions will be granted through open bids by any person or enterprise wishing to participate.

LLOYD AEREO BOLIVIANO (LAB)

The reform of the airline sector envisages the capitalization of Lloyd Aereo Boliviano (LAB)—the country's national airline, the restructuring and privatization of the Airport Services and Air Navigation Administration (AASANA) and reform of the regulatory framework.

With respect to Lloyd Aereo Boliviano, the enterprise is being rationalized to make it attractive to investors, and financial, technical and legal consultants and an investment bank will shortly be contracted.

The Proudfoot Corporation has been selected as the general strategic consultant, and will assist the Government in capitalizing LAB. To date, eight proposals have been received for legal assessment with a view to reforming the regulatory framework.

The capitalization strategy envisages transfer to private hands in July 1995. For promotional purposes, the Government will make international presentations of the enterprise (a road show) early in 1995.

In September, "Aéroports de Paris" was contracted to carry out studies of the institutional framework of the civil aviation sector and the airport sub-sector and of the strategy for privatizing them. It is initially proposed that all of AASANA's activities be privatized, dividing its activities into air navigation services and airport operations and separating the administration and operation of the airport services from the air traffic control activities.

YACIMIENTOS PETROLIFEROS FISCALES BOLIVIANOS (YPFB)

The hydrocarbons sector represents 6.5 per cent of Bolivia's GDP and the contribution of YPFB to the Government's income amounts to 35 per cent of the Treasury's receipts. YPFB produces about 64 per cent of the country's gas and 85 per cent of its oil and derivatives and refines 100 per cent of the exports. In addition, YPFB accounts for 25 per cent of the country's exports, through the gas pipeline to Argentina. This is therefore a sector of considerable size and importance to the Bolivian economy.

The proved and potential reserves give the sector enormous development potential, which has so far been limited for lack of an assured market for the export of gas.

The recent negotiations with the Brazilian Government and PETROBRAS guarantee us the large Sao Paulo gas market and recent contacts formalized in a recent visit to Chile ensure the export of gas to northern Chile. Thus Bolivia might be able to convert itself into the energy supply centre of the Southern Cone.

Three meetings with strategic investors have taken place, in which many transnational companies took part, to receive criticism and comments on the new hydrocarbons legislation and the possible restructuring of YPFB. After these meetings, the Government is considering the possibility of capitalizing the enterprise without restructuring, which is a more rapid and transparent mechanism.

The capitalization timetable envisages the hiring of the investment bank and the establishment of the capitalization strategy before December 1994, and the transfer of management to private hands before December 1995. YPFB's monopoly on exploration and production would then be eliminated, and the hydrocarbons market freed.

EMPRESA NACIONAL DE FERROCARRILES

The national railway system consists of two lines, unconnected in Bolivian territory, the Andean network and the Eastern network, with a total of 3,697 km. of track. They connect with ports on the Atlantic and Pacific and transport a large part of the foreign trade in products such as: minerals, wheat, soya, wood, flour, iron and steel. The construction of the link between the two networks was not carried out for lack of financing. Its

construction would make it possible to establish a bioceanic international corridor, from the Atlantic to the Pacific.

To promote the capitalization of the Empresa Nacional de Ferrocarriles a seminar was held with the potential strategic investors last July, in which the characteristics of the railway service, the potentialities of the sector and the progress made in the capitalization process were presented.

The current regulatory framework of the sector dates from the beginning of the century, which is why reform is necessary. International legal advisers have been contracted to prepare a proposal for reform of the regulatory framework which would establish rules for the granting of concessions, tariffs, rates and arbitration, and the functions of the supervisory authority.

What is being contemplated in the first instance is the capitalization of the entire railway system, Andean and eastern, as a single enterprise. The Government would remain the owner of the rights of way and works, which would be leased to the investor. If this proposal is not attractive to the investors, the two branches, Andean and eastern, would be capitalized separately, or alternative methods would be considered. Among them, the possibility has been raised of separately capitalizing the Arica-La Paz line, in view of the binational character of this railway, so as to have the capitalization coincide with the privatization of the Chilean stretch of this line. Discussions have already been initiated with the Chilean Government for this purpose.

EMPRESA METALURGICA VINTO

The Empresa Metalurgica Vinto is the country's principal tin metals processor. The lead and silver processing plant, Karachipampa, is at present inoperative.

The capitalization strategy for the foundries consists of creating optional packages, economically and financially viable, made up of the tin and antimony foundries (VINTO) and those for lead and silver (KARACHIPAMPA), together with the leasing of the main mines of COMIBOL and the surrounding areas of prospecting. The option of investing in zinc refining will also be presented. The central idea is to use Vinto as a vehicle for the reactivation of mining in the country, avoiding State interference in the sector.

Simultaneously, the amendments to the Mining Code necessary to make possible long-term leasing and the transfer of Vinto to the private sector are being prepared. In October 1995, taking advantage of an international mining event in England, the first presentation of the reform strategy for the mining sector was made.

REFORM OF THE PENSION SYSTEM AND THE FUTURE OF THE ECONOMY

The Capitalization Act authorizes the Executive to transfer to the citizens of Bolivia residing in the country, without charge to them, the State's shares in the joint enterprises capitalized. The Act also enables the Executive to establish appropriate and transparent machinery enabling qualified citizens to benefit from the transfer of such shares to individually capitalized pension funds to be established in accordance with the Act.

Accordingly, once a joint enterprise is capitalized, the State's portion of the shares will be transferred to a fiduciary, which will subsequently transfer them to the Pension Fund Administrations (AFPs) for the benefit of qualified citizens. Once the shares have been transferred to the citizens through the AFPs the administration of these shares will be a part of the pension system.

The great influx of capital for private investment will come from the capitalization process. It is estimated that approximately US\$ 2,500 million will be invested in the country in the near future in those sectors in which the present public enterprises operate. Because those sectors have great growth potential based on large unsatisfied domestic markets and specific export opportunities, it is hoped that the investments will become a reality quickly and generate multiplier effects throughout the economy.

With the influx of capital generated by capitalization, private investment will be able to reach the levels required for accelerated growth of the GDP. As a further effect, capitalization and the reform of the pension system will contribute to broadening the securities market, which could in the medium term become an important instrument for promoting domestic savings and the optimum use of capital resources.

In order to promote increased foreign investment, the Government is in the process of signing international guarantee and arbitration agreements to strengthen the opportunities and assurances provided by law for foreign investment.

17. Summary

The main goal of the privatization process is to promote accelerated economic growth without sacrificing stability, by means of increased productivity. Privatization was initiated by the promulgation of Act 1330 of 24 April 1992.

The privatization process is being carried out as an additional component of the structural adjustment programme in an economy of monetary stability both as regards prices and rates of exchange. The economy is being completely liberalized, giving broad freedom of negotiation to economic agents to determine prices and wages. The goods, currency, air traffic and capital flow markets are being deregulated. The State administrative bureaucracy is being reduced and taxation simplified.

The most important principles being employed in the privatization process are: the employment of independent assessors to prepare viability, valuation and sales strategy studies; the enterprises are transferred "as is"; the Government grants credits to the institutions owning the enterprises which do not have the resources to pay social benefits to their workers; the Government grants ex gratia bonuses to the workers; the latter may participate in the process under conditions established in each case; sales are made to the highest bidder; the funds obtained from the sale of the enterprises are used for projects in the areas of health, education and basic infrastructure in the region in which the enterprises are situated.

The deciding authority in the privatization process, the Public Enterprise Evaluation Commission, is made up of three Ministers and the highest authority of the enterprise's owner. This Commission determines the mode and strategy of transfer of the enterprises and makes a prior adjudication by resolution. Subsequently, where bids are involved, it adjudicates by superior decree.

The modes of valuation most often employed are those of discounted cash flow and asset depreciation.

The procedures authorized by law and used in the process are public bids, open bidding, auction and the sale of shares.

In one case, that of the Guabira Sugar Refinery, a joint enterprise was established with the participation

of the refinery's workers and cane sugar suppliers.

From the regional point of view, the privatization process involves an effort to save enterprises which would otherwise be completely shut down and liquidated because of their operating deficits. It also means that the regions in which the enterprises are situated obtain funds to be invested in the health, education and infrastructure sectors, but it is too early to be able to assess the benefits achieved. Nevertheless, the Government is determined to continue the process during 1995 by transferring all of the enterprises still in the public sector.

Annex 1

Unprivatized public enterprises, economic units and entities

REGIONAL DEVELOPMENT CORPORATIONS

Plate glass factory

1. National Plate Glass Factory
CORDEPAZ

Milk and milk derivatives processing

2. PIL-Santa Cruz Plant
CORDECRUZ
3. PIL-La Paz Plant
CORDEPAZ
4. PIL-Cochabamba Plant
CORDECO
5. PIL-Tarija Plant
CODETAR
6. PIL-Sucre Plant
CORDECH
7. San Javier Cheese Plant
CORDECRUZ

Cement factories

8. El Puente Cement Factory
CODETAR
9. National Cement Factory
CORDECH

Sugar refineries

10. Bermejo Agricultural Industries
CODETAR

Cotton mills

11. Santa Cruz Cotton Mill

CORDECRUZ

12. Pulacayo Cotton Mill
CORDEPO
13. Viacha Cotton Mill
CORDEPAZ

Meat and feed production

14. Tarija Feed Factory
CODETAR
15. Tarija Poultry Industries
CODETAR
16. Beni Cattle Farm
CORDEBENI
17. Portachuela Feed Factory
(Industrial plant and Piratininga fields)
CORDECRUZ
18. Blanca Flor Cattle Ranch
CORDEPANO
19. Feed Plant
CORDECH
20. Feed Plant
CORDEBENI
21. Pig Farm
CORDECH

Miscellaneous food industries

22. Improved Flour Production Co. (San Carlitos)
CORDEBENI
23. CHIMATE Tea Plant
CORDEPLAZ
24. Mairana Maize Products
CORDECRUZ
25. Sachojere Silos Plant

CORDEBENI

26. Fishery Promotion Plant
CORDEBENI
27. El Palma Flour Processing Plant
CODETAR
28. Quinoa Processing
CORDEPAZ
29. Composite Meal Production Co.
CORDECO
30. Agricultural Oil and Maize Production Co.
CODETAR
31. National Nut Co.
CORDEBENI
32. Chili Plant
CORDECH
33. CHICO CHICO Trout Farm
CORDEPO
34. Maize Improvement Centre
CORDECH

Hotels and Bus Terminals

35. Asahi Hotel Club
CORDECRUZ
36. Oruro Terminal Hotel
CORDECOR
37. Oruro Bus Terminal
CORDEOR
38. Potosi Bus Terminal
CORDEPO
39. Cochabamba Bus Terminal
CORDECO

40. Tarija Bus Terminal
CODETAR

Non-metal Minerals

41. Asbestos Plant
CORDECO
42. Robore Ceramics Factory
CORDECRUZ
43. Camiri Ceramics Factory
CORDECRUZ
44. La Enterriana Iodized Salt
CODETAR

Miscellaneous metal industries

45. Metal Industries
CORDEPAZ
46. Pewter Objects Factory
CORDEOR
47. SAM Chain Factory
CORDEOR

Non-functioning Enterprises

48. Oscar Alfaro Crystals
CODETAR
49. Rubber Laminating Plant
CORDEBENI
50. Imperial Airlines
CORDEPO
51. Tariquia Fishing and Forestry Co.
CODETAR
52. Channel 11 SISTEL
CODETAR
53. Sidras Paper Co.
CODETAR

- 54. Tarija Gas Co.-EMTAGAS
CODETAR
- 55. Gas Distribution Co.-EMDIGAS
CORDECH

Other enterprises

- 56. FINDESA
CORDECRUZ
- 57. Beni and Pando Cattle Pound
CORDEBENI
- 58. Television Channel 6
CORDEPANDO
- 59. Cobija Free Zone
CORDEPANDO

PREFECTURAL HOTELS AND STORAGE CENTRES

Prefectural hotels

- 60. Irupana Prefectural Hotel
PREFECTURA
- 61. Chulumani Prefectural Hotel
PREFECTURA
- 62. Copacabana Prefectural Hotel
PREFECTURA
- 63. Coroico Prefectural Hotel
PREFECTURA
- 64. Oruro Prefectural Hotel
PREFECTURA
- 65. Sorata Prefectural Hotel
PREFECTURA
- 66. Urmiri Prefectural Hotel
PREFECTURA

67. Viscachani Prefectural Hotel
PREFECTURA

Storage centres (silos)

68. Abapo Izozog Storage Centre
SNIC
69. Cliza Storage Centre
SNIC
70. Puna Storage Centre
SNIC
71. PACU Uyuni Silos
SNIC
72. JUNACAS Storage Centre
SNIC

3. PRIVATIZATION IN COLOMBIA

1. Introduction

The private sector has traditionally played an important role in the country's economy, chiefly in sectors such as industry, agriculture and finance. However, in areas such as infrastructure, the public sector has been the main investor. With the introduction of the economic openness model, greater room is being sought for private sector investment to encourage more active participation by it in the country's development process (Table 1).

As a partial result of the privatization process, the private sector has invested close to \$4,206 million, and it is hoped that as the process is consolidated it will invest approximately \$13,122 million.

Thus, in the infrastructure sector, specifically that of transport, private parties will invest about \$3,000 million in the next four years. In the energy sector, likewise, investments of about \$7,300 million will be made, and in communications \$1,700 million.

In the finance sector, there will be even more incentive for participation by the private sector because of the sale by the nation of the four main banks it owns, including the Banco Popular, valued at \$360 million, and the Banco Cafetero with an estimated value of \$335 million.

For the industrial sector, the Industrial Development Institute (IFI) has begun a process of disinvestment in which it will sell its share, valued at about \$359 million.

However, although results have already been achieved by the process, because it is new, many aspects of it must still be reviewed and improved, especially in the infrastructure area.

Table 1

COLOMBIAN PRIVATIZATION PROCESS (Millions of United States dollars, 1994)

Sector	Awards	Future participation
Infrastructure	3 629	12 068
Finance	536	695 ^a
Industry	41	359
Total	4 206	13 122

^a Includes only Banco Popular and Banco Cafetera. Figures are lacking for the State Bank and the Central Hipotecario (Mortgage Centre).

2. Transport sector

a. Background

The economic opening made clear how ill-prepared the transport sector's infrastructure was to operate in a framework of international competition and to meet the growing demand it faced.

For this reason, new formulas were sought which would enable the public sector to deliver better quality work to the community more quickly through the participation of the private sector, by freeing budgetary resources and increasing investment in the sector, as well as providing better services and transferring responsibility for maintenance of the infrastructure and its related services.

b. Development of the regulatory framework

An effort was made to establish clear rules for the private sector through the development of the institutional and regulatory framework. The national Government accordingly undertook a series of reforms of the transport sector.

Thus, Act 21 of 1988 established the principles on which the railway sector was to be restructured. Under it and its regulatory decrees the State enterprise Ferrocarriles Nacional de Colombia (FCNC) was liquidated and the operation of rail transport equipment was turned over to a joint venture.

Subsequently, Act 1a of 1991 liquidated the Puertos de Colombia (COLPUERTOS) enterprise, which was of State origin, and established a policy giving the private sector greater participation in infrastructural investment by granting concessions for installations and permitting their operation by private agents.

A year later, the Ministry of Public Works and Transport was reorganized as the Ministry of Transport and its regulatory and planning functions in all the transport sectors were strengthened.

Through the Transport Act, machinery was likewise established for the recovery of road investment by the use of tolls and/or value charges and long-term financing machinery such as bond issues. The State was also enabled to provide guarantees based on the resources of the entity involved, such as guarantees of minimum income.

Lastly, with the new legislation on contracting approved in 1993, the private sector's ability to participate in the bidding for construction of public works on a fair and transparent basis was broadened. It was also made possible for private firms to enter into concession contracts for periods longer than 20 years, making various forms of association in the submission and execution of bids by private individuals possible.

c. Modalities of participation

The forms of participation by the private sector have been varied and depend on the characteristics of each sub-sector.

In 1992 the bases for granting concessions for some of the country's trunk roads were laid down. The concessionaires participated in the construction, financing and operation of the road. They recovered their

investment by direct collection of tolls from users and transporters.

In the case of the road sector, guarantees of minimum traffic were provided covering demand risks by the private investor and the risk of regulatory changes. The means of compensation were also specified, including extension of the length of the concession and increases in toll rates if the contractor's economic viability was jeopardized for reasons beyond his control.

In the railway subsector the scheme was based on joint participation. With the reform carried out in 1989 it was decided to separate railway infrastructure and operation. While infrastructure is the responsibility of the State-owned Empresa Colombiana de Vias Ferreas (FERROVIAS), operation of the rolling stock is the responsibility of the Sociedad Colombiana de Transporte Ferroviario (STF) and the Sociedad de Transporte Ferroviario de Occidente (STF-O), which are joint ventures with majority participation by the private sector of 55 and 70 per cent respectively.

In the case of the ports, a monopoly scheme in which the Empresas Puertos de Colombia controlled the infrastructure and carried out all the port operations was replaced by the concession of port infrastructure and all the related services (wharves, cranes, shops, etc.) to five Sociedades Portuarias Regionales (SPR). They are responsible for the investments necessary to provide better services to the users. In addition, about 15 concessions in different parts of the country have been granted for port-related activities.

In 1994 the process of concession of the country's four most important airports was begun. The concessionaires will be responsible for the operation and management of the airport installations under a commitment to maintain optimal service conditions. The Colombian aeronautics authority, Aerocivil, will grant concessionaires the rights to payment for airport services in exchange for an economic consideration. Part of this consideration will consist of investments to recondition the airports involved and part will be placed in an airport compensation fund for investment in airports with less commercial potential.

An effort is also being made to promote the participation of the private sector in the construction of a second runway in the Eldorado de Bogota airport, which is very heavily used.

d. Current status of the process

As regards the highways, the concession system has made it possible to channel private sector resources to the roadworks. In the past year, 14 bids for construction and rehabilitation work have been accepted covering a total of 1,561 km. and amounting to \$706 million (Table 2). These concessions include the operation and maintenance of the roads. The scheme envisages the construction of second carriageways in the access roads of the country's main cities, the extension of roads, the construction of second carriageways on strategic high-density stretches of roadway and the renovation of existing stretches. However, private participation in the process has not taken place under the hoped-for conditions of competition, as there has not been a great variety of bidders for the contract awards. At present only one of the projects is under construction and there are projects like the Bogota-Villavicencio road for which contracts have been signed but the work not yet begun because of right-of-way acquisition problems.

Table 2

PRIVATE SECTOR PARTICIPATION - TRANSPORT

HIGHWAY SECTOR			
Project status	Mode of participation	Length (kilometres)	Cost (Millions of United States dollars)
Award	BOT	932	342
Opening	BOT	629	364
Future	BOT	1 933	1 425
RAILWAY SECTOR			
Future	Joint Concession	2 110	200

The new enterprises in the railway sector began operations in 1992. However, they have not had the hoped-for results, as they have not been able to rehabilitate most of the system and the transport-operating enterprises have not captured all of the potential railway freight market. In 1985 they moved 1.5 million tons, while during 1994 the two operators moved 0.8 million tons.

The port process has had the hoped-for results and the efficiency of the ports has increased. The movement of cargo in the public ports went from an average annual growth rate of 5.7 per cent between 1987 and 1990 to 9.7 per cent between 1990 and 1993. Moreover, the efficiency of the present structure is reflected in the reduction of the ships' time in port from 6 to 3 days and port charges for ship and cargo services which have gone down 52 per cent.

The process of transferring management of the country's airport infrastructure has begun. So far two contracts have been awarded: one for commercial operation of the Cali airport and the other for the construction, financing and maintenance of the second runway of Eldorado Airport in Bogota under a BOT system. Although the effects of the transfer of airports will not be seen for a year, it is hoped that the income of Aerocivil will increase once the process of private participation in airport management has been implemented.

e. Future challenges

The highway concession scheme must be improved so as to define more clearly the risks and responsibilities of each of the parties and thus avoid medium and long-term financing problems. To do this, the Government must establish a system that decreases the risks to the nation with regard to construction cost overruns and overestimates of traffic demand and clarifies the responsibilities of each of the parties. It must also adopt a more aggressive promotion strategy in order to increase the number of bidders. Moreover, the tax impact of the guarantees assumed by the national Government and how they will be financed have not yet been quantified.

Although specific results have not yet been obtained, the projects for private participation in the highway sector have been delayed more than expected because of the slowness of land acquisition and the contractual

negotiations.

The viability of the railway scheme is linked to the possibility of associating the private sector in the work of track rehabilitation in order to create the best possible system in the shortest possible time.

Port operation by private operators has not achieved the modernization of equipment and operating deficiencies persist while regulation and supervision of the sector have not been consolidated.

In the airline sector, AEROCIVIL must be strengthened technically as a regulatory body with regard to the tariff regime and security. Moreover, operation by private parties may entail a decrease in airport personnel.

3. Energy sector

a. Background

Because most of the activities of the energy sector are carried out exclusively by official enterprises, one of the main strategies in the sector has been to introduce private participation into all the activities in order to increase competition, transfer part of the sectoral investment, decrease delays and costs in the implementation of projects and reduce costs involved in the various activities.

In the electric sector there is a potential for private participation in the generation and wholesale of energy, once solutions have been found to the distortions created by vertical integration of the operations.

In the electric distribution system, in view of the high rates of energy loss (about 20 per cent of energy demand) and a coverage deficit of about 13 per cent of the country's potential users, it is believed that private participation through the acquisition of shares in the distribution enterprises could achieve more efficient operation of the enterprises.

In the hydrocarbons sub-sector, there has been a traditional reliance on private participation in prospecting and exploitation through concession and association contracts. About 80 per cent of the total number of exploratory wells drilled in the country has been the work of private companies.

Given the existence of a large potential natural gas market (present coverage is only 10 per cent of households) and in view of the availability of this energy source (proved reserves above 7000 GPC) and in order to promote substitution for high economic and environmental cost energy sources, a plan was drawn up to extend consumption at the national level. In this programme the participation of the private sector was envisaged in the construction of a gas pipeline system through BOT schemes and in gas distribution and sale.

b. Development of the legal, regulatory and institutional framework

The first step towards the establishment of rules for the participation of the private sector was taken in 1992, with the promulgation of Decree 700 which addressed the electric crisis of that year by allowing the sale of surplus generators by the system as well as free access to the transmission and distribution networks.

The legislative framework for the electricity and natural gas sub-sectors was partly defined through the approval of Act 142 of 1994 (system of public services to homes) and Act 143 of the same year (the Electricity Act). Among the main features of the Public Services Act were permitting public service enterprises, whether

public, private or joint, to transform themselves into joint stock companies and to be governed by private law. The Act also established regulatory commissions, including the Commission for Energy Regulation, with authority to regulate the monopolies and to promote competition. Lastly, the Act established a rate regime based on principles of economic efficiency, financial adequacy and redistribution, among others. The Electricity Act provided that electricity generation could be carried out by all economic agents, with rates to large consumers freely negotiated, allows generating enterprises free access and connection to the system and distinguishes between the activities of transmission and generation.

c. Modalities of private sector participation

Taking into account the legal framework described, the following schemes for private participation in the electric sector were developed:

- (i) production for individual needs with the sale of surpluses to the market;
- (ii) production through BOMT or similar schemes for the supplying of public enterprises;
- (iii) purchase of existing generating assets;
- (iv) purchase of shares of enterprises;
- (v) private management without the sale of a controlling interest;
- (vi) concessions for the renovation or repowering of plants;
- (vii) cogeneration for self-consumption and/or sale of steam and electricity;
- (viii) shared risk associations;
- (ix) independent producers.

For the oil sector, private participation was developed basically by means of two forms of contract. The first is a concession contract under which the private party is granted the exclusive right to explore and exploit a specific area and to appropriate its production. The Government for its part pays some commissions and taxes. The second is an association contract in which the Government's associate is considered a private party in order to carry out prospecting and exploitation jointly. Under this form of contract the Government contributes 50 per cent of development expenses while production is shared on the basis of 60 per cent for the Government and 40 per cent for the private party.

In addition, with the sale of the fuel distributorships owned by Ecopetrol to the private sector that activity has in practice been delegated to it. About \$50 million was obtained from the sale of those assets and six fuel distributing enterprises were established.

In the gas sector, a gas transport system was constructed, partly by the private sector, including the trunk line and regional sub-systems. The construction and operation of the urban distribution networks as well as the provision of services will be carried out by public or joint enterprises or by private enterprises under the concession system.

d. Current status of the process

i. Electricity

Generating capacity is 10,040 MW, 97 per cent of which is produced by the public sector and the remainder by the private sector. In the future it is planned to increase the generating capacity of the public sector by 978 MW and that of the private sector by 1,412 MW (Table 3). Accordingly, the private sector's share of the country's total generating capacity will rise from 3 to 14 per cent.

Although private participation is still very limited, these cases have made possible an almost complete change in the country's ideas about thermal generation, as may be seen from the short construction times (Termoflores made available the first 100 MW six months after the signing of the contract) and the great efficiency of the conversion procedures.

Historically, efficiency had not been above 20 per cent, but the new combined cycle plants installed by the private parties achieve efficiencies between 45 and 50 per cent. Similarly, availability, which historically had been below 70 per cent, may reach levels higher than 80 per cent. Moreover, the cost per KWh of thermal generation, which was previously estimated at above \$0.05, is being contracted for at between three and four cents, which makes it possible to reduce the system's generating costs. However, there are delays in the process of initiating the projects.

