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PRIVATIZATION IN LATIN AMERICA: FROM MYTH TO REALITY

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I. INTRODUCTION

Privatization has become a major trend throughout the world, not only in the North and the South but increasingly in the East. Over the last decade more than eighty countries have been transferring assets and the provision of services from the government into private hands. Privatization has occurred in a variety of sectors and industries throughout the world and much more is expected in the near future. Summers (1993) anticipates that the value of assets that countries will privatize by the year 2000 will be double that privatized up to 1993. Such numbers have kept the topic very much alive on the international agenda and has made lessons from previous experiences more relevant than ever.

From the 1940s to the 1990s, Latin America saw a colossal increase in public sector activities in production, regulation, credit, transportation, communications, etc. After World War II, several governments used current account surpluses accumulated in the early 1940s to buy foreign assets (both debt and equity). Since then, state participation in the economy increased greatly during the many experiments with populist macroeconomic policies.

Public sector activity rose on the expectation that state-owned enterprises (SOEs) could replace foreign investment and foster domestic investment in sectors and industries in which the private domestic sector was not competitive. Expectations went largely unfulfilled, except perhaps in the largest countries and in particular industries. In the late 1970s SOEs became increasingly perceived not only as inefficient producers and providers of services but -more often than not- as a drain on government resources. The inherently ambiguous objectives of SOEs, it has been argued, is what often makes them a failure: on the one hand, SOEs are expected to operate as profit-maximizing businesses; on the other hand they must respond to political and social concerns of governments whose policies are often inconsistent with the first objective. The inefficiency of SOEs in Latin America was perpetuated by the progressive closing up of these economies by policies that protected domestic producers from foreign competition. Over time, inward-looking strategies increasingly isolated these countries from competitive forces.

Although privatization in Latin America began with isolated episodes in the Dominican Republic in the 1960s and in Chile in the mid-1970s, by the turn of the 1990s it had become a key ingredient of stabilization **cum** structural reform programs. In the last four years privatization has proceeded at an amazing rate and in wide-ranging sectors including utilities, transportation, airlines, steel, banking, social security, media, infrastructure and even oil. Not surprisingly, this has led to a major re-examination of the role of government in the economy.

Privatization is a complex restructuring process involving a number of economic, financial, social and political issues. Not only do political conditions determine whether privatization is feasible, but the socio-economic changes resulting from it will in turn have short and long-term political implications in the restructuring countries. By transferring production and the provision of certain services to the private sector, privatization can have a major positive impact on increasing efficiency and domestic competitiveness, but it can also have serious negative social and political consequences.

We shall discuss the arguments for and against privatization. We shall then illustrate how, from the myth described by Shidlo as recently as 1990, privatization has moved to reality in Latin America in a very short period of time. Focusing on three case studies -Chile, Mexico and Argentina- we shall analyze the initial conditions that led to restructuring as well as those that affected the form, breadth, sequence and speed of the process. We shall present evidence of the impact restructuring has had on macroeconomic adjustment, growth, debt, foreign direct investment, employment and income distribution.

The objective is not to analyze privatization programs comprehensively but to highlight both the similarities and the differences between these experiences, the policy issues involved and the impact that they have on the economy. These may be relevant to policymakers in countries, such as Peru and Brazil, which have embarked on a second privatization wave in the region, as well as to the many countries throughout the world that are either considering the possibility or already in the process of privatizing their SOEs.

II. DEFINITION OF PRIVATIZATION

Before we analyze the objectives of privatization it is important to define what we mean by it. In a broad sense, the term privatization[1] refers both to the transfer of assets from the public to the private sector as well as to situations in which -though there is no transfer of assets as such- the government contracts or leases out services to the private sector.

The term