Table 3

PRIVATE SECTOR PARTICIPATION - ENERGY

ELECTRIC SECTOR			
Project status	Mode of participation	Capacity (Mw)	Cost (Millions of United States dollars)
In Operation	BOT	240	160
Awarded	BOO	200	140
	BOT	1 005	1 410
Future	BOT	150	100
	BOOM	300	450
	Sale of shares	850	830
OIL SECTOR			
Project status	Mode of participation	Pipeline length (KM)	Cost (Millions of United States dollars)
Awarded	BOT	575	200
	Concession	269	400
Opened	BOMT	344	112
Future	BOMT	788	240
Future	(To be established)	Refinery capacity (100,000 BPD)	800

ii. Hydrocarbons

In the oil sector, exploratory activity has declined in recent years. Thus, in 1988 61 wells were drilled through association contracts while in 1993 only 31 were (Table 4). At present there are 76 association contracts in force and 11 concession contracts.

Table 4

OIL EXPLORATION ACTIVITY

Year	Number of wells drilled under association contracts
1977	9
1978	13
1979	16
1980	31
1981	44
1982	61
1983	30
1984	33
1985	52
1986	36
1987	48
1988	61
1989	58
1990	58
1991	44
1992	36
1993	31

With respect to the transport of hydrocarbons, ECOPETROL will establish a transport company with private investors specializing in oil pipeline operations in order to develop the oil pipeline and port installation projects needed to transport production from the Cusiana, Cupiagua and other foothill fields. The initial transport infrastructure will have a capacity of 500,000 barrels a day. Total estimated investment for the project is \$6,000 million, of which \$2,500 million will be developed by the Transport Company.

In addition, the construction of the gas pipeline system by the private sector through the BOT scheme, although it requires ECOPETROL to grant investment guarantees, will enable it to free resources to carry forward development activities in the Cusiana field and the other projects required. It is estimated that the gas pipeline system will enter into operation in the first half of 1995, and the entire system, including the Ballenas-Barranca trunk line, will enter into operation in the first half of 1996.

e. Future challenges

One of the main elements that will have to be consolidated to establish the viability of private sector

participation in the energy projects is that of a pricing policy that provides the appropriate signals and will permit the participation of private investors. So far, real private participation within a free market framework has not been achieved, owing in particular to the legal and regulatory uncertainty that existed in the sector.

However, signs that this phase has now been overcome are beginning to appear considering the case of Termovalle, which did not require a Government guarantee.

Another priority activity that needs furthering is the regulation of the laws and development of the regulatory framework, including revision of the costs of the various activities, the establishment of tolls, rules of user protection and quality of supply and a pricing policy that does not create distortions between energy sources. Some of these rules have already been promulgated by the Energy and Gas Regulation Commission and the others are being worked out.

To keep private participation in the oil sector attractive, price policies will be revised, the Petroleum Code should be reformed and the tax system revised to accommodate it to the international market and the institutional restructuring of the sector. In order to promote the rational use of hydrocarbons, special attention should also be paid to fuel substitution in the transport sector.

Another fundamental element which must be developed in the future is the establishment of a specific regulatory framework for the gas sector. In order to promote private sector participation in oil prospecting activities, legal, regulatory and tax conditions should likewise be revised to make conditions attractive for private investors.

With respect to refining, the construction of a refinery with private capital, which would help increase the efficiency of that activity, should also be encouraged.

4. Communications sector

a. Background of the private participation process

Traditionally, telecommunications services have been limited to the telephone and telegraph, and the infrastructure consisted in large part of physical lines. These factors made investment costs high and therefore required taking advantage of economies of scale through mainly public monopoly operators. The technical changes that have taken place in the last decade brought the appearance of new services and began the elimination of the natural monopolies. These circumstances have created the beginning of a process of intensive private participation in the provision of telecommunications services.

In Colombia, local telephone service has been provided by 26 public enterprises. On average, coverage is adequate, with more than 11 telephones per 100 inhabitants, although there are areas without service.

National and international long-distance service is provided by Telecom, which is State-owned.

Private participation in the telecommunications services has sought to incorporate into the sector the technical, financial and management resources needed for the modernization of the existing infrastructure, the provision of new services and the expansion of coverage.

b. Development of the regulatory framework and institutional reforms to permit private participation

To permit private participation in the telecommunications sector it was necessary to carry out various legal

reforms. The main ones were the following:

(i) Act 72 of 1989 and its regulatory rules (Decreets 1900 of 1990 and 1794 of 1991) eliminated the monopolies held by public enterprises in the provision of basic telephone services by granting concessions to public, private or joint enterprises and enabling local and national long-distance services to be provided by private national or foreign parties. In addition it was provided that the value-added services would be provided in a competitive framework;

(ii) Act 37 of 1993 regulated the provision of mobile cellular service by enterprises which would be chosen by a public bidding process. The Act also permitted public telecommunications enterprises to enter into association contracts with private enterprises to provide services;

(iii) Decree 2122 of 1992 created the Telecommunications Regulation Commission whose principal function is to promote competition and prevent the abuse of dominant positions in order to guarantee efficient high-quality services;

(iv) Act 142 of 1993 freed the provision of local telephone services still further by eliminating the need to obtain concessions to provide them and also permitted the provision of international long-distance service by private parties. At the same time the Telecommunications Regulation Commission was strengthened;

(v) The Television Act, approved by Congress in December 1994, permits the operation of private television channels which will compete with the national public channels.

c. Modalities of private sector participation

On the basis of the above legislation, private participation in telecommunications has developed in two main ways:

(i) The direct provision of services. In some cases concessions granted by the Government are required. Conditions for the award of concessions and the provision of service vary depending on the service;

(ii) Association with public enterprises by means of which the private partner invests in a project operated by the public service and the income obtained is shared. In this case conditions are fixed by the contract and take into account existing tariff and regulatory rules;

However, in the case of basic local and long-distance telephone services, there are rules which only allow certain modes of private participation, thus impeding the complete liberalization of the sector. Act 37 also establishes a maximum term of 10 years, extendible only if the associate has not been sanctioned during the development of the project. However, the term fixed does not seem fair because the nature of the financing of the infrastructural projects requires a longer time-frame to sustain a competitive structure.

d. Current status of projects in progress

(i) Association contracts

Through this mechanism the public enterprises obtain financial and technical resources to promote projects. The private partner, generally an equipment supplier, contributes the investment necessary to develop the project

and obtains a share in the income obtained from operation of the service over a period of time. The public enterprise contributes the existing infrastructure and operates the service. Under this mechanism, Telecom has signed three contracts which will enable it to install more than 400,000 lines in three years, with an investment of more than \$400 million, which will be made entirely by the private partners. The Santafe Telecommunications Company of Bogota has used this association modality to provide new value-added services. In the case of Telecom, a financial projection of the business was made on signature of the contract to establish a base scenario. If, in the course of the project, income 10 per cent less than that projected in the base scenario is obtained, Telecom undertakes to pay the partner the difference; if, on the contrary, the real return is 10 per cent greater than projected in the base scenario, the private partner must pay Telecom the difference.

(ii) Concessions for provision of value-added services

Value-added services are supplied by public or private enterprises licensed by the Ministry of Communications on a competitive basis. They are required only to comply with certain technical and economic requirements and to pay a concession royalty corresponding to a percentage of the initial investment and a percentage of the concessionaire's income. Rates are freely fixed by the concessionaires, who assume all the risks of operating the service.

(iii) Concession for the delivery of mobile cellular telephone service

Mobile cellular telephone service is provided on a regional duopoly basis by joint and private enterprises chosen on the basis of public bidding. The concessions are granted to those enterprises which, having met the minimum economic and technical requirements, offer the highest payment for the concession. The concessionaires must also pay a percentage of their operating income. Rates for the public are fixed freely by the concessionaires.

(iv) Provision of local telephone service

As the current legislation provides for free entry into the local telephone service market, projects involving the participation of private investors have been begun. No concession of any kind is required to provide service except for use of the wave spectrum band, if that is the case. The rate regime is regulated by the Telecommunications Regulation Commission. The law provides that for this service the rates must cover costs.

e. Impact of the projects on efficiency

So far, private participation in the telecommunications sector has achieved two main goals:

(i) To provide new services, such as the value-added and cellular telephone services;

(ii) To improve the coverage and quality of the basic services by means of association contracts and the local telephone enterprises.

This is reflected in the investment figures for the sector. In 1990 private investment in telecommunications was nonexistent. In 1994 it increased to \$270 million. It is hoped that in the next four years the private sector will invest \$1.4 billion, which will correspond to 38 per cent of total investment. Thus, most of the investment required for the provision of new services, and the additional effort as compared with historical investment in the sector, will be made by the private sector.

f. Future challenges

The appearance of new services and a large number of new operators in competition requires the strengthening of regulation. Although the regulations, taking this situation into account, created new regulatory and supervisory bodies such as the Regulation Commission and the Public Services Supervisory Board, and strengthened existing ones like the Ministry of Communications, these bodies must be strengthened and adapted to the new competitive framework.

To permit and encourage private investment, what is required above all is stable rules and trustworthy and efficient regulatory bodies. The Regulation Commission and the Ministry of Communications must define how the long-distance and other new services are to operate. There is great private interest in them but private enterprises have not undertaken them because of the lack of regulation.

Similarly, the rate structure provided for in the Public Services Act has not been developed so that rates reflect costs and the subsidy system is transparent and efficient. This is essential in order to facilitate private participation in local and long-distance telephone service.

5. Financial sector

a. Background

During the past decade the financial sector was predominantly State-owned, closely regulated and had little competition, for which reasons it showed poor operating results. Additionally, between 1979 and 1982 the financial system which supplied the various types of investment deteriorated to the point where the Government had to nationalize the largest financial group in the country, transform it into a State Bank, liquidate the National Bank and other financial intermediaries linked to it and intervene in the Banco de Bogota (the second largest in the country) and the Banco Tequendema.

Subsequently, at the beginning of the present decade, the main characteristics of the sector were:

- (i) fragmentation of the system tending to prevent competition;
- (ii) complex regulation, which made the creation of new banks and other intermediaries as well as the entry of foreign investment difficult;
- (iii) the weight of exchange controls on the financial sector was very onerous;
- (iv) heavy taxation of the sector reduced the profitability of the banks and other intermediaries;
- (v) service costs were high, exceeding international standards.

b. Development of the regulatory framework

In order to make the entry of the private sector as well as foreign investment possible and reduce forced investment, it was necessary to carry out various legal reforms which sought to simplify regulation to make possible new financial options appropriate to world trends. The main ones were the following:

(i) Act 45 of 1990 organized the overall sector, facilitated the entry of new competitors and developed the market regulation of securities. It also established minimum capitalization rules and facilitated the entry, merger, conversion and removal of credit bodies;

(ii) Act 35 of 1993 established the machinery for State intervention, established a framework for inspection and supervision and regulated the procedures for the sale of State shares through intermediaries. It also moved the financial system towards a multiple bank system.

c. Modalities of private sector participation

The State used the mechanism of the promotion and sale of shares of the banks and financial entities through public offerings in which it participated.

d. Current status of the process

Considering the main lines of investment policy, it was decided to alienate the entities taken over and reorganized over the past decade. After the successful sale of the Banco Tequendama, the Banco de los Trabajadores and the Banco del Comercio, the process of privatizing the Banco del Estado, Colombia and Bancoldex was begun. In a second stage, the Banco Hipotecario, Banco Cafetero and Banco Popular will be privatized (Table 5).

Table 5

SALE OF NATIONAL ASSETS - FINANCIAL SECTOR
(millions of pesos)

Entity	Year	Total sales value	Receipts to nation
Banco de los Trabajadores	1991	3 255	3 255
Banco Tequendama	1991	20 723	20 723
Banco del Comercio	1992	50 547	50 547
Banco de Colombia	1994	400 037	328 347
Bancoldex	1994	958	N.D.
CORPAVI	1994	66 860	44 210
Total		542 350	447 051

Appraisal of the State and Colombia Banks was thus completed, and the Colombia Bank was sold for a total sum of \$400,307 million, of which \$328,347 was the nation's. To further the appraisals and sale process, international firms were contracted on a contingency commission basis.

The valuation of CORPAVI was likewise carried forward and in April 1994 it was sold for \$66,860 million, of which the nation received \$44,210 million as its share.

The Fondo Nacional de Instituciones (FOGAFIN) also completed its valuation of the Banco Cafetero at \$280,000 million, and 60 per cent of the bank will be sold to private parties.

The country now has 29 banks, of which 25 are in private sector hands.

e. Future challenges

A modern reserve system must be established in order to reduce the parafiscal burden and the high intermediation margins. The growth of the financial sector should be stimulated by private parties, as it is still very small as compared with national production.

The creation of a multiple and competitive banking system requires the development of new legal rules. In such a system the banks should be universal in scope in order to carry out all forms of banking.

6. Industrial sector

a. Background

The excesses of protection during the 1980s stimulated the formation of monopoly and oligopoly structures in industry, generating a supply of low-quality products at high prices and hindering growth and innovation in industrial activity. While manufacturing industry grew at annual rates of six per cent during the 1970's it grew at an annual rate of three per cent in the 1980's. Similarly, the productivity of industry fell at an annual rate of 0.7 per cent during the past decade.^{1/}

In addition, the State participated actively in the production and sale of goods and services, reducing the room for investment by the private sector. These activities in turn diverted the State's attention and prevented its concentration on the functions proper to it. Thus the Industrial Development Institute (IFI) held shares at the beginning of 1990 in about 56 enterprises.

b. Development of the regulatory framework

In order to further a programme of privatization of the enterprises in which the Government held shares and to clarify and simplify the existing regulatory systems, a series of legal reforms was carried out. The main reforms were the following:

(i) by Decrees 2350 of 1991 and 259 of 1992 the need for prior approval of contracts for the import of technology was eliminated;

(ii) the legal framework was created enabling the supervisory body for trade and industry to prevent practices restricting competition;

(iii) the supervisory body for trade and industry authorized the private sector to assume the certification of quality standards through the establishment of specialized centres.

c. Modalities of private sector participation

In 1991 the IFI initiated a programme of disinvestment and restructuring which was carried out in the three

following years. The disinvestment programme involved selling the Institute's shareholdings in the various enterprises to private parties.

For the sale of the Institute's shares a sales mechanism was employed which involved, first, a valuation of the shares, and then the listing and sale of the shares on the chief domestic or international stock exchanges depending on the enterprise.

d. Current status of the process

In the current decade the IFI sold its shareholdings in 20 enterprises for a total of about \$34,000 million (Table 6).

Table 6

SALE OF IFI ASSETS
(Millions of pesos)

Entity	Total sales value	Return to nation
1990:		
Fosfatos de Boyaca	9	9
Citricos de Colombia	14	14
Aeroindustrial Colombiana	190	190
Ingenio Risaralda	972	972
Papelera Colombiana	108	108
Cia Colombiana de Clinker	1 909	1 909
Cementos Rioclaro	2 185	2 185
1991:		
Colombo Coreana de Seda	255	255
Cia Pesquera Colombiana	956	956
Astillero Varadero	130	130
Textiles Espinal	3 534	3 534
Prod. Vinos Colombo Arg.	67	67
Prod. de Carbon de Occ.	9	9
Prod. Derivados de Sal	2 164	2 164
1992:		
Cia Colombiana de Astilleros	1 014	1 014
Fertilizantes Colombianos	1	1
Elf Atochem Colombia	1 223	1 223
1993:		
Fabrica de Textiles del Tolima	540	540
Corporacion Financiera de Dessarrollo	3 259	3 259
1994:		
Alcalis de Colombia	15 600	15 600
Frigopesca	2 500	2 500

However, about 16 enterprises remain to be sold. For that purpose, the IFI has divided the enterprises into three groups depending on their degree of importance in the Institute's total investment. Group A is made up of

5 companies representing 95.4 per cent of the total value of its investment, Group B of 6 enterprises representing 3.7 per cent of total value and Group C of 6 enterprises with 0.8 per cent.

The sale of Group A enterprises is planned through stock exchanges abroad. For the Group B enterprises, plans are being made in conjunction with the other shareholders to list them on stock exchanges and offer them publicly. Finally, for those of Group C, which are classified as institutional participation enterprises, a programme of alienation is being carried out through agreements with other official entities or with the Government.

To make the proposed sales, the IFI has used the mechanism of listing of the shares in the National Securities Register and the country's various stock exchanges, encouraging the participation of private parties in the purchase of State-owned enterprises. It has likewise, where possible, offered 15 per cent of the shares for sale to the workers, investment funds, cooperatives and other mutual help bodies.

Lastly, in connection with the sale of shares, it is important to note that an effort has been made to sell them in ways which will not affect the stability of the markets they operate in.

However, the smallness of the capital market and the weakness of the stock exchange market have hampered IFI's sales project.

e. Future challenges

Future challenges are to further modernize the State, particularly with regard to customs services, quality control and metrology, in order to improve the manufacturing industry environment, and to strengthen the supervisory machinery and its sources of information so that competition is real and transparent. Greater control must be exercised over the source and destination of goods involved in foreign trade.

The new task of the Industrial Development Institute must be defined, seeking to meet the needs unsatisfied by the financial market, promote competition in that market and remedy deficiencies in the financial services needed to support investments consistent with the liberalization of the economy.

The IFI needs to adopt a more aggressive strategy of promotion and sale of its shares in the various enterprises in operation, using mechanisms like the stock exchange and direct negotiation.

ENDNOTE

4. PRIVATIZATION IN GUATEMALA

1. Introduction

Incorporating the privatization process into the working agenda of the Government's Plan for the period 1994-1995 will require a speedy revision of the conceptual aspect of the Government's policy as stated in that Agenda, in order to determine how the implementation of that element would affect overall policy.

The Government's Agenda for the period mentioned above includes the following basic objectives:

- (a) to strengthen democracy and lawful government;
- (b) to fight against poverty;
- (c) to protect the environment and to promote the wise use of renewable natural resources; and
- (d) to modernize institutions.

In order to succeed in the process of improving the Government's implementation capacity, but above all to enhance the value and efficient use of public funds, it will be necessary to give impetus to the Government's institutional modernization in striving to improve its management capacity in all areas, so that it may be in a position to respond to the challenges arising from a changing global economy. Thus the goal of Governmental institutions will be to attain overall efficiency. The Government of the Republic has been engaged in the process of seeking alternatives to resolve this issue, not only because current circumstances demand it, but because it realizes that the structure of the Government apparatus is both bureaucratic and inefficient. The current administrative structure of the Government apparatus results from an accumulation of decisions made over time which reflect the policies of various administrations. While such policies were often well-intentioned, some were the product of disorderly and chaotic administrations. However, leaving aside the question of how such unrestrained growth within the public administration occurred, the fact remains that it has been unable to meet the needs of the population. This, of course, requires that measures be adopted to remedy the problems which may arise and implies, as a fundamental condition, the redefinition of the Government's function: what its tasks are, which services it should support, how it should provide assistance and in what areas, etc. Once its function has been defined and the nature and size of its structure have been determined, it will become obvious that a less complex structure, one that is decentralized, deconcentrated and small but democratically strong, established on a basis of competence and efficiency, must be envisaged. In seeking to achieve this objective, the Government of the Republic undertook to reappraise the administrative apparatus at the executive level by analyzing the structure of its institutions and reevaluating their necessity. From such a perspective, various alternatives present themselves: to eliminate redundancy and interference, consolidating where necessary, then filling the gaps that may have resulted from the adoption of such measures if available resources permit redistribution. In other cases, deconcentration and decentralization will be pursued in order to facilitate timely decision-making, thereby strengthening management capacity and eliminating excessive bureaucracy. Alternative methods of delivering services will likewise be investigated to meet the needs of the population, including co-participation involving communities, local governments, the central government, and the private sector. This method provides for shared responsibility and the solving of problems without major Government involvement. This would insure efficient delivery of services since the communities themselves are best at managing their own budgets.

Stemming from this different outlook on the function of government, comes the realization that the State does not necessarily have to be the only provider of certain services, nor should it have to deliver those services directly. The modern State seeks to eradicate monopoly, subcontracting services and privatizing those activities which may be able to compete in the open market. This helps to broaden the scope of services, thereby stimulating competition and improving efficiency, both of which are the cornerstones of a viable and modern market economy. In other words, institutional modernization constitutes the fundamental device needed to strengthen democracy and lawful government, to fight against poverty and to adapt the productive structure of the country to the requirements of a sustainable and just development.

As indicated, administrative decentralization is another essential part of the State modernization process since it engenders actions which in due time will guarantee the process of democratization, promote national integration, and mobilize the community to face the challenges of development. In the Working Agenda decentralization is seen as a process under which empowerment is transferred from the central Government to the local governments in the areas of decision-making, in taking charge of human and financial resource management, and in providing public services with minimum-scale requirements.

Having completed a description of the preliminary requirements set forth in the current Government's Working Agenda, which are considered prerequisites to privatization, the next step will be to develop a focus for the privatization concept, as outlined in that Agenda.

2. Privatization programme objectives

In accordance with the principle of subordination, an institutional administrative reform should seek to bridge the gap between the State and society by eliminating redundancy, interference or deficiencies in the managing of public affairs in order to achieve the highest degree of productivity and openness in the government process and to streamline government functions. The elimination of entrenched obstacle-forming bottlenecks in the public sector must therefore constitute an integral part of the Government's socioeconomic policy.

a. Restructuring the Government's subsidiary role

It is in the current administration's broad interest to stabilize and modernize the country's economy for the purpose of accelerating changes in productivity as a fundamental strategy in attracting private investments, especially in the production sector, to spur growth and employment. This, in turn, will become a major factor in providing Guatemalans with adequate incomes for their needs and in raising their income level. Such actions must go hand in hand with institutional reforms aimed at optimizing the Government's function. The introduction of rationalization programmes aimed at public administration will be used to effect a restructuring of the public sector, resulting perhaps in a smaller but democratically stronger Government able to respond to the demands of the population. In this undertaking, the amount and quality of resources allocated to identified priority areas will be vital to their success. However, the steady decline of the Guatemalan standard of living in recent years requires a major effort on the part of the State in seeking alternative means to provide a prompt response to demands. Therefore, the squandering of resources to maintain State agencies which are not serving the purpose for which they were created should be stopped immediately, not only to avoid wasting the State's meager resources, but also to conform the public sector to its subsidiary role. This role is to carry out only those tasks which individuals or groups cannot undertake alone, taking into consideration the fact that activities currently being assumed by the public sector could be dealt with more effectively by the private sector and that the participation of private business entities should be encouraged in the production and marketing of goods and services which are now either exclusively in the hands of the State or are not competitive. Such is the case in the sectors of energy supply,

transportation, telecommunications, storage of goods in essential areas such as customs, laboratories, etc.

b. Deregulation

The elimination of *de facto* and *de jure* monopolies currently enjoyed by State enterprises will facilitate the entry into the market of private business entities. While this does not abolish Government ownership of these enterprises, it will raise the level of competence and force State enterprises to become more efficient and to reduce costs.

Deregulation will eliminate hindrances and regulations which raise the cost of business in the private sector and favour the public sector. The objective is to improve the markets by establishing equal conditions for all. In brief, it will remove obstacles and privilege, contributing thereby to furthering the modernization of the country's economy. This, however, should not be construed as the Government's relinquishment of its regulatory function which, on the contrary, should be strengthened.

c. Alternative funding sources

The difficulty in obtaining resources and a surging demand for community services make it necessary to give thought to the process of dismantling public companies or entities which have not fulfilled the purpose for which they were established, and actions to that effect should immediately be carried out, not only to stop wasting the resources of the State, but in order to reduce the public sector and to liberate revenues generated by these institutions. In short, steps should be taken to provide other alternatives in order to make resources available for social investment, the payment of public debt, and to provide a solution to the monetary and fiscal problems affecting the country.

3. Different modalities of privatization

a. Social privatization

The aim of this process is to transfer the management of some institutions and services to communities, local governments, and non-governmental or non-profit organizations, in order to increase community involvement in the planning, operation, maintenance and financing of the infrastructure, thereby promoting alternative and non-traditional modes of operation with the broad participation of other actors in the community who are seeking to promote efficiency in the production of goods and services. This alleviates in large part the financial demands made on the State for that purpose and frees resources which may then be applied to other priority activities, while at the same time transferring responsibility to the interested parties.

b. Sale of shares

As indicated earlier, the process of restructuring the public sector and the break-up of State enterprises will include several options: mergers, transfers, sales and liquidations. The adoption of any of these options will depend on the activities involved, the financial situation and the prevailing economic trends at the time of the decision. In that phase, entities which have already fulfilled their objectives or, having not yet done so are nevertheless considered insufficiently viable to continue in operation, will be liquidated. Enterprises which are compatible or engage in similar activities and would benefit from pooling their financial resources, either because they complement each other's production operations or for marketing purposes, will be merged. Transfers to the centralized sector or to local governments will be effected in the case of entities which are linked to development

programmes, due to their local or regional significance or to their strategic role. Lastly, the option to sell, which is what concerns us here, will be chosen for those enterprises which are without strategic significance and are not considered a priority, and could therefore be sold advantageously to the private or social sectors, or as a joint venture. The Ministry of Public Finance is responsible for coordinating, supervising and executing the sale of State enterprises. However, to date, no such transaction has taken place due to the difficulties involved, stemming not only from political confrontations, but also from the adamant opposition of labour organizations. The first such operation, to be carried out shortly, involves the Empresa de Ferrocarriles de Guatemala (FEGUA) (Guatemalan Railways) and it is hoped that this will lead to other such transactions.

4. Implementation of the privatization programme

a. Creating the right macroeconomic conditions

As indicated in the preamble, the sustainable development challenge as it is envisioned in the Government's agenda involves four areas of action in the domain of economic policy to effect changes in production: higher levels of stability, growth, productive employment and social justice. The macroeconomic outlook for 1995 is favourable, with the contribution of the recently adopted fiscal reform playing a large part and triggering savings in the non-financial public sector, which in turn will encourage the development of public investment programmes without jeopardizing stability. Increased investment is planned and operating expenses have been cut down, thus making the fiscal deficit more manageable, as it decreased from 1.6 per cent to 0.8 per cent. Improved public finances and the results expected in the monetary sector as a consequence of the policy strategy adopted for the period will contribute to conditions of sustained stability and interest rates which will stimulate investment. The balance of payments should improve from higher revenues obtained from exports. A modest influx of private capital is also expected.

The 1995 outlook for the fiscal, monetary and external sectors points to a growth estimated at 5 per cent in real terms. This growth would mainly stem from increased investments, public as well as private, leading to the freeing of resources in the public sector and to sustained moderate interest rates in the private sector as well as having the multiplier effect of expanding exports. The guarantee of a stable economic foundation must exist to support the privatization process. Therefore, taking into consideration the outlook for 1995, the programme should be launched during 1995 and its foundations laid so that it may be implemented and completed by the next administration, which takes office in 1996.

b. Political agreements

As indicated, the problems encountered in implementing this process resulted in part from the opposition of labour groups who considered that privatization would lead to job losses, higher prices for services and products, and major economic problems at various social levels, etc. Within the framework of the projected institutional modernization programme for the public sector, meetings are being held with labour groups in order to establish a consensus for its implementation. Although these meetings have not made much progress, a positive breakthrough is anticipated in the coming months. The strongest drive for a positive outcome of the process comes from the private sector; the political parties of the majority likewise endorse any measures which may favour such a course.

c. Administrative and monitoring arrangements

It should be noted that although the administrative support system required to develop the programme is still being developed, the Ministry of Public Finance is nevertheless making the minimal administrative arrangements needed to complete the process.

Since the administrative aspects of the process are still being developed, there is no monitoring at this stage. However, monitoring is considered to be of critical importance; it is therefore felt that it should be placed under a jurisdiction higher than the administrative office responsible for implementation.

d. Specific technical characteristics of privatization

The characteristics vary from transfers to local governments, leases or outright sales to cooperatives, the formation of companies with a majority of the shares owned by the State and its former workers, the formation of companies with minority State participation, direct sales or auction sales, offerings on the stock exchange, etc. The specific modes and characteristics of a transaction would depend on the type of enterprise involved. Enterprises which have priority in regional and local development programmes will be transferred to local governments or groups organized in specific geographical areas. For instance, a dairy enterprise created for the purpose of producing dairy products in a specific zone would typically be transferred to groups of dairy cooperatives in that zone so as not to deviate from its original purpose. In the case of a telephone company, the best offer would be sought by tendering the shares on the stock market, making the stock available to any investor, whether domestic or foreign, in an attempt to obtain the most economic benefit. For services traditionally provided by the State, such as the postal service, but whose tasks must now be performed differently, the formation of a company with State and worker participation will be favoured.

e. Techniques for assessing the value of a company

As a prerequisite, a technical and financial assessment must be made, using the following references: book value, current value of future flows, liquidity, market value, etc. In making these assessments, a reference value should be used as a standard of comparison for any offer which may be received. Assessments should be made by experts in the field and, where possible, should be paralleled by the implementation of collateral actions so that they may be in a position to achieve the best financial results. In the case of the only company which is being sold, the Guatemalan Railways, the corresponding assessment was made: it comprised an evaluation of the Company's accounts, finances, human resources, labour situation, assets, future potential, etc. All these activities were entrusted to companies experienced in these matters. Before selling the company by public auction, company owners listed as potential buyers were invited to participate in a briefing about the company and were presented with a marketing study of its prospects in an effort to attract bids at the time of sale.

f. Restructuring public companies

Restructuring has already begun in some companies, with a view to future privatization, by splitting up some of their operations. Such is the case at the Instituto Nacional de Electrificación INDE (National Electrification Institute) whose operations will be broken up after they are demonopolized. Thus, the immediate challenge is to separate those operations engaged in the generation, transmission and distribution of energy. Restructuring will be accomplished by making a public offering of some of the operations, particularly those involved in transmission and distribution. This will not only attract private capital, since investment requirements are too heavy for the State to bear and it does not have such resources at its disposal, but will also contribute to

more efficient services and market expansion.

5. The impact of privatization on public finances

The major effects of privatization on public finances are difficult to assess as long as the process has not taken off; however, discontinuing the allocation of resources to the entities designated in the programme has made available significant resources which may now be applied to other areas, particularly the social sector. Once the process is confirmed, a substantial positive impact is expected to result since, on the one hand, the Treasury will no longer be burdened with providing financial assistance to unprofitable operations and, on the other, the sale of assets will generate financial resources.

6. Regulatory provisions governing privatization

In the course of the past few months, the implementation of the privatization programme has been the object of much debate and controversy. Labour groups, particularly those in the public sector, are adamantly opposed to privatization; therefore, the Government of the Republic has recently declared that it will suspend the process of privatization until it can be implemented on a consensual basis with labour. As a result, although the draft legislation concerning privatization has already been completed, it has not been submitted to the Congress of the Republic. Nevertheless, the Government of the Republic has clearly stated that the process is irreversible even though it is not covered by a specific law and can be implemented under the provisions of the State Contracts Law which establishes the course of action to be taken for the sale of State assets. Labour understands that its choice is between virtual liquidation if its position remains inflexible and a demand for labour stability.

7. Conclusion

Although privatization has been made a part of the Government's agenda, it has not been possible to implement it in full. However, efforts are under way to lay the foundations for its implementation in order to reap the anticipated benefits. The process must be institutionalized, not only by enacting legal provisions, but at the administrative level as well, by establishing an organizational support structure for its implementation. Due to the prevailing social and political climate, particularly the closeness of a final peace agreement, it is not feasible to implement the privatization programme in all its aspects.

5. PRIVATIZATION IN NICARAGUA

A. Background

1. The legal framework

The General National Public Sector Corporations Board (CORNAP) was established by Decree-Law No. 7-80 of 2 May 1990. The Decree established a General Board, attached to the Presidency of the Republic, made up of three members appointed by the President of the Republic—the Chairman, Vice-Chairman and Secretary. To carry out its work the General Board has a small executive staff.

CORNAP's mandate is multiple. Under the above-mentioned Decree-Law, it is CORNAP's responsibility among other things: a) "to propose to the President of the Republic the areas and policies of economic activity in which the State should play a part"; b) "In conformity with such policies, to authorize legal, non-judicial or legislative acts of privatization of the Corporations, their enterprises and assets. Actions taken in the normal course of the activity constituting the purpose of the corporation or enterprise shall not be regarded as acts of privatization"; and c) "To establish the policies which should govern the relations between State corporations with regard to the scope of their activity and to approve the general lines of policy applicable to the various corporations."

In addition to the Decree-Law establishing CORNAP, the legal framework for acts of privatization has been laid down by Decrees 11-90 and 23-91. These Decrees establish the procedures for the handling of claims submitted by parties considering themselves affected by confiscations carried out by the previous government. The resulting action, where the competent authorities uphold the validity of the claim, is restitution or indemnification in those cases where restitution is not possible.

It is within CORNAP's competence to administer the process of restitution of assets of confiscated enterprises to their former owners where the competent authorities so decide, to the extent that these restitutions are physically and socially possible.

2. The economic, political and social framework

The Government of Nicaragua regards privatization as one of the main instruments of development strategy for the rationalization of the State and modernization of the productive sectors. From this point of view the transfer of enterprises and assets to the private sector is part of a very broad programme of structural adjustment and a policy of openness to international trade whose central objectives are to promote the international competitiveness of the economy and achieve an increase in standards of living and per capita income through the creation of productive employment.

Thus, privatization is not an objective per se, but a means to achieve: the reconversion and modernization of the productive apparatus; reform of the State's finances; an increase in the generation of jobs, investment, production and exports; and to lay the foundation of Nicaragua in the year 2000.

The Coordination Agreements signed in August 1991 by most of the sectors representative of society established some guidelines with respect to the privatization of enterprises. The signers recognized: the need to give

impetus to the privatization process as a necessity for the reactivation and modernization of the Nicaraguan economy; the right of workers, organized in the manner of their choice, to opt for 25 per cent partnership in owning the total assets of the State enterprises through financial modalities and options to be agreed on; the need for the Government to examine and decide on those cases in which restitution should take place; and the right to indemnification of those persons whose property was unjustly confiscated or expropriated to whom the property alienated cannot be returned. Such persons are to be compensated with Indemnification Award Certificates issued by the Government and redeemable by the acquisition of State assets or enterprises.

The agreements also include a commitment by the State to continue to administer the enterprises "on the basis of their economic rationality", and a commitment by the workers to "promote the climate of stability necessary for the proper functioning of the enterprises."

In general, the Coordination Agreements have facilitated the Stabilization and Adjustment Programme and, as a part of that programme, the privatization of State enterprises, which could hardly have been carried out in a relatively orderly manner without the Agreements.

3. The situation of the corporations

The 22 independent corporations and enterprises which passed into CORNAP's hands under Decree 7-90 were, for the most part, in a state of financial insolvency and, because of the facilities offered by a financial system which was itself State-owned, had a high degree of indebtedness. An analysis of CORNAP's portfolio of corporations and enterprises with the State Commercial Bank and the Central Bank of Nicaragua shows indebtedness of the order of US\$ 310 million to the Commercial Bank and US\$ 77 million to the Central Bank on 30 April 1990. For all practical purposes the portfolio was in default or failing.

The productive plant of the enterprises turned over to CORNAP was obsolete due to the long time and restricted reinvestment prevalent from the mid-1970's; management decisions were based more on political logic than economic efficiency. The trade union guidelines functioned in the same way.

Even more important, because of their effect on the privatization process, were the generalized characteristics of redundant staff, low production and productivity, high indebtedness, the non-existence of reliable accounts and legal backing for the various transactions by which the assets—especially the real estate—had passed into the hands of the enterprises. This last characteristic represented an additional difficulty in the task of formalizing the acts of privatization.

The corporations held ownership of the productive or service enterprises under various ownership systems, including limited liability companies—joint or 100 per cent State-owned, agrarian reform enterprises and enterprises created by ministerial decree. These last two forms have their own legal regime, differing from that of limited liability companies.

The legal situation of most of the enterprises was not adequately organized, in some cases lacking up-to-date records of share ownership, in other cases lacking legal formalization of mergers between enterprises or of the legal establishment of enterprises which were in de facto operation.

Most of the enterprises belonging to the Corporations in the agricultural and stockbreeding sector had not duly legalized the landholdings of their property nor established their boundaries with any degree of exactness.

In general the enterprises operated during the 1980s with captive markets, special concessions, indirect subsidies and a high degree of protection, either through tariffs or because of the distortions and imbalances the economy was experiencing.

The state of insolvency, joined with the policies of subsidy elimination and more rational granting of credit, led a large number of enterprises to closure or semi-paralysis, which led the workers and management to push actively for their privatization as the sole de facto alternative to keep or recover their jobs. Because of this, processes of enterprise privatization were advanced which would not otherwise have entirely met the selection criteria originally established by CORNAP.

4. Strategy of privatization

In March 1991 a document was produced with the advice of UNDP, UNIDO, USAID and IDB, among others, setting out a "Privatization Strategy of the Government of Nicaragua". The strategy was reviewed in February 1992 to take into account the experiences of 1991 and the changing economic and social reality of the country.

The elements considered relevant for this paper have been extracted from the strategy paper.

Privatization in itself is understood as a process, not an objective. The objectives are very varied: to achieve the reconversion and modernization of the productive apparatus, reform of the State's finances through the elimination of direct and indirect subsidies, the democratization of capital, increased management efficiency, etc. All these objectives can be achieved during the privatization process, although they cannot all be achieved at the same time nor in each act of privatization.

Unlike the privatization strategy adopted in other countries, CORNAP has decided not to link privatization with the implementation of sectoral strategies. What is sought rather is to adjust, to the extent possible, the privatization strategy designed and implemented by CORNAP to the general strategy of social pacification on one hand, and stabilization and adjustment on the other, being carried out by the Government.

For the Government of Nicaragua, the general objective of the privatization process is to facilitate the restructuring of the economy in the direction of an efficiently operating market system.

More specifically, it has sought to:

1. Reactivate the economy by attracting private sector investment (domestic and foreign) and by increasing the efficiency of management;
2. Improve the balance of the national budget through savings and subsidy reduction as well as through the sale of enterprises;
3. Diversify ownership of enterprises, attempting to give all sectors the opportunity to participate in the process.

For the selection of enterprises to privatize, CORNAP considered that there were three clearly distinct situations which should be dealt with differently: a) enterprises which had no pending claims for restitution to the previous owners before the courts, whose legal and labour situation was conducive to the privatization process,

which were attractive to potential investors and whose financial situation made them seem economically viable after privatization; b) enterprises and corporations which should be privatized for social reasons, mainly agricultural and stockbreeding enterprises, and c) enterprises which for various reasons represented crisis situations such as would lead to their closure, justifying their accelerated closure or privatization.

The second group was made up of corporations and enterprises whose main activity was agricultural. The Government decided that the privatization process for these corporations and enterprises (chiefly HATONIC, CAFENIC and AGROEXCO) should be carried out in a process separate and distinct from that of State enterprises in the industrial, commercial and service sectors.

The special treatment for the privatization of these enterprises was because land was their most valuable asset, which in turn was the asset in greatest demand from the economic agents of the rural areas such as: the workers in the enterprises themselves, the former owners of the plantations, ex-workers, demobilized members of the National Resistance, demobilized soldiers and organized landless peasants.

The decision took into account the fact that the problem of demand for land was aggravated by the lack of funds to buy the land and by the defects of the surveying and registration machinery for agrarian property.

The economic, political, social and administrative complexity involved in the spectrum of those who wanted land, as well as the impact that the privatization measures might have on several thousand producers, led to the implementation of the privatization of agricultural enterprises on a case-by-case basis which sought to minimize conflicts which might impede the reactivation of production and to give minimum satisfaction to the above-mentioned social demands.

The third group was made up of enterprises in crisis with repercussions beyond the enterprise itself which called for some response from the Government. Some of these enterprises met the criteria laid down for the first group, in which case CORNAP accelerated their privatization in order to prevent their closure or stimulate their reactivation under private management. When this was not feasible the enterprise was closed in order to study the question of its possible liquidation or later privatization.

5. Organization and resources

In order to implement the privatization strategy without interfering with the normal work of managing the as-yet unprivatized corporations and enterprises, a Director General of Privatization, to whom Directors of Privatization reported, was set up within CORNAP. The Director General of Privatization is directly responsible for the conduct of the process, for monitoring its goals and the conflicts arising and for coordination of the activities of the process. In support of these units, a Directorate General of Finance and a Legal Advice Unit were established.

In order to carry out the privatization of agricultural enterprises, and in view of the conflicted nature of the sector and its strategic economic and social importance, a Directorate General of Agricultural Privatization was established. Some Directors of Privatization also reported to this Directorate.

In view of the importance of following up on the privatization process, a Clearance Unit was established in July 1992. It is this Unit's responsibility to ensure the formalization of aspects of the transactions relating to their final settlement, to verify compliance with contracts, manage the recuperation of the portfolio, and design and establish an information system to collect and process data relevant to the privatization proceedings.

The limited number of officials assigned to a task of this scope was a result of the policy of intensive use of national and international advisory services and other support services both for the valuation and preparation of enterprises for privatization and, in some cases, for the management of the privatization process itself.

To carry out the work of privatization, CORNAP from the closing months of 1990 had its own funds and support funding from international cooperation agencies. USAID committed US\$ 800,000 for designing strategies and the institutional strengthening of CORNAP; ASDI and NORAD US\$ 220,000 each to finance advisory work on the privatization of the mining and fisheries sectors and UNDP, from its own resources and the bilateral and multilateral resources provided by NORAD and ASDI, contributed an additional US\$ 2.3 million to be used both to strengthen CORNAP and to hire consultants. The Inter-American Development Bank in 1992 approved a non-refundable technical cooperation grant of up to US\$ 3.8 million intended chiefly to hire consulting firms to prepare studies of the enterprises to be privatized.

USAID sponsored studies relating to the privatization of Ingenios Azucareros y Hoteles which were carried out by Price Waterhouse. The IDB likewise financed economic and technical studies relating to 100 enterprises which were prepared by private consultants and INCAE participated in that part of the work relating to the selection of professionals and the coordination and supervision of the studies. The studies of the fishing and mining sectors were supported respectively by NORAD and ASDI. UNDP contributed to the selection and hiring of consultants on the various aspects of management of the privatization process.

In addition to the support they provided in financing, technical assistance and consultation, the international organizations carried out periodic audits to evaluate the management of the privatization process, the progress and the proper use of the resources they had provided. The Comptroller's Office of the Republic was likewise invited to attend the opening of the tenders in the public bidding carried out for the sale of enterprises and/or blocks of shares so that a representative of that institution could ensure compliance with the generally accepted rules governing such procedures.

B. The privatization process

1. Definition of terms

To facilitate interpretation of the results, the meaning of the terms used in the various privatization proceedings is given below:

Liquidation. By liquidation is meant the dissolution of an enterprise and the sale of its assets. This action is justified by a situation of financial non-viability, a lack of interest by investors, or other reasons hindering the normal operation of the enterprise.

Ascription. In this category are classified those acts of amalgamation of one enterprise within another existing enterprise or incorporation within a ministry or other State or para-State institution taken because of the economic or social function the enterprise fulfils.

Restitution. Acts of restoration of an enterprise or assets or of securities of an enterprise to its former owners or their successors are classified as restitutions.

Privatization. Privatization properly so called may take place by means of:

Sale. If the action envisages the transfer by sale of a functioning enterprise (firm name), functioning assets (operating units) or blocks of shares.

Lease. The leasing of assets of an enterprise is included in this category whether or not, for reasons of legal convenience, the firm name and the enterprise's management contracts are retained.

A stage prior to privatization which is not envisaged in the above-mentioned strategy paper is the final closure of an enterprise and the dismissal of its personnel.

As is to be expected, there are not many enterprises in which a single, unique act of privatization takes place. In a good number of cases, in order to proceed to privatization the assets of an enterprise have had to be split up, taking geographical location and areas of specialization into account, before carrying out various acts of privatization.

2. The process

The privatization strategy document sets out the following process, without distinguishing between kinds of privatization actions.

(a) Selection of the enterprises to be privatized, on the basis of the criteria referred to above. This stage of the process is the responsibility of the General Board of CORNAP, with the participation of officials of CORNAP and the corporations;

(b) Analysis of the legal, financial, organizational and operational situation of the enterprise. Most of the work of this phase is done by consultants, coordinated by CORNAP Directors of Privatization;

(c) Choice of the privatization strategy. In this stage the General Board of CORNAP proposes the recommended means of privatization to the Presidency of the Republic;

(d) The financial valuation includes the valuation of the enterprise/asset on the basis of various factors. It is the responsibility of consultants, coordinated by the CORNAP Directors of Privatization;

(e) The competitive bidding or negotiation includes the preparation of the offering documents where necessary and the bidding/negotiation process itself. This activity is carried out by the CORNAP staff, with the help of consultants. In this stage, where appropriate, direct negotiation is envisaged, to be carried out by a negotiating team;

(f) Adjudication includes comparison of the tenders, where tenders are made, and the award itself. The award decision is made by the General Board of CORNAP, on the recommendation of its staff, and is confirmed by the Presidency of the Republic by means of Presidential Agreements; and

(g) Privatization, a stage which is subdivided into: (i) legal formalization and (ii) physical transfer of the enterprise. Responsibility for privatization is distributed among CORNAP staff, chairmen of corporations and, in some cases, the directors of the enterprises concerned.

C. Corporations and enterprises under CORNAP

1. Background to the formation of the State Corporations

The presence of the State in the sphere of production and non-basic services (i.e. except for water, energy, etc.) was minimal. Beginning in 1979, the State confiscated or intervened in various ways in numerous enterprises in all areas of the economy. To these enterprises were added the production and service enterprises created by the State, of which the most important were the new investment projects.

The ascription of the enterprises to ministries, on the basis of some criterion of affinity or simply because of the need for someone to administer them, led to a conflict between the regulatory functions of the State and the specific interests of the State enterprises, to the detriment of the private sector and the efficiency of management of the State enterprises.

The need to reactivate the private sector and the search for greater efficiency in the State enterprises were the decisive elements in initiating, at the end of the 1980's, a process of separating the regulatory and entrepreneurial responsibilities of the ministries. This period was characterized by the creation of corporations to perform the production functions of the State, which were intended to function independently of the structures of the central Government.

However, the weakest aspect of the new corporation system was that the process of reorganization was incomplete. Although the corporations were separated from the ministries formally, they were managed and organized according to the interests of the ministries concerned, to such a degree that the ministers were the chairmen of the governing bodies, which were for the most part made up of officials of the same ministries. A clear example of the incompleteness of the process was the regulatory authority over fishing that the law establishing the corporation in question gave that corporation.

The inheritance of the corporations in 1990 left the recently-elected Government with an enormous problem, which was complicated by two factors:

a) The corporations determined the operations of the State enterprises, but with very little legal organization. The origin of the property taken over by the corporations was lost from sight, making the Government's work of privatizing difficult. The inchoate state of the corporations was also evidenced by their inability to determine what was their capital, in terms of enterprises, property, shares, etc.

b) In terms of their operational logic, the standards of profitability were also affected by political criteria not necessarily involving entrepreneurial considerations. At this stage in their development, when the corporations were attempting to keep hundreds of enterprises in all the vital sectors of the economy functioning, a programme of privatization was undertaken to dismantle an apparatus which had not yet been completely established.

2. The CORNAP corporations

A total of 22 corporations are included within the framework of the National Public Sector Corporations (CORNAP). A total of 11 enterprises were considered to be without corporate affiliation or ascription, either because of their medium or large size or because the previous Government had never incorporated them into any existing corporation. These enterprises are: PROA Engineering, the Palma Africana projects in El Castillo and Kucra Hill (ENDEPARA), the Empresa Agro-Industrial Patricio Arguello (YUCASA), the Empresa Agro-Industrial Valle de Sebaco, the Empresa Agro-Industrial Claudia Chamorro (FRUGALASA), 2/ OVIPE-ENFARA Construction and SOVIPE Investments, the Nicaraguan Basic Grains Company (ENABAS) and the Arlen Siu

Company.

Two corporations, ENABAS and COERCO, ^{3/} were transferred in toto to central State entities. The first serves as regulator of the country's basic grains and is itself going through a process of transformation outside CORNAP. The second was transferred initially to the Ministry of Construction and Transport to constitute the regional installations for maintenance of the road network without becoming part of the original list of Entities Under CORNAP (see Table I).

Two enterprises were of great importance at the time, although their physical assets were small, because they functioned more as financial holding companies than as productive enterprises. AGROINRA and INPERA managed the large agro-industrial and agro-stockbreeding enterprises which were later incorporated into the corporations system.

ENPRA, a pork producing enterprise with the characteristics of a corporation and which was in the process of becoming one, was temporarily ascribed to the meat corporation (CNC) at the beginning of the privatization process.

Table 1

CORNAP CORPORATIONS

CORNAP corporations and enterprises		Number of enterprises
A.	Agriculture and stockbreeding public sector corporations	80
1.	Corporación Avícola Nicaragüense (CAN)	5
2.	Corporación Nicaragüense de la Agroindustria Azucarera (CONAZUCAR)	9
3.	Corporación Nicaragüense del Tabaco (TABANIC)	5
4.	Corporación Nicaragüense de la Carne (CNC)	11
5.	Corporación Nicaragüense del Banano (BANANIC)	2
6.	Corporación Nicaragüense del Arroz (NICARROZ)	8
7.	Propulsora de Agroexportaciones de Nicaragua (AGROEXCO)	7
8.	Corporación Nicaragüense del Café (CAFENIC)	14
9.	Sociedad de Empresas Pecuarias del APP (HATONIC)	16
10.	Corporación Nicaragüense de la Leche (CONILAC)	3
B.	11. People's Industrial Corporation (COIP)	89
C.	Corporations relating to primary sector of economy	30
12.	People's Forestry Corp. (CORFOP)	13
13.	Nicaraguan Fishing Corp. (INPESCA)	7
14.	Nicaraguan Mining Corp. (INMINE)	10
D.	Corporations relating to foreign and domestic trade	83
15.	Nicaraguan Importing and Agricultural Services Corp. (IMSA)	11
16.	Construction Supply and Works Corp. (CATCO)	21
17.	People's Trade Corp. (CORCOP)	34
18.	Nicaraguan Foreign Trade Enterprises Corp. (CONIECE)	7
19.	Pharmaceutical Corp. (COFARMA)	10
E.	Corporations relating to transport and construction	28
20.	National Construction Enterprises Corp. (COENCO)	6
21.	People's Transport Corp. (COTRAP)	22
F.	22. Nicaraguan Tourism Corp. (COTUR)	30
G.	Independent Enterprises	11
	Nicaraguan Basic Grains Company (ENABAS)	1
	PROA Engineering	1
	ENDEPARA Palma Africana El Castillo	1
	ENDEPARA Palma Africana Kucra Hill	1
	Gustavo Argüello de R.A. Agroindustrial Co. (YUCASA)	1
	Valle de Sébaco Agroindustrial Co.	1
	R.A. "Claudia Chamorro" Agroindustrial Co.(IFRUGALASA)	2
	SOVIPE-ENFARA Constructions	1
	SOVIPE Investments	1
	Siu de R.S. Co.	1
Total		351

Some corporations were not transferred to CORNAP, like CORADEP, the corporation that managed almost a majority of Nicaragua's radio stations, which was dissolved during the period of transition. Another corporation, CONMENA, which manages the Managua markets, was always part of the Managua City government.

For different reasons, various groups of enterprises and individual enterprises which have no State regulatory character are not grouped under CORNAP and operate under various ministries. It is frequently stated, incorrectly, that all the enterprises created during the previous government are under CORNAP jurisdiction.

Other assets with entrepreneurial characteristics are managed by the Ministry of the Presidency; the Olof Palme Convention Centre and the Cesar Augusto Silva Convention Centre, in the installations of the former Nejapa Country Club, the Nicaraguan Tourism Institute, an entity of the central Government, inherited from the Tourism Corporation branch enterprises and other real estate it was already managing which was never part of CORNAP.

D. The acts of privatization

Once the universe of enterprises was defined, a subdivision was made, where appropriate, into acts of privatization. In many cases an enterprise was treated "globally", that is, it was sold, restored, ascribed or leased as a whole; but for many of the 351 the choice of dividing them into different acts was made, i.e. in one enterprise: a) blocks of shares were restored to their former owners, and b) other shares which were in the State's hands were sold.

Although, in the above example, only one enterprise is involved, two different acts of privatization took place. There are cases in which one enterprise has been divided into more than 30 acts of privatization, whereas in other enterprises the treatment was global because for accounting purposes only one action was involved. The current average is about 5 acts per enterprise.

The enterprises as a whole, or groups of their assets, have been privatized in various ways. The two forms in which privatization is being carried out are the sale of shares of enterprises or the sale of their assets. Generally privatization has been carried out through a privatization of blocks of shares, where a whole enterprise is concerned, and the privatization of assets in the case of parts or segments of the enterprises. There are mixed cases where whole enterprises have been privatized as packets of assets, or part of the assets of an enterprise have been reorganized so as to constitute a new enterprise of smaller size.

The total number of acts dealt with in this study is 1,532 which covers privatizations up to 31 December 1994.

1. Forms of privatization by individual acts

A form of privatization is recorded for each individual act depending on whether it was an ascription, a restitution, a liquidation, a sale or a lease.

A beneficiary of the act of privatization is recorded for each act, i.e.: ascriptions (the Government of Nicaragua); entrepreneurs; ex-combatants (demobilized members of the former RN, retired servicemen); workers, and other beneficiaries.

The amounts of the transactions are also classified depending on the form of payment, with the provision

that when they are added up, leases are not included as they are given in terms of annual rents only for comparative purposes. Many of the leases, in particular all the agricultural and stockbreeding leases, are leases to workers and ex-combatants with an option to buy, so that over time, as the option is exercised, they are recorded as sales to workers and ex-combatants.

The forms of payment were: cash; loans; the assumption of debts, and annual rents.

2. Number and amounts per form of privatization

Of the total of 1,532 acts of privatization, 80.7 per cent were privatized through ascriptions, restitutions, liquidations and sales; the remaining 19.3 per cent of the acts were leases of assets.

Excluding leases, restitutions and sales accounted for 44.0 per cent and 46.4 per cent respectively of the total acts. Ascriptions and liquidations represented 3.7 per cent and 5.9 per cent respectively (see Table 2).

The total amount of the transactions came to C\$ 1,129,399,798; in addition to which the lease transactions amounted to C\$ 22,182,028 per year.

Table 2

FORM OF PRIVATIZATION, NUMBER AND AMOUNT

Form	Acts		Transactions	
	No. of Acts	%	Total C\$ millions	%
Ascription	46	3.7	0.0	0.0
Restitution	544	44.0	131.3	11.6
Liquidation	73	5.9	0.0	0.0
Sale	574	46.4	998.1	88.4
Total	1 237	100.0	1,129.4	100.0
Annual rent	295		22.2	

Of the total amount of the transactions 88.4 per cent came from sales and the remaining 11.6 per cent were attributable to restitutions. The ascriptions and liquidations produced no income by definition.

3. Form of payment per form of privatization

The most common form of payment of the C\$ 1,129.4 million in completed transaction was debt assumption, as it amounted to 40.6 per cent of the total amount. Credit, in the second place, represented 40.3 per cent of the transactions, and, in the third place, payments in cash, with 19.1 per cent of the total (see table 3). Of these obligations C\$ 207 million were cancelled with CORNAP indemnification certificates.

Table 3

FORM OF PRIVATIZATION AND FORM OF PAYMENT

Form	Transactions C\$ millions			
	Cash	Credit	Debt assumption	Total
Ascription				0.0
Restitution	1.3	20.4	109.6	131.3
Liquidation				0.0
Sale	213.8	435.0	349.3	998.1
Total	215.1	455.4	458.9	1 129.4
%	19.1	40.3	40.6	100.0
Annual rent				22.2

In some transactions, the beneficiaries assume the debts of the enterprise or production unit; this amount forms part of the sales price and is recorded as "debt assumption". The same is done when the workers of an enterprise contribute their labour debt as part of the payment for the total or partial acquisition of the enterprise.

"Debt assumption" also includes the amounts of the obligations contracted by the corporation or enterprise and which were cancelled by the transfer of assets (payment in kind).

Most of the leases are concentrated in the agricultural and stockbreeding corporations, and are leases with an option to buy. This transfer figure was used as a temporary solution until the sale is formalized. As the option to buy has not been exercised, what is legally involved is a lease. Where these cases are formalized they would be transferred to the sales category and the rental capitalized at the value of the plantation. This situation would occur in those cases in which the beneficiaries are in the worker and ex-combatants categories.

The C\$ 22.18 million for leases is an indicative figure as the annual rents are calculated for comparative purposes even where the leases run for less than twelve months; moreover, the rent contracts were signed at different dates and do not all begin in January.

In the case of acts of restitution, the amounts shown correspond to increments to the State, that is, the decrease in debt obligations or the value of the investments made by the State in the restored property during the time that it was under State administration.

4. Number of beneficiaries and amounts per beneficiary per act of privatization

In 51.6 per cent of the acts of privatization the entrepreneurial sector was the beneficiary; workers accounted for 23.4 per cent of the total number of acts, and the ex-combatants sector 15.7 per cent. The central Government was the beneficiary of 2.5 per cent of the acts, those categorized as ascriptions. Other beneficiaries (municipalities, autonomous bodies, etc.) accounted for 6.8 per cent.

Table 4 shows the distribution of the acts of privatization by beneficiary sector and the corresponding amounts.

Table 4

BENEFICIARIES, ACTS AND AMOUNTS

Beneficiaries	Acts		Transactions (C\$ mn)		Annual rentals (C\$ mn)	
	Number	%	Total	%	Total	%
Ascriptions	39	2.5	0.0	0.0	0.0	0.0
Enterprises	790	51.6	666.4	59.0	8.3	37.5
Ex-combatants	241	15.7	15.4	1.4	3.8	17.0
Others	104	6.8	113.7	10.1	0.0	0.0
Workers	358	23.4	333.9	29.6	10.1	45.6
Total	1 532	100.0	1 129.4	100.0	22.2	100.0

5. Origin and use of funds

In May 1990, to begin its operations, CORNAP received contributions from the main corporations that had passed under its administration. The remainder of its resources comes chiefly from the income generated by the privatization transactions. It also received funds from the central Government to cover costs of privatization.

At 31 December 1994, CORNAP's income from transfers from the central Government and the corporations amounted to C\$ 44.6 million, which represented 12.5 per cent of its total income.

The sums provided by the central Government were used to initiate the process of privatization of State enterprises pursuant to the structural adjustment plan for the country's economy. It covered various debits, chiefly labour debts, in the first enterprises privatized.

The funds generated by the privatization operations (sales, leases, increments to the State) amounted to 87.53 per cent of its total income.

CORNAP's participation in the redemption of the bonds issued by the Government to indemnify the owners of confiscated property affected the figures. At 31 December 1994 a total of C\$ 207 million had been received by CORNAP, representing 66.2 per cent of its total income from privatization.

CORNAP's largest item of expenditure consisted of what are classified as "privatization costs" (labour charges, debts to suppliers and financial costs of the enterprises to be privatized). Up to the cut-off date, CORNAP had disbursed C\$ 103 million under that heading, which represented 28.9 per cent of its total income.

"CORNAP costs" represent 6.4 per cent of total income, that category being made up of CORNAP's operating costs and expenditures for security services and other minor costs in the enterprises closed or in process of liquidation.

Although international agencies have provided the bulk of the technical assistance and consultation costs, CORNAP has provided a sum of C\$ 3.9 million from its own funds (1.1 per cent of total income) for that purpose.

The transfers to the Ministry of Finance and the government of the Atlantico Sur Autonomous Region (RAAS) have been classified as "other expenditure" and amount to 1.8 per cent of total income.

CORNAP's contributions to RAAS are for operation of the fisheries plants in that region and constitute an important source of income which will be used for the social and economic development of the region.

A summary of the source and use of the funds is presented below.

**SOURCE AND USE OF FUNDS
SUMMARY**
Millions of Cordobas

May 1990-December 1994

SOURCE		
INCOME	357.4	100.0%
Contributions	44.6	12.5%
Income from privatization	312.8	87.5%
- Cash	105.8	
- Bonds	207.0	

APPLICATION		
EXPENDITURES	135.9	38.1%
Costs of privatization	103.0	28.9%
CORNAP costs	22.6	6.4%
Technical assistance and consultation costs	3.9	1.1%
Other	6.4	1.8%
BONDS	195.9	54.8%
Remitted to MIFIN	195.9	
CASH AND RECEIVABLES	25.6	7.2%
Cash	14.5	4.0%
Bonds	11.1	3.1%

A breakdown of the expenditures shown for the use of funds is given below.

**USE OF FUNDS
BREAKDOWN OF EXPENDITURES**
Millions of Cordobas

May 1990-December 1994

PRIVATIZATION COSTS	103.0
Labour liabilities	81.4
Supplier liabilities	19.8

Financial liabilities	1.8
CORNAP COSTS	22.6
Wages and salaries	12.9
Goods and services	9.6
TECHNICAL ASSISTANCE AND CONSULTING COSTS	3.9
Consultants, technical assistance	3.2
Announcements, prospectuses, publicity	0.7
OTHER	6.4
Transfers to MIFIN	4.2
Transfers to RAAS	2.2

E. Evaluation of economic impact

The evaluation of the economic impact of the privatization carried out up to 31 December 1994 is presented at the macro level—expressed as a reduction of the participation of the "CORNAP enterprises" in the creation of gross domestic product—in the first three sections. The last section of the chapter evaluates, on the basis of the little information available, the impact of privatization on the subsidies.

1. Participation of CORNAP enterprises in GDP

The Government of the Republic of Nicaragua in various unofficial documents prepared in 1990-1991 used the figure of 30 per cent as an approximate estimate of the participation of the group of enterprises originally ascribed to CORNAP in the generation of Nicaragua's gross domestic product.

On the basis of the information collected on the enterprises and with the assistance of the Vice Presidency for Economic Studies of the Central Bank, which is the only governmental body dealing with national accounts information, an effort was made to estimate with greater precision the real participation of CORNAP in the GDP prior to 1990.

The first step was to determine the sectors of the economy in which CORNAP did not participate at all. These were: the central Government, banking and securities, energy and clean water, property and housing—in which its participation was marginal—and other services. During the period between 1987 and 1989 these sectors generated an average of 28.7 per cent of GDP.

The second step consisted of establishing the sectoral distribution of the remaining 71.3 per cent and estimating the participation of CORNAP corporations and enterprises in the sectors of agriculture, stockbreeding, fisheries, forestry, manufacturing industry, construction, mining, trade and transport and communications.

Within the official product classification, the amounts for transport and communications (which are handled as a single sector) and trade are estimated indirectly on the basis of weighted indices of aggregate supply of goods and population.

With data at the enterprise and group of enterprises level provided by the Central Bank, it was possible to specify CORNAP's participation in the industrial sector; the main categories of the agricultural sector; the cattle component within the stockbreeding sector; and the fisheries and mining sectors. The aggregate value of the

CORNAP enterprises within these sectors represented about 36 per cent of the total and constituted a contribution of approximately 16.9 per cent to the national GDP under the structure prevailing for the years 1987-1989.

The participation of CORNAP enterprises in the other sectors and subsectors had to be estimated as explained below:

For both the construction sector and pork and poultry production within the stockbreeding sector, the relative participation of CORNAP enterprises was estimated at 36 per cent, like that of the average of the two sectors referred to above;

For the forestries subsector, their participation was estimated at 60 per cent on the basis of the size and number of the forestry enterprises under CORFOP and COIP management.

In the transport sector, taking into account that the CORNAP enterprises at the local level were heavily involved in the international air transport of goods and passengers, that ENABUS controlled urban transport in Managua and that State enterprises had a large role in the internal transport of goods, the participation of CORNAP enterprises was estimated at 60 per cent of transport GDP, putting it at 30 per cent of both subsectors together.

In trade, the control of the supermarkets, shops and importing enterprises by CORCOP and, through ENABAS, of at least 70 per cent of basic grain distribution, made it possible to estimate the participation of those enterprises conservatively at 50 per cent of trade GDP.

The result was an estimated participation by the CORNAP-administered enterprises of 29.1 per cent of GDP in the years immediately prior to 1990. Table 5 shows the distribution of GDP among the relevant sectors and subsectors and the estimated relative contribution in each case, in the aggregate, of the enterprises ascribed to CORNAP.

2. Impact on participation in GDP

Taking this table as a basis, the impact of privatization on CORNAP participation in the GDP was then calculated, using a similar methodology. Owing to the scarcity of specific information, the impact was measured on the premise of *ceteris paribus* on the basis of the estimates of sectoral distribution and relative weight of the CORNAP enterprises calculated as explained in the previous section, and was referred to the 1987-1989 period, using the product composition of 1988 expressed in 1980 cordobas.

Table 5

Aggregate value of CORNAP sectors 1988 Millions of 1980 cordobas					
	Value			1988 Structure	
	Total	Private	CORNAP	Private	CORNAP
Total GDP 1988	18 473				
CORNAP SECTORS	13 177	7 811	5 366	59.3%	40.7%
Agricultural subtotal	2 657	2 028	629	76.3%	23.7%
Cotton fibre	379	271	108	71.4%	28.6%
Cottonseed	42	30	12	70.8%	29.2%
Banana trees	27	0	28	0.0%	100.0%
Green coffee	806	705	101	87.5%	12.5%
Maize	330	303	27	91.7%	8.3%
Sorghum	133	96	37	71.9%	28.1%
Burley tobacco	44	28	16	63.3%	36.7%
Kidney beans	171	168	4	97.8%	2.2%
Sugar cane	264	154	110	58.3%	41.7%
Havana tobacco	24	0	24	0.0%	100.0%
Rice	200	123	77	61.7%	38.3%
Others	236	151	85	64.1%	35.9%
Livestock subtotal	1 348	1 069	279	80.8%	19.2%
Beef cattle	956	818	139	85.5%	14.5%
Pigs	68	43	24	64.2%	35.8%
Poultry	324	208	116	64.1%	35.9%
Silviculture	48	19	29	40.0%	60.0%
Fisheries	56	28	28	50.0%	50.0%
Mining	97	0	97	0.0%	100.0%
Industry	4 168	1 988	2 180	47.7%	52.3%
Construction	694	444	250	64.0%	36.0%
Transport and communication	905	634	272	70.0%	30.0%
Trade	3 205	1 602	1 602	50.0%	50.0%

A) AGRICULTURAL AND STOCKBREEDING SECTOR

The relative number of State enterprises in the agricultural and stockbreeding sector does not adequately reflect their importance in the sector.

Some indicators for the 1987/88 cycle show that:

a) The AGROEXCO enterprises represented 27.091 per cent of the area devoted to cotton cultivation and 12.5 per cent of the production value generated by that activity. For the 1991/92 cycle the State had no participation in that activity.

b) The CAFENIC enterprises had 12.2 per cent of the area cultivated for coffee and 12.5 per cent of the production value generated by that activity. For the 1991/92 cycle the State had no participation in that activity.

c) During the period, 14.5 per cent of the production processed by the slaughterhouses came from CORNAP agricultural and stockbreeding enterprises (essentially HATONIC). All the production had already been privatized by 1991.

d) Privatization was also important in the activity of basic grain production. For 1987/88, 8.3 per cent of the production value generated by maize production, 28.1 per cent of the production value in sorghum, 2.2 of it in kidney beans and 38.4 per cent of it in rice, came from State enterprises. By 31 December 1994, production in those areas had for practical purposes been completely privatized, leaving only a participation of 0.01 per cent with respect to rice production.

e) Banana production, which generated about US\$ 20.1 million in exports in 1989, has been privatized, as has been the processing of cane sugar, whose contribution to exports in the same year was US\$ 17.9 million.

B) INDUSTRY

With respect to industry, privatization, as measured by the number of production units, has been relatively less than in the agricultural and stockbreeding sector, because it was subject to the limitations already explained, but its importance in terms of the GDP is considerably greater. The State enterprises had greater relative weight in industry than in agriculture, where the participation of the private sector was always preponderant. With the exception of agroindustry, most of the manufacturing industries were organized under the People's Industrial Corporation (COIP).

COIP brought together 88 industrial enterprises and had minority share participation in others. By 31 December 1994, 73 enterprises (83.0 per cent) had been handed over to private entrepreneurs and workers or had been liquidated or closed.

With respect to the GDP, CORNAP manufacturing enterprises generated 52.3 per cent of the industrial GDP and 11.8 per cent of the national GDP in the 1987-1989 period used as a reference (see Table 6). The enterprises now privatized had generated 11.1 per cent of the GDP during that period.

C) OTHER SECTORS

The participation of the privatized enterprises in the sectoral product in construction, commerce, transport and communications was estimated on the basis of the percentage and relative size of the privatized enterprises

within each sector. At present there are no CORNAP-operated enterprises in the construction or communications sectors.

With regard to the transport sector, CORNAP's participation has been considerably reduced through the privatization of the shares it held in NICA (51 per cent) and with the ascription of Ferrocarril del Pacifico de Nicaragua to the Ministry of Construction and Transport.

For consistency with the "original" list of 351 enterprises, the contributions of ENAP have continued to be calculated as under CORNAP although that enterprise is no longer under it. As a result, "CORNAP" participation in the aggregate value of the transport sector has not been reduced to zero. The same situation exists in the case of ENABAS although that enterprise was officially transferred to the Ministry of the Economy and Development in November 1994.

Table 6

Privatized aggregate value of CORNAP sectors				
Percentage distribution				
	GDP structure 1988			
	Private	State	Privatized	Residual
Non-CORNAP sectors	28.67			
CORNAP sectors	41.97	29.36	28.10	1.26
Agricultural subtotal	10.66	3.72	3.71	0.01
Cotton fibre	1.46	0.59	0.59	0.00
Cottonseed	0.16	0.07	0.07	0.00
Banana trees	0.00	0.15	0.15	0.00
Green coffee	3.82	0.55	0.55	0.00
Maize	1.64	0.15	0.15	0.00
Sorghum	0.52	0.20	0.20	0.00
Burley tobacco	0.15	0.09	0.09	0.00
Kidney beans	0.59	0.33	0.33	0.00
Sugar cane	0.83	0.60	0.60	0.00
Havana tobacco	0.00	0.13	0.13	0.00
Rice	0.67	0.41	0.40	0.01
Others	0.82	0.46	0.46	0.00
Livestock subtotal	5.78	1.51	1.51	0.00
Beef cattle	4.43	0.75	0.75	0.00
Pigs	0.23	0.13	0.13	0.00
Poultry	1.12	0.63	0.63	0.00

Silviculture	0.10	0.16	0.11	0.05
Fisheries	0.15	0.15	0.15	0.00
Mining	0.00	0.53	0.14	0.39
Industry	10.76	11.80	11.10	0.70
Construction	2.40	1.35	1.35	0.00
Transport and communication	3.43	1.47	1.36	0.11
Trade	8.67	8.67	8.67	0.00

An overview of the privatized participations is given in Table 6. It can be seen that the reduction in participation resulting from the acts of privatization carried out up to 31 December 1994 amounts to 28.1 percentage points. This would leave—it must be said once again, *ceteris paribus*—the participation of the enterprises which still remain under CORNAP in the generation of the GDP at 1.3 per cent.

The above calculation tends to underestimate CORNAP's residual participation by being referred to the 1987-1989 period in view of the general decline of activity in the Corporation's enterprises, in the expectation of a possible privatization and the forced closing of some industrial enterprises on the one hand and the increases in production experienced by the privatized enterprises after their restructuring on the other. Both factors tend to alter the relative weights observed in the reference period, decreasing those of the State enterprises.

3. Impact on trade and marketing channels

A. DOMESTIC

The 34 enterprises that initially made up CORCOP (the People's Trade Corporation) have been privatized. The dissolution of the corporation has therefore essentially been concluded.

In the domestic consumer products trade the private sector has established a substantial participation in the supermarkets, which were formerly entirely in State hands and in the establishment of many shopping centres, which were previously nonexistent. In the distribution of basic grains, ENABAS has been reducing its role and now functions chiefly as a price regulator through the management of supply and demand.

B. FOREIGN

There has been a reduction in the role of CORNAP enterprises in the handling of exports of traditional products. Before 1990 the CORNAP enterprises, grouped in the CONIECE corporation, had a monopoly with regard to foreign trade in the traditional export products. In general, the participation of these and other CORNAP enterprises in the handling of exports was estimated at about 91 per cent. After the privatizations were carried out, this participation was reduced to 0.3 per cent, which corresponds to the export of gold from the mining units still awaiting privatization.

With respect to coffee, the participation of the State enterprise ENCAFE in export was reduced from 100 per cent for the 1990-1991 harvest to an estimated 20 per cent for the 1992-1993 harvest as a result of the liberalization of foreign trade, and to zero in the following year because the marketing enterprise was privatized for the benefit of its workers.

In the export of meat, which amounted to US\$ 35 million in 1991, State participation dropped radically from 100 per cent to zero.

In banana exports the change was similar. From representing all of the US\$ 28 million exported by the sector in 1991, the State's participation was eliminated in 1992.

In cotton exports, although marketing was liberalized, the private sector behaved conservatively and did not attain the degree of participation it reached in other products. Nevertheless, the participation of the private sector in cotton exports is estimated at about 10 per cent for the 1991/1992 cycle and reached 100 per cent in the following cycle.

As indicated previously, the exports of the CORNAP sector have been reduced to about 0.3 per cent according to BCN figures. In 1994 the country's total exports amounted to US\$ 343,536,700, with unprivatized mining production accounting for US\$ 930,500.

With respect to the import trade, the privatization of ENIMPORT and the approaching privatization of ENIA will reduce the participation of CORNAP enterprises to practically zero.

4. Fiscal and financial impact

Analysis of the impact of privatization on the subsidies received by the State enterprises directly or indirectly is practically impossible, for a series of reasons of which the following are the most important:

a) The frequency and intensity of State intervention in price fixing, which benefited (or in some cases harmed) different sectors of society regardless of their property regime.

For example, the sale of subsidized fuel (at an officially fixed rate of exchange) to the national flagship airline involved a transfer (subsidy) from society as a whole to the enterprise and to the users of transport on the local routes; on the other hand, the high level of protection enjoyed by the national flagship airline (and the private foreign airlines with route franchises) represented another kind of transfer. In that case, the subsidizer was the user of international air transport (via prices fixed under an oligopoly regime) and the beneficiaries were the national flagship (State) airline and other (private) airlines. Innumerable similar examples can be cited in all sectors of the economy.

b) The frequent variations in subsidy policy.

In fact, towards the end of the 1980s a large part of the direct subsidies granted by the Government had been eliminated or drastically reduced. That was not true of the distortions introduced by various ad hoc rates of exchange and some unreal interest rates.

c) The lack of consistent information, which makes an evaluation of the impact of subsidies possible for only one of the privatized enterprises within the scope of this study.

To illustrate to some degree the impact of privatization on subsidies, resort must be had in a qualitatively and quantitatively limited way to the impact of the privatizations with respect to taxes and finance, i.e. with respect to its relationship to the national treasury and the decentralized autonomous bodies on the one hand and to the State Bank on the other.

It is a generally accepted fact that the chief sources of involuntary financing employed by the State enterprises vis a vis the treasury and autonomous entities were:

- a) Taxes withheld from employees and not turned over;
- b) Failure to make payments to the social security system;
- c) Loans from other State enterprises;
- d) Defaults on debt payments by the public service enterprises; and
- e) Delay in the payment of customs duties and other taxes.

It has already been noted that complete and consistent information that would make estimates possible does not exist.

One of the main achievements of privatization has been the reactivation of the tax system, which has considerably increased its contribution to the central Government's regular income.

The bottlers ENSA and MILCA and the Nicaraguan Beer Company (CCN), enterprises in which large blocks of shares were returned and shares were privatized for the benefit of the workers, have increased their levels of production and consequently their tax contribution has increased from 1.1 per cent of GDP in 1990 to an annual average of 2 per cent for the 1991-1994 period.

According to information provided by the Directorate of Large Contributors with respect to the contributions made by a group of enterprises in which large-scale acts of privatization were carried out, the CCN, FOGEL, Hotel Intercontinental, Hotel Las Mercedes, ENSA, MILCA and the match company together contributed C\$ 428 million during the 1992/1993 and 1993/1994 fiscal periods, which on average represented 20 per cent of the total collected.

With respect to banking, it has been possible to quantify the size of the subsidy represented by unpaid loans. What has not been possible to quantify nor segregate is the size of the indirect subsidy from which all credit recipients benefited, without maintenance of value, during the 1980s. Although the State enterprises are predominant among this group, it also includes the small agricultural and stockbreeding enterprises and large private producers and marketers. At the end of the decade, this subsidy was estimated by international economists at about 15 per cent of GDP annually. On the assumption—based on official information during that period—that the State enterprises received about 50 per cent of the total credit extended, the level of subsidy by inflation (negative real rate of interest) can be estimated at 7.5 per cent of GDP.

As at 30 April 1990, the "CORNAP enterprises" had documented pending debts of 1.54 billion cordobas (of March 1991), the equivalent of US\$ 309 million, to the State Commercial Bank and the Nicaraguan Investment Fund.

It should be emphasized that the dollar amount, which represents the point of departure, underestimates the real size of the subsidy in view of the fact that most of the loans were originally granted without a maintenance of value clause.

By 31 December 1991, this debt had risen to C\$ 1.7 billion, the equivalent of US\$ 350 million, as a result of interest accumulation and several new financings.

The debt to the Central Bank amounted to US\$ 204 million on 31 December 1991.

In view of the inability to pay most of the debtors and the need to clean up the portfolios of the State banks, the Ministry of Finance took over the delinquent portfolio (100 per cent of the portfolios of BND and BANIC and approximately 90 per cent of the FNI portfolio) with a view to possible recovery.

The total amount of the reorganized portfolio, even though it is undervalued, provides an indication of the size of the other component of the subsidy provided by the financial sector (in the last analysis the public affected by tax inflation) to the State enterprises, amounting to approximately \$554 million which, distributed over ten years, represents 3.7 per cent of an average GDP of US\$ 1,500 million (1980 dollars).

When the two components are added together an estimate is obtained of 11.2 per cent of GDP annually in subsidies to "CORNAP enterprises", the equivalent of an aggregate sum of US\$ 168 million annually.

6. PRIVATIZATION IN PANAMA

A. Introduction

The search for ways to involve private investors in the delivery of public services and the need to find alternative funding for government projects were prompted by the economic decline which many countries experienced as a result of indebtedness and the global economic recession they faced during the last decade. The industrialized countries were not immune to these consequences, but the developing countries were affected to a much greater degree as they saw their financial capacity dwindle, thus limiting their ability to obtain credit from various funding sources and international bodies.

The most common experience in Latin America has been one of inefficient management of State enterprises on the part of most States, resulting in low or negative profitability and the burden of an unproductive work force. The corollary has been expensive basic public services and low income levels which led to rate subsidies for some utilities, which have not been adjusted for over a decade, as has been the case in Panama for the services of electricity, water and telecommunications. To the foregoing should be added a growing demand for basic services on the part of the population, low proceeds from internal resources, the need to modernize the State and to acquire new technologies and, because of the growing burden of debt servicing, limited access to traditional sources of funding which in the past provided massive resources to expand those services; nowadays these same sources can only provide a modest fraction of the capital needed to satisfy demand and to acquire the new technologies necessary to bring about economic development.

Within such a context, options emerge that would favour private sector participation in some activities, since a gradual waning of the Government's role in the production of goods and services makes this necessary. However, the Government's function in guaranteeing that the population's basic needs are met requires it to provide a base to allow civil society to participate to the greatest possible extent in the production of goods and services, as well as in the benefits of development resulting from the modernization of the economy and of the State apparatus as a whole.

This reality has forced most countries, whether developed or developing, to devise strategies aimed at encouraging a major involvement of the private sector, local or international, in business activities producing goods or services, and the introduction of new technologies to stimulate socioeconomic development. The involvement of the private sector gained global momentum, resulting in over 80 countries privatizing about 7,000 public enterprises. In the course of 1993, private funds have been invested in more than 500 public infrastructural projects at a cost exceeding US\$ 300 billion. Latin America is currently offering more than US\$ 36.0 billion worth of infrastructural undertakings to private investors, besides being the region of the world where the most intense privatization activity is currently taking place in the telecommunications sector. At this time, the region has major offers in the sectors of harbour activity, sugar production, fisheries, copper mining, railways, air transport, energy production and distribution, water supply and solid waste disposal, among others.

The African countries are privatizing the production of rubber, steel, sugar, cement, gas, the manufacture of specialized electric motors and diesel engines, highway and harbour construction, hydroelectric plants and other infrastructure needed to achieve economic diversification. Countries such as Indonesia, India, Pakistan, Malaysia, the Philippines and others are expanding private investment in telecommunications, local telephone services, satellites, the production of chemicals, gas, cotton, steel, the construction of hydroelectric plants, building materials plants and petrochemical plants, while also opening the door to investments in tourism, new highways and hotels.

Europe is also opening up to the private sector to resolve problems concerning expanding water supply distribution services, solid waste and garbage recycling; it is also granting greater access to new firms to produce pharmaceuticals, agricultural products, tyres, textiles, shoes, electronic goods and many other business activities in order to be competitive in the world market and to meet the challenges of trade globalization. In that perspective, Europe is putting up for sale more than US\$ 2,500 billion in assets and infrastructure to the private sector in the five-year period 1995-2000.

All of the foregoing has great significance. It points to an unlimited demand for assets, in which Latin America is not alone in seeking to attract the large investments it needs for its development and to satisfy the basic needs of its countries.

Judging from experience, and while attempting to refine the process with the political and resource adjustments needed to fully develop the country, attend to social needs and fight poverty, it will be necessary to pursue the modernization of the State and to provide broader access to the private sector in managing the production of goods and services where traditionally State interference, predominance and monopoly prevailed. The rate at which privatization occurs is therefore in direct response to the fact that the State (i) has scarce resources at its disposal and limited financial capacity, (ii) is facing a growing demand for basic services, (iii) has a limited budget due to its meager internal revenues, and (iv) has a heavy debt and debt servicing burden. Under such circumstances, private involvement would enhance the mobilization of resources, encourage local and foreign investment in unexploited or lagging sectors, strengthen competitiveness and efficiency, open up capital markets, expand employment in new fields and enable staff and workers to own shares in the companies. This would eliminate traditional dependency on the State as the entity which must resolve all problems and be responsible for all social and economic imbalances affecting citizens.

In view of all the foregoing, allowing private participation in Government investment activities has become one of the fundamental instruments in the search for new capital needed to implement the huge funding requirements which economic modernization and its attending social development entail. These requirements have been spelled out based on the research carried out by the Latin American Energy Organization (OCLADE), which estimates that US\$ 19 billion would be required to provide energy supply to Latin America and the Caribbean for a ten-year period. The World Trade Telecommunications Development Report estimated that investment needs for telecommunications will exceed US\$ 3.3 billion annually, and the requirements for pre-investment research and technical assistance in that sector fluctuate between US\$ 70 and US\$ 100 million. In addition, the World Bank estimated that Latin America needs US\$ 50 billion to develop a basic infrastructure, including sanitary installations, highways and roads.

B. Background

In view of the above, many Governments have endorsed private investment in public services and in the infrastructure, since these actions would tend to demonopolize such activities, eliminate unfair competition by the Government, and expose these areas to the efficiency and vitality of a market economy. This process, already implemented in Panama, included worker participation as shareholders of a company; this was accomplished in the case of the sale of Cítricos de Chiriquí (10 per cent) and the Bayano Cement State Plant (5 per cent) in accordance with the Government's economic objectives and the implementation of the privatization law which incorporates the right of workers and rural pioneers to share in the management of privatized companies.

In Panama, Law No. 16 of 14 July 1992 establishes and governs the privatization process of all State enterprises, property and services, and also stipulates privatization mechanisms. The Law was enacted within the

context of a global economic policy of modernizing the Panamanian economy, for which purpose it established the Coordinating Unit for the Privatization Process (ProPrivat).

The law defines privatization as an "action by which the Government transfers to the private sector, upon payment, ownership in enterprises, property, shares or participation rights and relinquishes or cedes to private individuals the management or direct exercise of business activities or the delivery of services". The privatization process established and governed by the Law is based on public interest and social well-being, since the funds obtained from privatization can only be used for investments in infrastructure and for social investment.

Before and after the enactment of the Law of 1992, several privatization actions were implemented. They are summarized below:

Taboga Hotel:

In March 1990, the third convocation was held to sell the physical property and assets of the Taboga Hotel, through public bidding. In November of the same year, the property was awarded to the company Agro Ganadera de Santa Fé, S.A., for an amount of B/.567,000.

Washington Hotel:

The property was sold in September 1991 by means of public bidding to the company Hotelera Falingo, S.A., for an amount of B/.2,001,001.

Balneario de Playa Kobbe: (Kobbe beach resort)

The operation of the resort was transferred to the private sector.

Corporación Bananera del Atlántico:

By Cabinet Resolution No. 77, dated 27 March 1992, the Cabinet Council exempted Corporación Bananera del Atlántico (COBANA) from public bidding and authorized the direct sale of real estate belonging to it and other movable and semi-movable assets. In accordance with the foregoing, on 27 March 1992, Cabinet Resolution No. 79 was adopted, which endorsed the contract between COBANA and the Cooperative for Multiple Services Bananera del Atlántico, R.L., to sell the State enterprise for the sum of B/.6,777,094.

Air Panama International, S.A.:

By unnumbered contract dated 7 November 1991, the enterprise Panama Air International, S.A. acquired the assets of the State enterprise Air Panama Internacional, S.A.

In November 1993, the contract was rescinded by mutual agreement and the Government of Panama reimbursed PANAMA AIR's expenses incurred in good faith, based on a general audit balance approved by the Cabinet Council and the Budgetary Committee of the Legislative Assembly, by Cabinet Resolution No. 655 of 27 October 1993; No. 698 of 17 November 1993 and Resolution No. 34 of 30 December 1993, respectively.

Fábrica de Ropa la Esperanza: (La Esperanza Garment Factory)

The Cabinet Council authorized the grant of an extraordinary credit, as stated in Cabinet Resolution No. 361 of 12 July 1993, as approved by the Legislative Assembly Budgetary Committee in its Resolution No. 12 of 10 August 1993, to lay off the employees of the factory. By Resolution No. 94 of 19 July 1994, the Ministry of Finance and Treasury reallocated the movable assets of the factory to the National Police under the Ministry of Government and Justice.

Proyecto de Palma Aceitera del Barú: (Barú Palm Oil Project)

By Cabinet Resolution No. 751 of 15 December 1993, the Cabinet Council endorsed a proposed agreement among the Ministry for the Development of Farming and Animal Husbandry, the Ministry of Finance and Treasury and cooperatives of palm growers for the immediate and final sale of ownership rights and installations on the public lands on which the Proyecto de Palma Aceitera del Barú was developed, located in the Province of Chiriquí, in favour of the Cooperativa General Omar Torrijos Herrera, R.L. (COOPEGOTH); Cooperativa Corozo Palmito, R.L. (COOPAL) and Cooperativa Empresa Productora de Palma Aceitera (COPEMAPACHI) (Cooperative Enterprise for the Production of Palm Oil), for the sum of B/.6,066,145.

Matadero de Azuero, S.A.: (Azuero Stockyard)

By Cabinet Resolution No. 116 of 24 March 1993, the Cabinet Council authorized the Ministry of Finance and Treasury to transfer to Cooperativa de Servicios Integrales de Productores de Carne y Leche Río La Villa, R.L. (COOPROCAL, R.L.) (La Villa Full Services Meat and Dairy Producers Cooperative) a State loan issued to Matadero de Azuero, S.A. Likewise, payment for the credit transfer to be received by the National Treasury in the form of tax credit, was also authorized, in the amount of B/.2,265,000.

Mention may also be made of the liquidation of the Corporación para el Desarrollo Integral de Bocas del Toro (CODEIBO) (Corporation for the comprehensive development of Bocas del Toro) and the transfer of the enterprise Servicio de Autobuses del Corregimiento de Ancon (SACA) (Bus service of the Corregimiento of Ancon), to the workers' cooperative.

Within the framework of Law 16 of 14 July 1992, the following privatizations of Government enterprises were considered to have been carried out successfully by the Administration then in office:

Cítricos de Chiriquí, S.A.:

The privatization statement for this State enterprise was issued under Cabinet Resolution No. 316 of 4 October 1992. On 16 December 1993, 80 per cent of the shares of the new company established for the purpose, Agro Industrias del Barú, S.A., were sold on the Bolsa de Valores de Panamá, S.A. (Panamanian Stock Exchange) to the company Extractora del Barú, S.A., with Colombian capital, for B/.5,640,000. As a part of the privatization process, an agreement was reached on its labour aspects, under which a co-ownership programme was devised, offering the public employees of Citricos de Chiriqui, S.A. the option to exercise their right of purchase of 10 per cent of the shares of the new company under favourable credit terms.

It was also agreed that the public employees would receive the benefits offered by the Voluntary Retirement Programme for Public Employees.

The company co-ownership plan also gave the public employees priority rights to purchase shares of the new corporation, at the price paid by the other shareholders.

Empresa Estatal de Cemento "Bayano": ("Bayano" State Cement Company)

The privatization statement concerning this Government enterprise was contained in Cabinet Resolution No. 122 of 31 March 1993. On 19 August 1994, a public offering was made of 95 per cent of the shares of the company Cemento Bayano, S.A., on the Panamanian Stock Exchange. The company was sold to the consortium Corporación Panamena de Cemento, S.A. (CORPACEM), with Mexican and Panamanian capital, for the sum of B/.59,660,000.

The Government received over US\$10 million above the base price established for the sale. The sale of Empresa Estatal Cemento "Bayano" also envisaged, as part of the transaction, a co-ownership programme through which public employees might acquire 5 per cent of the shares of the new company, with a discount taking into account their seniority and salary level. The programme offers public employees the option to join the Voluntary Retirement Plan or to receive an indemnity for being terminated, calculated on the basis of existing labour legislation.

Transport Sector:

In the port authority sector, a contract for the operation, development and management of a container terminal in the Harbour of Manzanillo, Coco Solo, Colón Province, was approved by Law No. 31 of 21 December 1993, for an annual amount of B/.8,000,000.

In December 1994, a concession in the same form had already been granted for the construction, operation and maintenance of the north lane of the Panama-Colon highway.

The following other privatizations are currently being implemented:

Corporación Azucarera la Victoria:

The Cabinet Council, by Resolution No. 563 of 22 September 1993, authorized the implementation of an action plan to undertake a technical survey aimed at identifying a sugar policy and options that would result in the Corporation's increased profitability. In March 1994, in collaboration with the Technical Negotiation Unit for the Economic Programme of the Ministry of Planning and Economic Policy, terms of reference were worked out to hire a group of specialized consultants to conduct the above-mentioned survey, with the help of the World Bank. The terms of reference for the future hiring of a group of consultants who will define a sugar policy and the modalities for future privatization are currently being revised by a joint commission which includes members of ProPrivat, the Ministry of Planning, the Ministry of Agriculture and Corporación Azucarera la Victoria.

Instituto de Seguro Agropecuario: (Farming and Animal Husbandry Insurance Institute)

In November 1993, draft legislation was submitted to the Legislative Assembly for the purpose of allowing competitive farming and animal husbandry insurance on the market, thereby eliminating the Government monopoly. The draft legislation was endorsed by the Cabinet Council and is currently awaiting discussion by the Committee for Farming and Animal Husbandry Affairs of the Legislative Assembly.

Telecommunications Sector:

In the telecommunications sector, terms of reference are being prepared with the help of an international

consultant to grant a concession to operate cellular telephone Band A in Panama. This activity should be completed in the course of the current year.

As has already happened in previous cases, in Panama as well as in other countries, the sale of these enterprises encountered opposition from various groups who are against their privatization.

Due to the importance of such public services as telecommunications, energy and water supply, the Legislative Assembly decided that the privatization of those activities must be governed and regulated by specific laws. One of the key procedures to ensure private contribution to the delivery of public services is to define the legal and institutional framework and the mechanisms which will regulate the delivery of those services, and establish a regulatory agency for that purpose.

At the end of 1992, the Government unsuccessfully submitted draft legislation for the privatization of the telecommunications company, the National Institute of Telecommunications (INTEL), to the Legislative Assembly. The new Government obtained approval for the privatization of that company and of the power supply company (IRHE) in February 1995.

The political debate engendered by the privatization process slowed down the approval of initiatives in that area. In the opinion of some, the privatization process has not achieved the promised goals, while others believe that it consists of actions aimed at reducing the number of public service employees and therefore will only increase the social cost of the economic and modernization programme without offering in exchange anything concrete in terms of benefits for the neediest sectors of Panamanian society.

Public opinion, in Panama and in other countries, tends to associate privatization with the fact that it will affect a number of workers who will be terminated after the companies being transferred undergo restructuring and modernization and come under the control and private management of multinationals or new investors. While it is true that the idea of privatization has encountered a great deal of resistance, especially from labour groups representing public service employees, it has been observed that, as proposals and benefits derived from the process become better known, the concept is gradually being accepted, not from ideological or political considerations, but as part of a strategy aimed at increasing economic efficiency, increasing competitiveness in a market economy, restoring the health of public finances, encouraging economic growth, and enabling workers to participate in the ownership of the new companies. There are also many instances in which the injection of new capital has resulted in expanded services, diversification of services, increased numbers of customers served, and as a corollary, a significant surge in new, better-paid jobs.

C. Private participation and the development policy programme

1. Public enterprise policy

One of the components in the country's public policies for overall development is the restructuring and privatization of public enterprises. That component opens up broad investment opportunities to the private sector (local and international) in activities concerned with the production of goods and services which had hitherto been the exclusive domain of Government institutions and corporations.

The inefficiency, unreliability and high costs of public services are some of the obstacles to an improved and more competitive economy. In that context, the President of the Republic, Dr. Ernesto Pérez Balladares, stated in his inaugural address, on 1 September 1994: "to these factors should be added the historical inadequacy of some

public services: unreliable electrical power, scarcity of safe water supplies, inadequate telephone service, expensive and inefficient harbours and a poor public infrastructure". This points to the urgent need to modernize the State through the implementation of a coherent set of public policies aimed at the overall development of the economy.

In choosing the instruments by which the private sector could participate in the delivery of public services, options are being sought which will bring about the greatest possible increase in efficiency, reliability and rationalization of costs of the services delivered. This should translate into lower rates, expanded user access, alternative choices to the population and other benefits. In order to achieve all these objectives, the following actions may be undertaken:

- (a) With some exceptions, public companies will be converted into corporations owned by the State with boards of directors freely elected, and with the President of the Republic retaining the deciding vote. These corporations will be required to publish financial statements audited by independent auditors in accordance with generally accepted accounting standards.
- (b) For each of the large enterprises providing basic public services, the best possible method will be selected to incorporate domestic or foreign private capital into their financial and administrative structure.
- (c) Operation of the major harbours will be contracted out to operators having international experience in the field, while the State will retain ownership of the facilities as well as the authority to levy taxes, as is commonly the case for the majority of modern harbours.
- (d) All funds proceeding from the sale of shares in public enterprises or from privatization will be paid into the Development Trust Fund (FFD), which will allocate the money only to permanent and productive investment programmes in areas of social development compatible with the plan. Such resources may never be used to pay off the internal or external debt or to cover routine Government expenditure, as stipulated under Law 16 of 14 July 1992.

2. Programme and implementation for the period 1994-1995

If the programme is to be successful, various actions will have to be combined and undertaken by a similarly oriented "Government team" provided with financial resources, political support and a local, high-level staff assisted by consultants and experts in each field, and an organization headed by the Ministry of Finance with a clear awareness of what it wants to achieve. In that respect, the action programme outlined below, with specific deadlines which must be met, represents an additional challenge for the organization and operations of ProPrivat which must provide the necessary coordination among institutions, their technicians, and foreign experts, in order to achieve the goals of the 1994-1995 Programme. The actions which are of the most critical importance in attracting private participation are mainly related to transactions involving three institutions: the National Telecommunications Institute (INTEL), the Institute of Water Resources and Power Supply (IRHE), and the National Port Authority (APN). To summarize, INTEL must consider the matter of Telefonía Celular, the creation of a regulatory body for telecommunications, and the subsequent sale of 49 per cent of INTEL, S.A. shares. The task of IRHE is to complete its analysis of a regulatory body which will govern the concession to design, build and operate the Estí Hydroelectric plant; lastly, APN must proceed with its study of and options for the concession involving the Harbour of Cristóbal, including that of other harbours, the consideration of a railroad and its future prospects, and the establishment of a regulatory mechanism. For each of these institutions, a work plan has been established as follows:

(a) Instituto Nacional de Telecomunicaciones (INTEL) (National Telecommunications Institute)

(i) Draft bill of incorporation and bill covering the regulatory body. The Institute is responsible for coordinating the actions taken under the law to authorize the incorporation and subsequent sale of 49 per cent of the shares, in accordance with the draft bill approved by the Legislature in February 1995. A revision and commentary on the law to institute a regulatory body was initiated at the beginning of 1995 and will be submitted to the Cabinet Council and forwarded to the Legislature in April 1995. The regulatory body will establish mechanisms whereby competition and an objective evaluation of services without political interference or pressure are made possible, setting forth a clear definition of the rights of concessionaires, their functions and obligations, quality control of services, rate controls, etc;

(ii) Implementation of the regulatory body's operations. By mid-1995, the sealed bids to contract the consultants responsible for the implementation of the regulatory body for telecommunications must be ready. This unit must have a structure, budget, staff and resources to train very high-level technical personnel, and to obtain the funds necessary to purchase equipment and technology, enabling it to carry out its task of supervising and regulating services, rates, investments, and the use of new technology. After the consulting firm has been hired, all research and implementation tasks, which are funded by the World Bank, are expected to continue through 1995 and into the beginning of 1996, at which time the regulatory unit should be installed and operating, ready to function in conjunction with the sale of 49 per cent of the INTEL shares;

(iii) Sale of 49 per cent of INTEL Shares. This action requires a sealed bidding process and the hire of consulting firms and investment banks to analyze the technical and financial aspects, the demand, the value of the assets of the company before selling, and the rights and obligations of INTEL, S.A. The research, preparation of contracts and determination of the final conditions of sale must be completed by the end of 1995 so that the sale can take place in the first months of 1996. The World Bank, through the Ministry for Planning and Economic Policy (MIPPE), has granted funds to INTEL for these purposes; and

(iv) Cellular telephones concession. After examination by the OAS in November 1994, the process was assisted by experts from Coopers & Lybrand December 1994 - February 1995, at which time a formal visit by an OAS consultant, with the assistance of ProPrivat, will be arranged for a final review of the sealed bids of Telefonía Celular, and the procedure should be concluded by April 1995. Once this is done, ProPrivat will draft a Privatization Statement approving the study and its modality by April, and will solicit bids for the international consultancy agreement. The consultants should participate in the preselection of investors, in drafting the provisions of the concession contract, and, with the help of the Government, establishing a reasonable price and the rights of the concession, setting up a sales plan, and conclude the concession with Telefonía Celular no later than September 1995.

(b) Instituto de Recursos Hidráulicos y Electrificación (IRHE) (Institute of Water Resources and Power Supply)

(i) Regulatory framework. This institution does not have any definite medium-term programme to extend access by the private sector to its generation, transmission, distribution and marketing activities. It is nevertheless obvious that in order to grant a concession for the Estí Hydroelectric Plant, a regulatory framework covering electric power generation must be worked out. To that end, and pursuant to agreements with the OAS mission in November 1994, a consultant already approved by IRHE has been hired for March 1995. The task will involve a final revision of the sealed bids, and the award of a contract to a consulting firm to establish a regulatory framework which will give guarantees to the strategic investor. This activity should be completed by September

1995 in order to implement the Estí concession;

(ii) Law governing concessions in the electric power sector. The draft bill and related observations were submitted to the Cabinet Council in December 1994 with a view to obtaining its endorsement and subsequent submission to the Legislature during extraordinary sessions in order to proceed with the bidding and concession at Estí. This objective was achieved with the recent approval of Law 42 in February 1995, which enables IHRE to transfer to private hands as much as 42 per cent of its "electric power generation". A draft bill for the creation of a regulatory framework and agency will be submitted to the Assembly in the course of the next session starting in March 1995; and

(iii) Bidding concession for the Estí Hydroelectric Plant. The OAS mission has entered into a consultancy agreement with IRHE, with both institutions sharing the cost, under which an expert is to prepare the Estí bidding procedure, with the assistance of other national experts. IRHE will then proceed with the bidding for this project within two or three months following approval and acceptance of the recommendations.

(c) Cristóbal Harbour-Railways

The importance of granting a concession for Cristóbal harbour has become evident because of the need to meet the competitive challenge presented by the installation of the port of Coco Solo, which will be operated by MOINSA, as both harbours are in the Atlantic sector of the Panama Canal. Another option which must also be considered is that of attracting strategic concessionaires who might consider the advantages of linking the harbours of Balboa and Cristóbal at either end with a dry container transit canal between the Atlantic and the Pacific. Following this line of action, ProPrivat has requested that APN prepare an information package for each harbour (Balboa and Cristóbal) in order to assist the consultants and to speed up their task, and to assess the benefits these facilities offer to strategic investors who might consider it advantageous to have a harbour at both oceans, Atlantic and Pacific, scarcely 75 km apart, at both entrances to the Panama Canal.

Panama Railways has been the object of an endless number of technical surveys of various kinds and of recent Japanese and Spanish consultant surveys done by the Japan International Cooperation Agency (JICA) and the Spanish Cooperation Agency, respectively. There are also surveys made by Canadian and Argentinean groups which have been under review by the OAS mission since November 1994.

This mode of transportation is considered a "dry canal", but it need not just be a mode of passenger transportation between the cities of Panamá and Colón, and could compete very advantageously in the area of cargo transfer. In April 1995, the results of the above-mentioned surveys will be analyzed and, with the assistance of the OAS, the terms of reference used in the technical and investment analyses will be established, and its linkage to the transit between the harbours (Balboa and Crístobal) of the Atlantic and the Pacific will also be considered. Thus, the Government's possible options will be set out in relation to the concession transactions for the harbours which are to take place in October 1995. These tasks will be executed with the assistance of ProPrivat as recommended in discussions with consultants for the selection of the Government's best option in negotiating the concession.

(d) Corporación Azucarera La Victoria (La Victoria Sugar Corporation) Survey and proposal for a sugar policy—options to improve competitiveness in the sector

Since October 1994, ProPrivat has made observations concerning the preliminary terms of reference being set forth by the Ministry of Economic Policy and Planning (MIPPE) for the purpose of implementing a sugar

policy and defining options to improve the corporation's productivity. In November, ProPrivat expanded on its comments regarding the terms of reference which were to be established in consultation with the World Bank with a view to initiating surveys and defining a policy for the sugar sector. A policy is expected to be defined and implemented between July and December 1995. Recommendations for subsequent actions to increase competitiveness and productivity in the sugar industry and the possibility of opening to private investment after 1995 are also to be included in the surveys.

In February 1995, ProPrivat signed a technical assistance agreement with the Organization of American States for a sum exceeding US\$ 200,000. The agreement covers the following activities to be carried out during the next two years:

SECTOR	INSTITUTION	ACTION
1. ProPrivat	Ministry of Finance and Treasury	Coordination, promotion and dissemination
2. Communications - INTEL Sale - Regulatory framework - Telefonía Celular	MGYJ	Privatization Regulatory Agency Concession
3. Harbours	Port Authority	Concessions
4. Railways	Panamanian Railways	Concessions
5. Energy supply - Law & regulatory framework	IRHE	Regulatory Agency Concession/Privatization
6. Water supply and sewers	IDAAN	Restructuring
7. Solid urban waste	DIMA	Restructuring
8. Games and betting		Concession
9. Sugar factories		Privatization
10. Correction Department	MGYJ	Concession/ Construction
11. Farming and Animal Husbandry Market Institute		Privatization
12. Public Register		Restructuring

7. PRIVATIZATION IN PARAGUAY

A. Introduction

The decision to privatize is a sign of our times. From France to the Soviet Union, from China to Germany, from Austria to Paraguay, everywhere new methods of privatization are being discussed, adopted and put to the test.

The general context in which this process is taking place in Paraguay is as follows. Agriculture is the dominant sector of the economy (26.3 per cent of GDP in 1992). It employs almost half the active population and accounts for the country's principal exports: cotton (35-40 per cent of exports) and soy (20-30 per cent). Industry (23.4 per cent of GDP) is mainly engaged in the processing of agricultural products (textiles and processed foods). The country exports a major part of its energy output to Brazil, its main market, which accounts for 28 per cent of exports and 21 per cent of imports.

As a combined result of its tight-budget policy and good crops in 1993 (after two years of drought), the country shows favourable macroeconomic indicators. GDP increased by 3.7 per cent in 1993 and inflation is under control at 20.4 per cent.

In 1994, the yield of cotton and soy crops increased by 5 per cent. This level of activity will draw investments to the energy sector. Yacyreta, another dam under construction, will be operational in 1995, while hydrocarbon mining will be developed, especially the recently discovered gas reserves of the Choco (300,000,000 m³). In 1994, the growth rate was 5 per cent. The World Bank anticipates average sustained growth of 5 per cent to the end of the decade.

The unification of exchange rates, freeing interest rates and the inauguration of a stock exchange were the hallmarks of a thorough reform of the financial system, which has now become less rigid and more effective in tapping national savings. The reduction in public expenditure parallels the December 1991 tax reforms. The new tax system is much simpler and undoubtedly more efficient. Since the end of 1993, only three tax rates are applied: 3 per cent on semi-finished goods, 5 per cent on capital goods, and 10 per cent on all other goods.

The new reform plan revolves around an ambitious privatization programme which comprises the national airline, the railways, the river merchant fleet, distilleries, cement plants, steel mills, the telephone company, etc.

The Treaty of Asunción, to which Argentina, Brazil, Uruguay and Paraguay were signatories, marked the opening, on 1 January 1995, of a new common market which includes the free transit of goods and services, capital and labour, the elimination of tariffs and unquantified obstacles, the preparation of common external tariffs (general categories of 20 per cent) and the coordination of economic policies.

The Mercosur constitution is of particular significance to Paraguay, a country with a relatively open market (exports/GDP ratio of 20 per cent). The implementation of the reform process should enable Paraguay to take advantage, in a general way, of the inter-regional exchange activity deriving from Mercosur. The foreign investment regime is an advantageous one and the country's wage levels are one-third lower than those normally prevalent in Argentina and Brazil. Such conditions may stimulate direct investment, especially in the textile and food processing sectors.

Paraguay has repurchased the greater part of its debts to commercial banks (with a discount) and has relieved its bilateral creditors from late payments in accordance with the Club of Paris framework. In consequence, apart from deriving good commercial results from these actions, the country experienced a meaningful reduction in its debt service, which now represents 10 per cent of exports. At the end of 1993, the debt amounted to \$1.73 billion or 28.0 per cent of GDP. Paraguay's tolerable burden of debt should enable it to obtain new bank loans even though new multilateral loans may become essential in financing its development.

B. STATED OBJECTIVES OF THE PRIVATIZATION PROGRAMME

The Government of Paraguay recognizes and supports the privatization programme as one of the instruments for the reform of the public sector. The purpose of privatization is to inject into activities hitherto protected from competition the discipline and efficiency of the private sector as well as to expand and develop such activities.

Nevertheless, in Paraguay privatization is a political as well as an economic process. A realistic privatization strategy must identify those who will in all likelihood benefit from the process and those who will not, and the nature of their concern. Paraguay has worked out a strategy which is sensitive to the political situation and the structure of the privatization process must therefore address and allay such concerns as much as possible.

The Government's commitment to privatization is a critical element in any future implementation strategy. In order to further this process, all of the Government's plans have been identified clearly, and so have those of the relevant Ministries and the Privatization Council. This will ensure that the strategy mapped out for each enterprise will succeed in substantially achieving these goals. Such plans form the framework of the different strategies (social, legal, financial, and accounting) and their ultimate objective is to introduce into the privatization programme such elements as employee participation in privatized enterprises, the avoidance of defaults which may result from the transfer of enterprises to interested but unprepared investors, etc.

An essential element in working out privatization strategies was the clear definition of objectives for which options were spelled out and compensatory devices identified to correct differences, and sometimes conflicts, between objectives. For example, a compromise was sought between the need to maximize revenues from the sale of assets and the stimulus provided by the introduction of new technologies by foreign investors, and their beneficial repercussion on the country's social and economic life.

On the other hand, a key decision was to identify the restrictions which Paraguay's political and regulatory policy impose on the privatization process, of which they form an integral part. Legal restrictions will be kept under continuing review and any restrictions applying specifically to privatization or the restructuring of privatized enterprises, as well as their impact on the Paraguayan Government's overall objectives, will be examined.

A wide disparity of opinions exists in our society, as indeed in all others, with respect to what should be in the private sector and what should remain under the jurisdiction of the public authorities. Our country has, in actual fact, a wide-ranging public sector which is inefficient and politicized. In a democratic and free society, legal rights must be protected and due process observed. A realistic strategy must take into account political restrictions and the privatization process must be set up in such a way as to address and allay concerns arising from it.

C. THE DIFFERENT PROGRAMME MODALITIES CONSIDERED

A democratic and free society must safeguard legal rights and uphold due process. The first question was: which privatizations should take precedence? Which sector will benefit the most from privatization? In what direction should we focus our efforts?

The experiences of other countries point to the following criteria:

(a) **COMPETITION:** National enterprises which would be very competitive were it not for State control and ownership, were considered to be the best candidates for privatization. The argument is a simple one. The competitive system is extremely efficient in providing motivation to reduce costs and to satisfy consumers and customers.

On the other hand, national enterprises are mainly concerned with political patronage in the area of employment, and possibly investment as well, but are minimally interested in the customer. Their output consists of useless work rather than serviceable products. A competitive privatized enterprise will eliminate a large part of the waste.

(b) **RAPID TECHNOLOGICAL CHANGE:** When an industry is either in the process of or about to undergo rapid technological change, that industry must be regarded as a prime candidate for privatization, even if it is not competitive. The fundamental reasons here are obvious. Enterprises under political and bureaucratic control are less likely to engage in the difficult task of adapting to rapid technological change or initiating it. It has been amply demonstrated, theoretically as well as by experience, that a public service employee is not the best person to make such decisions.

The fact that these criteria presented themselves in establishing the Government's privatization policy does not mean that they were the only aspects considered. As may readily be assumed, there were many others.

It is understood that the object of privatization is to transfer control to the private sector. In legal terms, this means that a number of shares representing more than 50 percent of the total are sold to the private sector.

In practice, a major part should be sold to the private sector so that the part held by the public sector is small enough not to constitute a danger.

However, how should the transfer be effected? We found several methods:

(a) By issuing fixed-price shares. Government shares are offered for sale at a price which is usually set before the bidding begins;

(b) By selling shares to the highest bidder. Instead of setting a price, the Government offers the shares and invites investors to indicate the prices which they would be prepared to pay for a specific number of shares; and

(c) By merger, placement of shares, and purchase by management and employees. Merging one company into another and placing shares are perhaps typical methods of acquiring assets in the private sector.

In principle, the choice between the fixed-price method and that of sale to the highest bidder depends on the

precision with which the issuer is able to establish the market value of the shares.

D. PRIVATIZATION PLANS FOR PARAGUAY

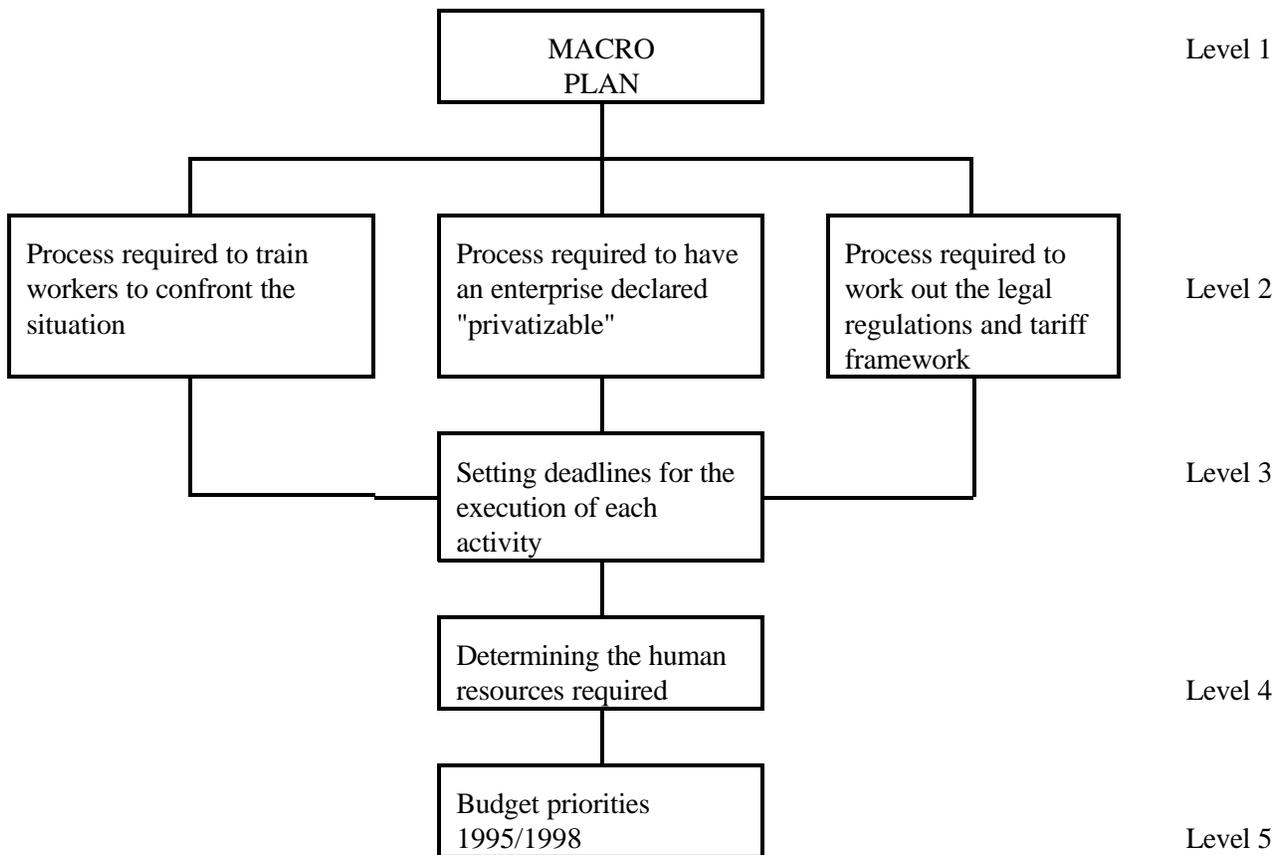
In Paraguay, privatization still has a long way to go. That journey may be broken up into four stages. The first stage involves the privatization of those enterprises which have been found to be "privatizable", or of assets which should be converted into private property.

The second stage covers the privatization of enterprises which it is agreed by all should be transferred to the private sector. These are the companies which have long ago been placed on the list of enterprises to be privatized. This might be referred to as the official privatization programme.

The third stage concerns those enterprises which have not yet been placed on the official lists of companies to be privatized, but because of their precarious position are gradually creating a consensus that their privatization is needed in a relatively short time.

The fourth stage would cover those companies or sectors for which private capital participation would be beneficial, but where the prevailing political trend does not yet permit it.

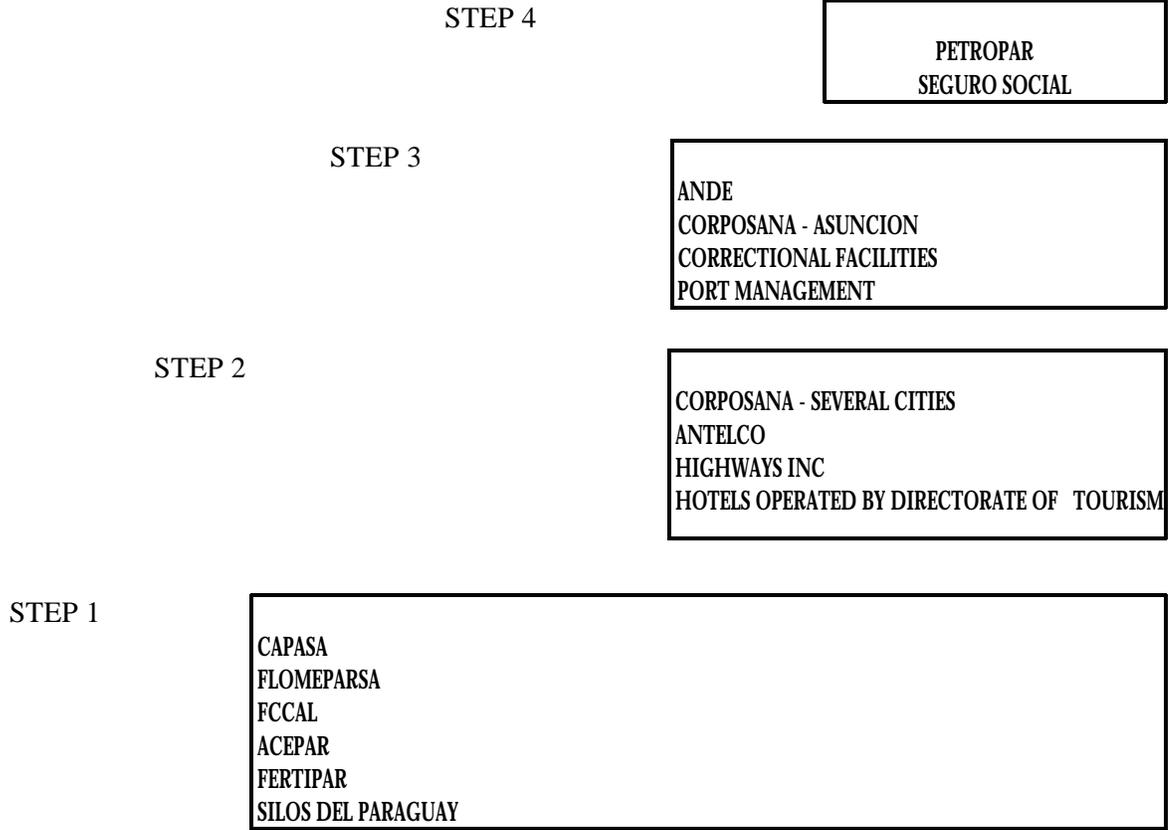
This does not necessarily involve the sale of enterprises but a gradual opening up to private capital participation.



RESULTS SOUGHT

- LEVEL 1: Should produce a priority plan, using the "level of consumption" as a frame of reference.
- LEVEL 2: Detailed listing of the activities comprised in each "process", preferably in order of progression.
- LEVEL 3: Estimation of time required to carry out the activities identified. Sufficient time must be allotted for their realistic accomplishment.
- LEVEL 4: Determination of the resources required to put into operation the activities identified. This should include human as well as general resources.
- LEVEL 5: By combining the data obtained at the third and fourth levels, we should arrive at a first budget priority project for 1995/1998.

LEVEL 1 - MACRO PLAN



+)) ,
 * LEVEL OF CONSENSUS
 .)) -
 HIGH

*
 LOW

E. CURRENT STATUS OF PRIVATIZATION IN PARAGUAY

(a) LINEAS AEREAS PARAGUAYAS SOCIEDAD ANONIMA (PARAGUAYAN AIRLINES)

On 29 August 1994, the tenders for the sale of 80 per cent of the shares in Líneas Aéreas Paraguayas Sociedad Anónima (LAPSA) were opened and three offers were made: "Consortio Cielos de América" (Skies of America Consortium), "Consortio VASP & PARAGUAY" (VASP & PARAGUAY Consortium) AND "Sady Bazan de Noguez". The award was made to Consortio Cielos de América, a group of entrepreneurs from Paraguay and Ecuador, which submitted the highest bid.

On 21 October 1994, a transfer agreement for the shares of LAPSA was signed by the Government of Paraguay and Consortio Cielos de América.

(b) Consultancy Agreement to advise the Privatization Council on the Privatization Programme of public companies declared "privatizable:" "Aceros del Paraguay S.A. (ACEPAR)" (Paraguayan Steelworks), "Canas Paraguayas Sociedad Anonima (CAPASA)" (Paraguayan Cane), "Ferrocarril Central Carlos Antonio Lopez" (Central Carlos Antonio Lopez Railways), and "Flota Mercante Paraguaya Sociedad Anonima (FLOMPARSA)" (Paraguayan Merchant Marine Fleet)

On 17 March 1994, the tenders of previously qualified companies were opened. The bidders were: "Banque Paribas and Associates", "Coopers & Lybrand International and Associates", "Price Waterhouse and Associates", "Ernst & Young", and "Pistrelli, Díaz and Associates". The bid was won by Consortio Banque Paribas y Asociados and work began on 15 November 1994.

(c) Work began on the preparation of the regulatory and tariff framework for the Corporación de Obras Sanitarias (CORPOSANA).

(d) The work of planning, designing and drafting a privatization project for the National Cement Industry was begun.

(e) Starting in the second half of February 1995, bids for the following entities will be accepted:

- Planta Industrial de Fertilizantes Paraguayos (FERTIPAR) (Paraguayan Industrial Fertilizer Plant), located in the District of Bella Vista, Itapúa Department.
- Silos located in the following towns: Villeta, Capitan Meza, Fram, Raúl Peña, J.E. Estigarribia, Santa Rosa de Aguaray, and Pedro Juan Caballero.
- A total of six buildings located in Asunción, property of the Paraguayan Liquor Administration.
- One building located in Asunción, property of the Flota Mercante Paraguaya Sociedad Anónima (FLOMEPARSA) (Paraguayan Merchant Marine Fleet).
- Hotels which are the property of the General Directorate of Tourism, located in the towns of Ayolas and Villa Florida.

8. PRIVATIZATION IN URUGUAY

A. Introduction

The purpose of this paper is to assess and review very briefly the main issues in the privatization process in Uruguay. As will be seen further on, this process has been limited in scope and depth due to the few but powerful State-owned enterprises and to idiosyncratic factors founded on more than 50 years of a welfare state and patriarchal legislation. This prevented many of the privatizations and restructurings that were planned during the period of 1990-1994. The few processes that were successful were plagued with problems during the first stages. In spite of this, many lessons can be drawn from the Uruguayan experience that can be used to evaluate new proposals elsewhere. The chapter concludes with a statement of the main conclusions of the experience and a series of recommendations for future plans.

B. The Privatization Programme in Uruguay: A Retrospective

1. BACKGROUND

In the last five years, the Government has taken a series of actions and measures intended to resolve problems endemic to the country, such as the trade deficit and inflation. For this purpose, short-term measures were taken which were intended to decrease and rationalize public expenditure and increase tax revenue. In addition, in order to create conditions in the medium and long term conducive to sustainable development of the Uruguayan economy, an effort was made to implement measures intended to establish an adequate macroeconomic framework for the country. Among these were industrial reconversion, reform of social security and reform of the State. The privatization programme in Uruguay is a part of the last of these reforms. Given the latitude of the term privatization, we shall understand it to mean any identifiable programme or activity intended to promote increased participation by the private sector in the economy, improve the interrelation of individuals with public institutions, and repropotion and rationalize the State's area of action. With these goals in mind, we turn to an analysis of the process of privatization, in terms of the administration's efforts and achievements in that field.

2. OBJECTIVES

(a) General objectives

(i) Reduction of the State's activities in those areas in which the private sector can operate more effectively, through private provision of the goods and services supplied by the public sector, the transfer of productive activities to the private sector in order to increase their efficiency and return and by eliminating, simplifying and making more flexible the procedures and controls for the exercise of private activities.

(ii) Improvement of the State's management in all its areas of activity through rationalization and modernization of the activities carried out by it or contracted to private entities in order to improve management and organizational downsizing and resulting in an increase in the quality of the goods and services provided by public agents.

(iii) Establishment and improvement of the institutions intended to regulate the relations between private concerns and between private concerns and the rest of society or the State.

(iv) Redefinition of the State's role in the economy, centring its activity on regulatory concerns rather than direct production of goods and services, so as to enable it to fulfil more effectively the functions inherent in it and which therefore cannot be delegated.

To achieve these objectives the Government of Uruguay has prepared and implemented a series of programmes carried out by specific technical units and supported by legislation.

(b) Specific objectives

Beyond the objectives set out above, the privatizations planned or carried out sought to achieve a series of material objectives which can be summarized as follows:

- (i) To improve the quality of the services, price, efficiency and effectiveness of the units involved;
- (ii) To reduce the size of the State and the tax burden involved in maintaining the enterprise or unit in question;
- (iii) A substantial increase in investment in the sector of the unit involved resulting in the modernization of equipment and the extension and strengthening of the service in question.

3. STRATEGIES EMPLOYED IN PRIVATIZATION

The strategies employed in the various cases of privatization varied depending on the characteristics of the unit or service in question, but the general procedure may be summed up as follows:

- (a) Identification of the areas requiring a priori redefinition of the role of the State and the units interacting within them;
- (b) Establishment of the legal framework and regulations on the basis of which the privatization and/or restructuring of the enterprises or units involved was to take place. This included the establishment of specialized technical and economic support units for the enterprises. In some cases specific legislation was passed, for example the Act concerning ports and the Securities Demonopolization Act. The Public Enterprises Reform Act contained a series of elements of differing character.
- (c) Careful analysis of each enterprise or public entity relating to the sector under analysis. Assessment of the framework within which it operates, identifying and evaluating in each case the various viable alternative solutions to their key operating and development problems. (Some analyses were made before the adoption of the legal frameworks).
- (d) The next stage consisted of implementation of the strategy which would permit solution of the problems detected in the previous stage. This solution might vary from the restructuring of the enterprise while retaining its current legal form to the complete privatization of all the services provided by it, passing through a whole range of possible combinations.

In all cases in which the State's presence is not justified an attempt will be made to encourage the participation of the private sector in the provision of goods or services. The technical solutions suggested should take into account the political, legal and institutional viability of total or partial participation by the private sector

in each of the sectors currently occupied by public enterprises and the regulation to be applied to the private sector once the process is completed.

C. Public Enterprise Reform Programme

1. GENERAL

Unlike the other Latin American countries, Uruguay has a small number of public enterprises, although they are of great size and weight in the sectors they operate in. Uruguay's public enterprises are characterized in general by the following elements:

- (a) The monopoly or exclusive character of the provision of certain goods or services;
- (b) Authority and the use of that authority for the actual technical and economic regulation of its own areas of activity and the activities carried out by the private sector in its area;
- (c) With some isolated exceptions, Uruguay's public enterprises function in areas traditionally regarded as public or strategic services;
- (d) A great confusion of objectives in the exercise of entrepreneurial and State functions, particularly in administration and decision-making, because of political directives;
- (e) The persistence of operational surpluses, although with a decline in the level of real charges, except for two of them—AFE (railways) and PLUNA (commercial aviation);
- (f) Employees of the enterprises are governed by public employee rules although they are in enterprises carrying out entrepreneurial activities and facing competition.

2. MODERNIZATION AND DEREGULATION OF THE PUBLIC ENTERPRISE MARKETS

The strategies employed in the modernization and transformation of public enterprises have been varied in nature, depending on the sectors involved and the structure of the market in each sector. Thus, the Government has succeeded in achieving various degrees of participation by the private sector depending on the level of interest in the service or activity and its strategic character, and within the political restrictions in the framework of privatization (the sale of enterprises or majority participation in them) and the possibilities of granting concessions in the sector. Among the possible strategies and formulas employed, mention should be made of the liquidation and sale of assets to the private sector, association with private capital under the majority system, the concession of new public services to private entities under the BOT (build, operate and transfer) system, rental, licensing or granting of authorization to use publicly owned goods to provide public or private services. Of these, the main strategies are noted below:

- (a) Elimination of commercially non-viable public enterprises (or units of them)
 - ILPE (State Fishery and Sealing Industries). This was a commercial enterprise engaged in fishing and fish processing and in the sealing industry. This activity was carried out by the State in competition with private agents, except with respect to sealing. The enterprise was characterized by huge operating losses in a commercial activity clearly entrepreneurial in nature and in the absence

of any strategic public service considerations. Because of the deterioration of the enterprise, the Public Enterprises Act (No. 16211, adopted in November 1991 and partially rescinded by referendum in December 1992) provided for the liquidation of the enterprise's assets, which was completed in 1992. It should be pointed out that this decentralized service also carried out regulatory activities with regard to sealing in Uruguay, thus confusing the roles of operator and regulator.

- El Espinillar. This entity consisted of a sugar refinery and 4,000 hectares of land which were the property of a public enterprise, ANCAP (National Fuel, Alcohol and Cement Administration), and had been created for the purpose of promoting industrial development in sugar refining in Uruguay. Sugar production in Uruguay had survived as a result of a policy of subsidization and commercial protection. Being a non-competitive activity, when these distortions were eliminated and it faced a regime of competition, it incurred large losses. The land was recently divided and sold to four private enterprises and the machinery was sold as scrap.

(b) Transfer of the operation of public enterprises to the private sector

- Montevideo Gas Company. This business, which was not legally a public enterprise, had been conducted by private operators until it was expropriated by the State in 1973 because it was felt that its state of abandonment at that time endangered the provision of a public service. Probably because it was subject to price control and its rates (and consequently its profitability) declined in real terms, its expansion halted and its infrastructure decayed. For example, 50 per cent of the network was more than 70 years old, as no line replacement work had been carried out for more than 25 years. Likewise, the obsolescence of the plant's technology and the age and condition of its meters, among other things, pointed to the need to invest in priority areas in order to enable the service to function efficiently. Consequently, and in order to maintain a balanced budget, the adjustment of rates by a parametric "cost place" system tended to institutionalize operating inefficiencies, making the rates for gas distributed by the network the most expensive in the country.
- PLUNA (First Uruguayan Airlines). Established in 1935 as a private initiative and later nationalized as a public enterprise with no possibility of participation by the private sector. The purely commercial character of the activity and the degree of competition in the sector justified allowing it to operate according to private sector standards, which would give it greater flexibility and freedom of movement in decision-making. The burden of controls, the rigidity of the public statutes and the lack of economic incentives had led to an enterprise with a high level of indebtedness, a relatively old fleet and a high number of employees per aircraft. The form of privatization provided for in Act No. 16211 is a corporation with majority private participation rather than total sale. The participation of private capital in the enterprise will be accomplished through the establishment of a new enterprise, PLUNA SEM (joint enterprise) in which the State will receive 49 per cent of the shares and the private consortium 51 per cent. By this means, the State will ensure a greater return on a possible future sale of its share of the enterprise than it would obtain from a sale under present conditions.

D. Innovations in the Operation and/or Administration of State Property

In recent years, in addition to the privatization of public enterprises described above, and as a mechanism for providing greater participation by the private sector, a series of instruments has been used to transfer activities to the private sector, which constitutes an innovation with respect to the administration of State property. The

following are examples:

1. Contracts in the form of public works concessions

The concession of public works is a legal instrument enabling a private agent to construct and operate new State or municipal owned works, thus transferring the financing and operating risks and costs to the concessionaire, to be recovered through the income from the operation of the works. At the end of the concession period the operation of the works reverts to the State.

(a) MTOP (Ministry of Transport and Public Works). Montevideo-Punta del Este Highway Project. This is the first case of a highway operated by a private group. Traditionally the construction of roads on national routes was financed by the entity itself and international institutions, with the MTOP assuming the risks of operation.

(b) Compania del Gas. All the expansion and major renovation works offered for competitive bid by this enterprise will be carried out under this system.

2. Concessions and transfers of operations under the Ministry of Defence

(a) Laguna del Sauce Airport. This is the first international airport operated by the private sector in South America.

(b) Domestic freight airline. This service was previously provided by the Air Force (military air transport).

(c) Ground support in the Carrasco International Airport. These services were provided by the State enterprise PLUNA.

(d) Cargo terminal in the Carrasco International Airport. The terminal was operated by the General Directorate for Air Infrastructure of the Ministry of Defence.

3. Reprivatizations

(a) Bank restructuring programme. The purpose of this programme was to transfer to the private sector three large commercial banks (Banco Comercial, Banco Pan de Azucar and Banco La Caja Obrera) which had been taken over by the monetary authority and operated by the National Development Corporation with a view to their restructuring and sale. The monthly losses incurred by these three institutions averaged three million dollars. Two of the institutions have already been restructured and sold and the third will be sold during the current year.

(b) Canelones and Colonia Cold Storage Plants. In order to avoid the failure of these production units and the consequent loss of foreign markets, the National Development Corporation assumed 100 per cent of the shares of these two establishments in 1988. After their restructuring they were sold to the private sector.

4. Concessions and licences to exploit activities and use property of the National Port Administration

The programme for transferring activities in the Port of Montevideo to the private sector carried out by the

National Port Administration is undoubtedly the most ambitious plan carried out during this administration. Among the areas for which concessions have been granted or are expected to be granted are the following:

The ANP floating dry dock;

The fruit markets and adjoining areas;

The Julio Herrera and Varadero warehouses and adjoining areas;

The cold storage complex; and

The river and ocean passenger terminal.

E. Difficulties in the Privatization Process

The privatization process is far from completed. With the rescission of some of the articles of Act 16.211 by the referendum of December 1992 it will be slowed down even further (almost 75 per cent of the electorate rejected the articles in question). Obviously the political cost of carrying an ambitious programme further may be very high. In other countries privatizations were carried out within the framework of serious economic crises or during very special situations. In this connection attention should be drawn to two basic points to be given serious consideration when such a process is initiated.

1. Establishing awareness of the advantages of privatization. A privatization process should be preceded by a public analysis of its advantages and benefits. The general resistance created by uncertainty about the effects of the process, especially in sensitive public service areas, must be overcome. In order to do this, round-table discussions, especially with members of parliament, and seminars and public debates should be held. By way of example, in the case of the privatization of the local telephone company ANTEL the public was unclear as to the consequences of the process and compared it suspiciously with what had until then been the poor results of the Argentine example.

2. The need for sectoral legislation. Act 16.211 had the defect of covering a large number of sectors and was therefore neither clear nor thoroughgoing in any of them. With privatization (or legislation authorizing private participation in a specific sector or activity) a series of transformations generally ensues which transcend the privatization itself. For example, it is necessary to specify the new areas of activity of the agents, the tax mechanisms, the State's new objectives with respect to the legislation, the supervisory bodies, etc.

3. Unit responsible for privatization. Even if a unit responsible for privatization is created, it cannot function independently to the extent that its decisions depend on the decisions of the directors of the enterprises. This delays and complicates some privatizations to the extent that there are various actors in the process.

F. Conclusions

Although the privatization process in Uruguay has been heterodox and complex because of the country's social and economic characteristics, and limited in its possibilities, it has had some successes and experiences to be taken into account for the future. In particular, the difficulties pointed out above should be avoided in the future.

Post-Privatization Conference in Latin America
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Mr. Tony Bennett
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IV. SPECIAL GUESTS

H.E. Giuseppe Mario Borga
Italian Ambassador to Argentina

Mr. Boris G. Fedotov
Chief Expert, Department of Currency
Finance Regulation
Ministry of Finance
Russian Federation

Mr. Iouri A. Gladilov
Chief of Division
General Department of Multilateral
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Mr. José Maria Puppo
Resident Representative
Inter-American Development Bank

Mr. Patricio Millan
Resident Representative
The World Bank

VII. PROCEEDINGS OF THE CONFERENCE

Monday 20 March 1995

OPENING STATEMENTS

Mr. Arturo Hein-Caceres, UNDP Resident Representative, extended a welcome to all participants from the region, and a particular welcome to the representatives from Bulgaria, Rumania, Poland and Russia.

He introduced the subject of post-privatization which, he said, looks at the broader political, economic and social issues which are not always solved before the process starts. He mentioned the UN Conference on Social Development recently held in Copenhagen, and the importance attached by Conference delegates, as well as the UN system, to human resource development. UNDP has supported economic restructuring programmes involving liberalization and privatization in 80 countries by technical assistance with the mechanics of privatization, the introduction of competition, and raising the credibility of the process. Privatization is one of the "pillars of reform" but it has not visibly contributed to sustainable human development. When the process is rushed, or when sale of enterprises is treated as an end in itself, the results have been poor. Mr. Hein emphasized the need to achieve not just growth but a distribution of benefits which would widen the options open to the poor and raise their participation in the mainstream of development, and protect and enhance the environment. On the positive side, privatization has reduced fiscal pressures and increased the funds made available to social programmes and areas not yet reached by privatization.

Given the interdependency of economic reform and democratic reform, it was especially relevant to show how the reformed governments and privatized enterprises can work together more effectively. He anticipated that the Conference would reveal the links between these parallel processes and indicate the way forward.

His Excellency Carlos Eduardo Zaballa, Under Secretary for International Cooperation, Ministry of Foreign Affairs, referred to the Argentinean experience of privatization. There have been problems but there have also been significant benefits. He endorsed the view that privatization was not a panacea and that there was no one recipe for success. Debate and international exchanges assisted us all in the process of change. He agreed with Mr. Hein on the relevance of the process to human resource development. He had great pleasure in declaring the Conference open.

REGULATORY ISSUES

Mr. Alejandro Rausch presented his paper on Regulation in Argentina: Its Design and Implementation. After explaining the background of structural reform and the massive privatization programme recently undertaken by Argentina, he discussed the new regulatory role of the Government. This has emerged from the public service character of its infrastructural public enterprises, all of which were privatized between 1989 and 1993, and the natural monopoly elements and other market failures which merit government intervention. Privatization resulted in greater concentration of industry, and a legal monopoly for the first stage of privatization of the telecom sector. The justification for price regulation was the conventional argument that it simulated the competition missing in high sunk cost industries.

Despite the fiscal priorities, there was from the start an active interest both in price regulation and reducing entry barriers. Sector-specific regulation was preferred because of the complexities of each set of markets. Electricity was vertically segmented into generation (which is now fully competitive in respect of large consumers), transmission and distribution (natural monopolies). Telecoms was divided into four separate

enterprises. Gas was separated into transportation, provided by two licensees, and distribution, provided by eight licensees, who are controlled by yardstick competition. The railway network was split into six lines operated by concessionaires with prices capped (though rail competes with road haulage). Trunk highways are operated by concessionaires on a sliding scale subsidy/rental fee which depends on the level of traffic. Competition for the water and sewerage market in greater Buenos Aires was introduced by inviting bids to provide the services at the lowest tariff.

Since 1991, eleven regulatory agencies have been (or are being) set up. The functions of these regulators are broadly similar--to set a cap on prices at levels which are fair to consumers and investors, to ensure the maintenance of access to services, to maintain quality and consumer standards, to promote competition, to set and monitor concession contracts (including the monitoring of investment commitments), to prevent restrictive business practices, and to apply penalties for non-compliance. For natural monopolies, price regulation has been through the RPI - x formula, with RPI being based on the US index. Regulators conduct consumer surveys and investigate complaints. In 1995, nine of the 11 agencies have a total annual budget of US\$118 million and 904 employees. This is 1.6 per cent of the turnover of the markets regulated. Each agency is run by a directorate which is autonomous in principle. A director can be removed only with just cause and subject to Congressional review. Lack of political independence was noted in some appointees.

Mr. Rausch cited a number of unresolved issues--legal, procedural, and organizational. A technical issue is how to ensure the maintenance of infrastructure towards the end of a concession period, when it pays the concessionaire who is not expecting renewal to neglect maintenance. A second is how to promote distributive impacts such as regional balance. There are grey areas in the respective roles and responsibilities of the regulatory agencies vis-a-vis the sectoral Secretariats, e.g. with respect to sectoral policy and coordination both within national sectors and regionally. Regulation should be viewed against its political and institutional environment.

Evaluation of the Argentine regulatory regime is premature as companies are still working through their start-up conditions. However, the indications are favourable. There is higher labour productivity arising from voluntary retirement. Quality has improved, but there is a long way to go. A common pattern of consumer rights and guidelines is emerging.

Mr. Roberto Toso, Managing Director of SOCIMER International (Chile) pointed out that Chile had twenty years experience of privatization, the longest in the region. He saw privatization as an important component in the global movement to strengthen markets and reduce the microeconomic role of governments. Central issues of reform, however, should be dealt with before initiating divestments. The legal and policy framework must first be put in place so that investors know the rules of the game and believe them to be stable. If this is not the case, investors discount prospective cash flows at rates which reflect their uncertainty; proceeds of disinvestment are lower and, what is worse, there is less commitment to quality. The price is not so important as who is buying and the impact of the new owner on efficiency.

Many of the problems today are due to massive and speedy privatization programmes which have left regulatory gaps. On the other hand, governments should not heed those who say the time is not right merely to delay privatization. The institutionalization of reforms, so that they are irreversible, together with transparency, equity and management efficiency are features of successful privatization.

Mr. Toso pointed out that the most sustainable regulatory system is one which distributes the benefits to

all groups. Both price-cap and rate-of-return regimes are costly and imperfect. The more productive emphasis is on the strengthening of competition so as to empower consumers (the power to migrate). Conglomerates can be dismantled. For natural monopolies, inter-temporal competition can be introduced; producers compete for a period franchise. Mr. Toso cited some examples such as the French water franchises, and solid waste disposal in the US, which have been very successful. Regulation should not hinder access to international capital markets.

Mr. Willie Macleod, Director of Consumer Affairs, OFGAS (UK), congratulated Mr. Rausch on his comprehensive paper and the Argentinean Government on the improvements at the "business end" of the utilities, such as higher productivity, managerial strength, service quality and capacity to meet peak demands. He said that the regulatory problems appeared to be the same in Argentina as in the UK--quality and scope of services, tariff adjustment and rebalancing. Network interconnections have not hitherto been a problem for OFGAS. A monopoly, though it may be committed to service to its customers, does not have the same culture or incentives as a firm in a competitive market. OFGAS initially undertook a lot of consumer research and looked at utilities in other countries in order to set up benchmarks of performance. British Gas policy and practices were also closely examined. OFGAS believed the corporation had a big potential for cost savings and the former regulator had a running battle with the corporation. Substantial changes in enterprise culture came with a new chief executive. At the same time a new regulator adopted a less adversarial approach; she sought to promote consensus and to leave "breathing space" for the regulated companies.

On tariff adjustment, Mr. Macleod mentioned the furor in the UK arising from the electricity regulator's reversal on an agreed price formula. The aim in all sectors is to set price caps for a period of five years. Secondly, the utility cannot discriminate against any class of consumers, i.e. prices to each group should reflect the costs of serving that group. In the UK, industrial and commercial users of gas can now buy from about 40 suppliers; British Gas has only 46% of that market. The area of price regulation has been progressively reduced so that it now applies only to users of less than 6,900 cm³/year, virtually the domestic users only. As BG is now in a competitive market, it is starting to rebalance its prices according to transport distance.

The domestic market is also being opened up. Enabling legislation is being passed. BG is being divided into five independent businesses: domestic gas supply, business gas, transportation and storage (called Transco, a natural monopoly), appliance retailing and customer services. Transco will be completely separated from the other units. BG plans for a very substantial staff cut-back. The domestic market will be opened to competition in Spring 1996 and licences will be issued to transporters, suppliers and shippers. Substantial price reductions are promised.

In conclusion, Mr. Macleod stressed the need to keep regulation away from social concerns, which he said are the province of the government. The aim of good regulation is to make regulation unnecessary.

Representatives from Panama and Venezuela asked about labour policy on those laid off in Argentina. Mr. Rausch answered that voluntary retirement schemes were very generous, particularly in a time of hyperinflationary uncertainties. Opposition from railway unions was countered by threats of branch line closure.

A representative from Bolivia pointed out that the employment problem applies even without privatization. The private sector cannot respond quickly to absorb the surplus, and regulators are under pressure from both the Government and foreign investors. Mr. Toso commented that unemployment is a

consequence of restructuring, not just privatization, but that employment recovers due to post-privatization growth. He emphasized the urgent need to move on reforms so that investors respond sooner. Privatization is a process of change and a process of learning. First privatizations always have to be revised later. Mr. Rausch mentioned the use of privatization proceeds for human resource development. He agreed that not all the checks and balances can be in place immediately, but political and economic stability is a pre-condition.

A Chilean representative referred to the complexity of regulation. Companies are often very powerful--regulators risk being captured. Alternatively they may be captured by government. Regulation in Chile has repercussions not only in Chile but in New York and London, so is very subject to government pressures. He agreed that competition is preferable to regulation.

A representative from Colombia asked about road concessions and cream-skimming. Mr. Rausch confirmed that, of the 9,000 km trunk roads given on concessions, this could be called cream-skimming, but that concessionaires pay fees or are paid subsidies according to the level of traffic and the resulting cash flows. The problem arises where there is insufficient traffic, as in some access roads, to attract capital. Mr. Toso expected that, with the current difficulties in the international bond markets, as much as 60-70% of road finance would have to be provided from equity. However there is a hopeful trend towards the securitizing of short-term commercial bank lending and refinancing by long-term institutional investors such as pension funds. He pointed out that bonds for road projects had no corporate history, so risk had to be carefully assessed and shared out.

PROMOTION OF COMPETITION

Mr. Richard Prebble, of Guinness Gallagher Consultants (New Zealand), presenting his paper on Promotion of Competition, set out five basic propositions:

- * there are no post-privatization issues, only pre-privatization issues which have not been tackled;
- * from an economic point of view, competition is more important than privatization;
- * neither competition nor privatization can be effective without a sound framework of economic and fiscal policies;
- * regulation does not work (or not as intended);
- * competition can be introduced into almost any sector.

He pointed out the parallels between New Zealand and Latin America and the remarkable turnaround in the economy of New Zealand since 1984, involving extensive liberalization and deregulation. Examples were given from postal services, telecoms, air and rail transport, and oil. Only after this framework of policy was installed did the Government start privatizing. New Zealand is said (by the Economist magazine) to have privatized a larger share of its GDP than any other country. Nevertheless, it has no "post-privatization" problems.

As a principle, no monopoly was sold with its privileges intact--unlike what happened in the UK, where the political objective of widespread share ownership resulted in monopolies being sold intact at low prices.

The New Zealand airline did not lose from deregulation or cream-skimming because its network gave it an overwhelming competitive advantage.

Mr. Prebble disagreed with the economic orthodoxy that natural monopolies should be price-regulated. He asserted that, even with the honest and capable civil service in New Zealand, price control never worked, except to guarantee a profit to the producer. In fact, price control discourages new entrants to the industry and defeats the main purpose of regulation. Regulators cannot say how many operators there should be in any sector. No-one predicted the 22% per annum growth in New Zealand's manufacturing sector; regulators are equally in the dark. He was sceptical of all the new and sophisticated models of price regulation, which he said are like snake oil (they don't work!).

To promote competition, New Zealand relies on the Commerce Act of 1986. This prohibits restrictive trade practices but does not proscribe monopolies. There is no social control of prices in any sector. Prices are controlled by competition or the possibility of competition, e.g. the cement market is contestable by the possibility of imports. In addition, since competition thrives on information, there is compulsory disclosure of separable services, e.g. bills for electric power have to show the line charge separately from the energy charge.

Mr. Eduardo Modiano, Vice President of the Banco Itamarati, Sao Paulo, described Mr. Prebble's talk as a breath of fresh air, and also a cold douche for regulators. The "invisible hand" of competition is the best regulator of all. State regulation is difficult, expensive, inaccurate and slips easily from economics to politics. The question was whether extending competition by means of the honey pot of monopoly profits could avoid the need for regulation. He noted that break-up alone does not lead to efficiency: only competition does that. Innovative methods of regulation, such as interconnection protocols and yardstick competition, may help.

Most countries, he continued, have had a myopic fiscal view of privatization, using it to reduce fiscal deficits. Even in Argentina, where the budget gap was closed, it was at the expense of increased prices. In fact, the only way to maintain price stability is through productivity gains from increased competition. Most countries have not followed this path and the contribution of privatization to price stability has been minimal. Mexico has substantially privatized its public sector, but this did not avert the recent crisis. In Brazil, political expediency and the need to reduce the deficit remain the main driving forces; privatized services have actually deteriorated. Since foreign debt can only be paid with foreign exchange and this can only be generated by cost-competitiveness, he wondered whether the lack of commitment to full competition was at the root of the problem in Latin America.

The Chilean representative questioned the New Zealand conclusions that price controls do not work, and that they are in any case unnecessary. Networks having high sunk costs would not be duplicated by competitors. Connection agreements allow new entrants into the market, but still have to be enforced by the regulator. Contestability theory does not apply where there are high sunk costs.

Mr. Prebble admitted that these questions were still being debated in New Zealand and that there are still problems with electricity distribution and water. However, while he was the responsible minister, he sold some gas pipelines, and gas prices went down to world prices. Water was deregulated and drought motivated the private sector to find new sources. These were equal to 5 per cent of all consumption. He doubted whether duplication of facilities would be more expensive than the gains from allowing competition. If many supermarkets are allowed, why not allow competition in water and electricity?

A representative from Colombia asked how competition could be introduced into railway transport,

keeping in mind the safety aspect. Mr. Prebble said that rail competes with road and other forms of transport. However, the competition is usually unfair, as road haulage trucks (which do almost all the damage to the roads), do not pay for road maintenance. In New Zealand the playing field has been levelled by taxing trucks on their weight and number of axles. All branch lines, which were formerly said to be uneconomic, are now paying their way without subsidies. Mr. Macleod admired the radical approach of the New Zealand Government but doubted that it would be politically possible in the UK.

Mr. Prebble condemned privatization carried out for purely fiscal relief, which is short-term at best. He said that the New Zealand approach was solely concerned with efficiency, and that is why it has been successful. In fact, the Government is now privatizing the social sectors by bringing competition into health, education, etc. Like the state-owned enterprises, they are 50 per cent over-staffed. In pension administration, they are learning from the Chilean experience. Mr. Bitran commented that Chile had made the change from pay-as-you-go to a fully-funded system, but that the administrative cost was very high (US\$120 per person). Mr. Prebble was in favour of individualizing pensions and putting them in the name of the beneficiaries. He thought that \$120 might be a bargain for first rate fund management.

Tuesday 21 March

SOCIAL SAFETY NETS

Professor Jorge Beinstein presented his paper on Social Safety Nets. He pointed out that the need for safety nets arises, not only from privatization, but also from the accompanying structural reforms such as deregulation and liberalization, which are part of the globalization movement.

Privatization has had a negative effect on employment in the short term in the UK, France, Italy, etc. This is also true in Argentina. Public enterprises had 250,000 employees in 1990. This is expected to reduce to about 60,000. He cited the case of SOMISA, a steel plant which was the major employer in San Nicholas. Out of 12,000 employees, 6,200 accepted voluntary early retirement packages averaging \$22,000 each. They used the money partly to purchase automobiles, etc. and partly to start up micro-businesses such as kiosks and paddle ball courts with little market research. Within a year most had gone bankrupt. The municipal authority got UNDP/ILO assistance in training ex-salaried employees how to be entrepreneurs. The lesson was that money is not enough to make a person an entrepreneur.

Mr. Beinstein pointed out the paradox of expecting governments which are in crisis and suffering from "generalized corruption" to be able to administer major labour retraining programmes. He referred to the remedy, often suggested, that the informal sector can absorb a large part of the temporary surplus labour. Despite statistical problems of definition and measurement, the informal sector is growing in all countries. In Argentina it is responsible for some 25 per cent of all output and in Bolivia as much as 50 per cent. He recommended further study of how the informal sector acts as a mattress to soften the impact of sudden unemployment. In conclusion, he predicted growing unemployment in the short and medium term, but said that there was no dramatic short-term solution. Long-term work on business development was the only answer.

The commentator, Professor Ramanadham, complimented Professor Beinstein on his paper and presentation. He defined safety nets as temporary protections for persons, enterprises or places which lose benefits previously enjoyed and which are judged to be deserving of support. He emphasized the need to understand the impacts of privatization on poverty and unemployment and to promote systemic change,

especially among government bureaucrats, enterprise executives and workers or their unions. The essence of the problem is that privatization is often driven by fiscal deficits which impose major constraints on the provision of safety nets. The design of safety nets should be compatible and coordinated with the overall policies of poverty alleviation, but the very cause of adjustment policies is the lack of government resources to cope with the outcome. While Prof. Beinstein had looked to the informal sector as a source of new employment, Prof. Ramanadham attached importance to the economic viability and sustainability of this employment. He cautioned against the complacency implicit in the general thesis that growth would automatically take care of social problems.

Prof. Ramanadham talked about selected countries to illustrate how the need for safety nets, and the method of provision, has varied among countries. In Guyana, for instance, structural reforms have not caused substantial retrenchment. The losers have not been workers but rather those on low or fixed incomes during inflation. The loss of subsidies, for instance, can create a class of "new poor", e.g. users of privatized buses in Sri Lanka who were formerly subsidized.

In India, by contrast, the opening up of the economy domestically and externally is likely to result in big reductions in employment and the Government has set up a National Renewal Fund to finance retraining and compensation to those displaced. However, it is too small for the magnitude of the problem, which has not been fully assessed. Even if Government tax revenues improve later, it will be necessary to find funds in the meantime, e.g. by a compulsory levy on all enterprises. It is sensible to restrict retrenchment benefits to those who are unemployable and to ensure that retraining is for jobs that are coming into existence. Fiscal reliefs for ailing enterprises are not consistent with the rationale of privatization, but political compromises might be necessary for the larger programme. Prof. Ramanadham suggested that the funding should be objectively estimated and planned for, preferably from domestic sources.

In some countries no safety net is spread specifically for the privatization losers: they are covered by general welfare or social security arrangements. In Sri Lanka, the Janasaviya programme which finances those who start their own businesses is an example. In the UK, the general tone of regulation has been against the preferential treatment of customers within any group, but certain "deserving" groups may be differently treated. For instance, old age pensioners and the disabled get their electricity meters installed free. Apart from such small exceptions, the needy are covered by income support and other general programmes derived from the government budget.

He pointed out that safety nets may be built into privatization policy by requiring purchasers to take on all workers at their existing pay for a given minimum period, as in Sri Lanka, Pakistan and Malaysia. Similarly, the sale of an enterprise to the employees at a low price is a disguised safety net, as it reduces the capital costs and enables the enterprise to continue without lay-offs, though at some risk to its financial viability. In each of the above cases, the government pays for the safety net by receiving smaller proceeds of sale. Regulation policy has a bias against cross-subsidization, e.g. the equal treatment of rural consumers. The need for safety nets may be substantially avoided by restructuring enterprises so that they use all their employees productively.

In conclusion, Prof. Ramanadham advocated a clear analysis of the affected groups, including the consumers, and distinguishing those who would be driven below the poverty line. Policy should be formulated on the type of support and the length of time it would be needed. He emphasized that this needed technical skills and administrative integrity, as does the monitoring of the implementation of safety nets.

The representative for Chile said that in his country unemployment dropped from 30 per cent in 1982/83 to 5 per cent ten years later. Also the proportion of the population below the poverty level dropped from 50 per cent to 30 per cent. This was due to a drop in real wages eroded by inflation, competition policies and export growth. Pockets of unemployment are now mainly among the young. A special programme was arranged by which private firms were contracted to give them training and find them jobs, either inside or outside the firm. 150,000 were trained and 100,000 got jobs, at a cost to the Government of \$500 per job. He warned against governments deciding what training to give, since this does not work. Prof. Ramanadham trusted the minimum wage was met, and commended this strategy. He contrasted it with the position in India, where funds are given to 23 training institutions but the trainees are still unemployable. Effectively this is a safety net for the training institutions!

Prof. Beinstein agreed that a drop in real wages may increase employment but there may be bottlenecks (e.g. a lack of building plasterers). These can be broken through appropriate training. Mr. Rausch said that the drop in employment in restructured enterprises may be partly remedied by new management practices such as out-sourcing. Former employees may be contracted to use their skills and deliver needed inputs. The government should support the concept and promote training in this kind of procurement. Argentina was trying to promote entrepreneurship as in Chile but the per capita cost in Argentina is much higher. There is still a need for institutional rethinking and restructuring.

The representative from Poland agreed that there was a relation between privatization and unemployment. In his country there was an acute shortage of labour in the 1980s. Privatization started on 1 January 1990 and 50 per cent of GDP is now under private management. Unemployment is 16 per cent, but he ascribed this to the stabilization measures as there has been little retrenchment in the privatized firms. By contrast, the Czech Republic has privatized more than Poland, but the new owners are investment funds, which are mostly owned by the State, so there has not been any radical change in enterprise behaviour and unemployment is only 5 per cent.

Mr. Macleod commented on the "safety net" content of regulation in the UK. It was true that those who cannot pay their bills are not immediately cut off--every effort is made to maintain essential supplies, but he saw this as part of the new consumer service culture rather than a social safety net. Mr. Prebble advised governments not to adopt short-run palliative policies which are not consistent with medium and long-term goals. He agreed that in the long run we are all dead, but if our policies are wrong we are dead quicker!

Speakers from Peru, Argentina, Costa Rica and Bolivia referred to developments in their countries. In Peru, wages are so low that public service employees take second jobs, as in Argentina and many other countries. This is a form of safety net. In Bolivia, Argentina and Costa Rica, the reduction in social services is also reducing the standard of living of workers. In Bolivia, privatization is called "capitalization", as they have a unique plan to recapitalize state enterprises on 50 per cent sale of equity to foreign buyers. The other 50 per cent goes into a general pension fund.

There was an extended discussion on the informal sector. A speaker from Brazil complained that governments tend to be very negative about the informal sector, despite its size and valuable buffer role against unemployment in every country. There are ethical problems, as the informal sector includes undesirable activities and does not pay taxes. In Bolivia, the most important industry is informal, illegal and globalized. Nevertheless, there is also a large and growing content of legitimate, though unregistered, activities. Excessive regulation drives business into the informal sector, and governments should deregulate and simplify business start-ups, so as to keep the sector as small as possible.

There were five short presentations by representatives of regulated Argentine gas, water and electricity companies, moderated by Mr. Carlos Sersale Di Serisano. These companies have concession contracts which are in course of execution. It was too early to speak of post-privatization, it was generally agreed, since companies are still being privatized and the first quinquennial cycle is not yet finished. One comment was that regulation needed to be flexible because plans, on which investment commitments are made and concessions drawn up, do not always fit with realities. Feelings about the regulatory regimes were mainly positive and cautiously optimistic, though there had been differences of understanding with regulators. An investor in one utility emphasized that the criteria of good regulation, from the investment standpoint, are that it should be clear, stable, consistent and politically independent. He rated the Argentine regulatory regime on these criteria and found it satisfactory so far, but reserved judgement till the first reviews.

This was followed by comments from the regulators, who briefly outlined the systems of regulation and procedures used, including the setting of price caps, the drafting of concession contracts, and public hearings. To a question on how the regulatory agencies were financed, Mr. Devoto explained that concessionaires pay fees.

WORKSHOP ON REGULATION

Representatives from countries just starting on privatization asked about the experience of countries that had privatized extensively, such as Argentina and the UK.

The main lesson, it was said, was the importance of determining the objectives of privatization in each country and issuing a clear statement of policies, procedures and guidelines for valuations. These are important not only for public transparency but also, if the procedures are followed, to protect the privatization agency from charges of corruption (as has happened in East Europe after a change of government).

The privatization agency and regulatory agencies should have their jurisdictions clearly defined and distinguished from those of the sectoral ministries. Responsibility for sectoral policy-making, indicative planning and regional integration should remain with line ministries, and not be taken over by regulators. Bearing in mind the importance of a stable regulatory regime, regulatory agencies should be created by law, rather than by executive decree which is liable to change. Regulators should have political independence and continuity. The regulatory agencies should be kept to the minimum size required to perform their functions. They are funded by rates paid by consumers through their invoices; this does not risk capture by the regulatees.

A major problem arises with the control of investment commitments by the privatized companies. Quality control alone is not enough. However, information is imperfect, so concession contracts should allow some flexibility in the priorities and sequencing of market commitments, so that they respond also to market signals. Penalties for non-compliance are necessary, but not a sufficient condition for compliance.

WORKSHOP ON PROMOTING COMPETITION

The workshop discussed how competition might be introduced into natural monopolies such as electrical transmission lines, water systems and telephone local loops.

On investigation, it appears that the principal reason these areas are given local monopoly status is because of the existence of cross-subsidies and the fear that new suppliers will profit-skim. The participants

agreed that such cross-subsidization is very inefficient. It is cheaper and more effective to grant direct income support and to allow price rebalancing.

The group agreed that effective competition policies are essential to successful privatization.

WORKSHOP ON SAFETY NETS

The workshop on safety nets considered some of the issues raised earlier in the day at the plenary session. Professor Ramanadham acted as the facilitator. The Peruvian example came up for substantial discussion. The difficulties of the Peruvian Government in finding the resources needed for making payments to displaced labour were highlighted.

The issue of finding the funds necessary for safety nets, especially for meeting the obligations of payments to displaced labour, was raised by Mr. Keith Hillyer. In the course of the discussions the point was emphasized by Professor Ramanadham that the fundamental question was one of how the moneys involved were utilized. If they were effectively utilized for productive purposes by the recipients of the compensations, there would be no argument against the government raising loans from abroad, particularly from the international financial agencies, as there was a prospect of repayment. Mr. Tony Bennett advised that the choice of projects should not be made by a government agency, since this was a business decision. Rather it should be made by grass roots non-government organizations and financial intermediaries who were close to the borrowers and who had a financial interest in the success of the projects so financed. He cited an example in Sri Lanka, where part of a World Bank line of credit to a private development bank was channelled through a producer cooperative to farmers in a silkworm breeding project.

The Peruvian representative referred to the IMF's direction against poverty relief measures beyond a certain specified point. This would bring to the fore the importance of arriving at the most appropriate budget policy decisions at the government level.

The workshop looked at the macro-context of government expenditures for the sake of displaced workers. These, in many developing countries, are not the poorest in the community. The case for priority expenditures by the government in the interest of the poorest or for poverty alleviation is stronger. This applies in particular where retrenchment payments went to those who would not have to be retrenched by the enterprises on grounds of efficiency. Professor Ramanadham suggested that, if privatization involving retrenchment of labour was sure to relieve the government budget, the expenditures would be clearly justified. In other situations, it would be a matter for the Finance Minister to decide on how far to go in finding resources for doles to labour as against using the available resources for poverty alleviation programmes in general.

Wednesday 22 March

LOOKING AHEAD

Mr. Alan Stoga presented his paper "Looking Ahead: Privatization and the Future of Latin America". He referred to the threat posed to the economic reforms and recovery since 1988 by the recent collapse of the Mexican peso and the reversal of capital flows affecting the whole region. The question was whether the region's apparent recovery from the debt crisis of the 1980s was ephemeral, and whether the growth model centred on privatization was somehow fatally flawed.

His thesis was that the privatization reform model remains viable and that policy makers should persevere with it. Just about everything can and should be privatized. In Somalia, even law and order had been privatized because there was no government, but this was going too far! He recommended more privatization, more tax reform, more incentives to invest and save, more transparent capital market conditions, more efforts to liberalize labour markets, more predictable policy environments, and more competition. Governments should realize that they face a buyers' market in the sale of enterprises.

He reviewed the evolution of privatization in its political context in Latin America. State enterprises had caused large recurring drains on overburdened government budgets. After initial opposition, privatization has become popular. It has created new political constituencies with stakes in the reformed system. Most importantly, privatization has attracted new investors, capital, technology and management skills. Mr. Stoga cited case studies which show that privatization has significantly increased profitability, productivity, efficiency and total employment. However, privatization alone could not achieve the necessary economic transformation, nor could it eliminate the swings of growth and recession.

It has been argued that the Hemisphere has been too reliant on foreign speculative capital which is highly sensitive and mobile to perceived changes in risk and return. Mr. Stoga recommended greater emphasis on promoting domestic savings, e.g. by privatization of social security, as pioneered by Chile, in order to reduce dependence on external portfolio capital flows. Countries should also look at measures which reduce the velocity of cross-border capital flows, though there is a risk that minimum investment periods may be difficult to distinguish from capital controls. Some new thinking is needed on how to stabilize capital markets when government finances are basically sound. He believed that privatization should be seen in terms of improving efficiency rather than in terms of government revenue. If privatization is seen as an alternative to debt strategy, it will fail. In almost all industrial and service activities competition can and should be introduced to improve efficiency. Mr. Stoga also emphasized the need for profound judicial and civil service reform to sustain private investment. It is the job of government to set stable rules of the game, since business people are looking for monopoly rents--"no businessman believes in free markets" and "greed is good". There is no "reasonable" rate of return. Even 100 per cent is reasonable if the investor is clever enough to find such an opportunity in an open market.

Mr. Prebble pointed out the realities of investment in Latin America. Investors were looking: (1) for absolute assurance that they could get their money out; then (2) for a minimum 25 per cent return. Government incentives hardly affect the decision. Where an industry is regulated, it has only one customer--the regulator. It is to the investor's advantage to make a further investment on lobbying for higher tariffs. A price cap formula becomes a rate-of-return cap. Regulation often operates to guarantee a certain level of profit and to prevent any improvement of standards above the minimum. Some customers will pay anything for quality service, but cannot get it under regulation. He agreed on the need for reform of the judicial system, so that business trusts the courts.

He added that if simple divestment is central to the model, then it will fail. There is no one simple policy. The point of privatizing was to improve efficiency; Mexico sold banks to the highest bidders, who had no banking experience. The same happened in New Zealand.

Prof. Ramanadham agreed with Mr. Stoga's broad definition of privatization and that the main purpose is to raise efficiency; this was stated five years ago in the UNDP Guidelines on Privatization. However, he said that Mr. Stoga had considered only the foreign investor's point of view. In a developing country, distributional impacts were of equal importance. As a consumer, he would not be happy that an investor was making a 100

per cent return at his expense. Safety nets are a national problem and he was worried that governments did not understand the scale of the problem. He warned that the pendulum, which has swung from nationalization in the 1960s to privatization in the 1990s, could swing back unless protection of consumers and other "parallel requisites" were met in privatization programmes. Mr. Stoga preferred to separate welfare and safety nets from privatization, which he saw as quite separate issues. He warned against burying subsidies in unaccounted cross-subsidizations in operating companies. Any subsidies should be explicit. He hoped that there was no "pendulum" as this would condemn Latin America to return to the "lost decade". The evidence shows that all groups, including labour and consumers, had benefited from privatization, and no country can be said to have privatized too far.

Mr. Prebble said that New Zealand, where foreign investment is a higher percentage of GDP than in any Latin American country, is a good example of the division of returns from investment. Returns to New Zealand on its highways had been higher than the returns to foreign investors. Similarly, British investors had made 100 per cent returns in the US railroads, but the Americans did even better. Mr. Rausch pointed out that the countries of South East Asia were able to minimize foreign investment because of their high savings rates, a cultural phenomenon.

Wrap-Up of the Conference

The draft Conference Report for the first two days was distributed. Mr. Tony Bennett, UN-DDSMS, explained that, since the report was chronological and not thematic in structure, he would present some of the main issues that had risen under each of the Conference topics.

With respect to regulation and competition, he noted that all participants supported the maxim "competition where possible, regulation where necessary". They tended to attach greater importance to the role of regulatory agencies in promoting competition than to their role of simulating competition by price caps and other regulatory devices.

Some speakers, especially the Argentineans, had emphasized the need for organizational and jurisdictional clarity with respect to the central privatization agency, the regulatory agencies, and the line ministries (secretariats). This was linked with the need for stability in the investment environment. Policy stability is as important as macroeconomic stability. There is scope for greater coordination and standardization of treatment of issues that are common amongst regulatory agencies, such as consumer guidelines, penalties and tariff-setting concepts, and for strengthening their management systems.

A general issue arising from the discussions was the short-sightedness of giving higher priority to fiscal objectives over efficiency objectives. The most radical expression of this came from the New Zealand experience, where public enterprises were sold only after they had been opened up to competition. Divestment there had become an optional extra, rather than the main focus. All the gains were attributed to the winds of competition. Even "natural monopolies" were not regulated lest this reduce the attractiveness of the industry to new entrants.

Other examples came from the criteria used to evaluate bids for public enterprises. The Mexican crisis was attributed at least partly to the sale of banks to the highest bidders, who proved to be unfit to run the banks. A general recommendation was that bidders should be pre-qualified, then the highest bidder might be preferred. Though pre-qualification is open to abuse, this procedure would be more transparent than, for instance, systems of evaluating bids on multiple weighted criteria. In the same vein, there was support for

methods of divestiture such as trade sales, which result in a strong controlling shareholder and effective governance, rather than broad-based shareholdings which might not be able to replace non-performing management. Mr. Bennett noted that this policy is constrained in many developing and transitional countries by the skewed distribution of wealth (or the "wrong" people having the money) and the political unacceptability of greater concentration of ownership. The same applies to foreign ownership. Even though a dollar from any source is equally valuable, public perception of foreign ownership is very different from perception of domestic ownership, even in the UK.

There were repeated references to the importance of getting the objectives and policies clear from the start and the primacy of competition policy. Most Latin American privatization had been driven by fiscal pressures and this had militated against the promotion of competition. Some of the UK privatizations had been poor models as they had preserved monopolies. Only now was British Gas, for instance, being broken up and competition introduced.

The social and distributional aspects of privatization had tended to be neglected in the rush to privatize. Mr. Bennett pointed out that decisions on what enterprises to privatize, how to privatize them and to whom to privatize, all had social consequences as well as fiscal and economic consequences, and privatization agencies making these decisions could not ignore one set of consequences. Just as major resource decisions are preceded by environmental impact assessments, they should also be subject to social impact assessments.

A number of safety net devices had been mentioned by the speakers. In Latin America, voluntary early retirement packages have been common, but these have been ineffective where benefits have been taken by those who could get jobs elsewhere, or even by those who were needed within the firm and who returned through the revolving door. The Kenya Power and Lighting Company had not made this mistake: each application for early retirement was screened and accepted only if the company could spare the person. If there were not enough voluntary retirements, a compulsory scheme came into effect, with the same benefit package.

Requiring buyers to maintain pre-existing levels of employment is often thought of as counter-productive, but this has been successful in Malaysia, said Mr. Bennett. The telecom, electricity and other enterprises had grown strongly after partial privatization and had absorbed the former "excess" staff. In East Germany and Macedonia, buyers had been encouraged to take over employees by having the purchase price reduced by a given amount per worker. An even more market-oriented policy was that of Chile, which offered a fixed sum to any enterprise willing to offer training to displaced workers and to guarantee them jobs at the end of the training. Mr. Bennett added that it was an important principle that those giving training for jobs or for self-employment should have a financial incentive in the success of the training. This made it effective and sustainable.

Looking ahead, Mr. Bennett agreed with Mr. Stoga's thesis that privatization efforts should continue in Latin America and that the dangers of a reaction back to the statist policies of the past were greater than the dangers of privatization. The process requires a stable macroeconomy, a stable political regime, a stable legal and regulatory environment, and a playing field which is open to all who want to play and is kept level. This needs a capable and honest civil service and judiciary.

Participants discussed the problems of political interference in regulation. Latin American regulatory bodies mainly consist of boards of directors, which are sometimes constituted on a representative basis. Prof. Ramanadham warned against the concept of having individual directors representing investors, consumers, the Ministry of Finance, etc. He said that all appointees should represent the industry as a whole. This would

make the board stronger against political interference. Apart from this, boards should be set up by law and directors given fixed-term appointments. There is also the problem of regulatory capture, e.g. by offer of a job with a privatized utility after leaving the regulatory agency.

The need for a general body to control restrictive business practices was discussed. The UK has an Office of Fair Trading which is closely linked to the Monopolies and Mergers Commission. This agency responds to complaints of anti-competitive action in any sector, including predatory pricing, tie-in sales, refusals to deal, and restrictions on supply. Argentina does not at present have any general competition agency.

Mr. Keith Hillyer, Director, UNDP/PSDP, wound up the discussion and thanked the local organizers, translators, UNDP Buenos Aires staff and all those who had contributed to the success of the Conference. It was agreed that more emphasis should be placed on the introduction of competition, which will have a favourable impact on the public budget and public debt as enterprises will be more profitable and generate greater revenue streams. The sustainability of the reform process will depend also on its distributional and political impacts. Privatization is first and last a political process, and it is its impact on the quality of life of the ordinary individual in the street which will determine its credibility and sustainability.

CLOSING STATEMENTS

Mr. Jose Petrella, Deputy Minister of Foreign Relations, Government of Argentina, addressed the Conference. He expressed his pleasure that the United Nations had agreed to co-sponsor this Conference with the Government of Argentina. After up to two decades of privatization and the most thoroughgoing commitment in some countries of Latin America, this Conference on the impact of privatization and a focus on the post-privatization issues was very timely. In Argentina, he noted, privatization had been started in 1985 and renewed vigorously from 1989. Privatizations in Argentina have had positive effects in terms of productive efficiency, quality and coverage of public services and public revenue.

Mr. Ji Chaozhu, Under-Secretary-General, UN Department for Development Support and Management Services, responded on behalf of the UN System. He recalled the start of privatization in Latin America in the 1970s and 1980s, when it could not have been imagined that would be the start of a global change in the partitioning of public and private sector roles and responsibilities. Today there is hardly a country in the world in which public enterprises are not being restructured or privatized.

It is clear, he said, that privatization has in many cases generated clear gains in efficiency and productivity, and the associated changes in the structure of each industry have promoted competition to the benefit of consumers. However, privatization is not the end of history. The former problems have been replaced by a new set of problems. The pace of structural change has caused at least temporary increases in unemployment. He emphasized the need for safety nets--the human face of privatization--and for careful preparation of privatizations. He cited the case of British Telecommunications, the first major privatization in the UK, which was privatized only five years after the Thatcher administration took office.

Privatization of monopolies requires independent regulation of prices, availability and quality of services. It was recognized that regulators have to perform a difficult balancing job, arbitrating between the interests of consumers and investors and between incumbent utilities and new entrants to the industry. He recommended objective evaluation of the impact of country programmes on their objectives.

He expressed his deep appreciation to the Government of Argentina, in particular the Honourable Minister and Deputy Minister for Foreign Relations, for their support in organizing this Conference and for their generous hospitality, to the co-organizers from the UNDP Regional Bureau for Latin America and the Caribbean and the UNDP Private Sector Development Programme, to the paper presenters and commentators, and to all the participants and guests for their contributions.

1/ Hommes, Montenegro, Roda: "Una apertura hacia el futuro" (An opening to the future); Ministry of Finance and Public Credit and National Planning Department.

NOTES

2/ Industrial Frutera del Gran Lago S.A. (FRUGALASA) is made up of two enterprises – one which consists of the producing plantations and the other which manages the agro-industrial production.

2/ CORECO consists of the enterprises created under the MINVAH and MICONs Companies Act. Article 8.12 of Decree 7-90 transfers the ascriptions under the "MICONs Companies Act" to CORNAP. This Decree does not include COERCO itself nor the enterprises created by the MINVAH Companies Act. The Decree ascribes to CORNAP the COERCO enterprises created by the "MICONs Companies Act":

1. **Empresa Constructora "La Segovia" (ECONS) (R-I)**
2. **Empresa Constructora de Occidente (ECO) (R-II)**
3. **Empresa Constructora (ECONS) (R-II)**
4. **Empresa Constructora "Dirianguen" (ECODIN) (R-IV)**
5. **Empresa Integral de la Construcción "Manuel Escobar Pereira" (EICMEP) (R-V)**
6. **Empresa Nicaraguense de Construcciones (ENIC) (R-VI)**
7. **Ingeniería de Construcción (ICO) (RAAN)**
8. **Ingeniería de Construcción de la Zona Especial III (ICZE III) (Special Zone III)**
9. **Empresa de Señalamiento Vial (ENSEV)**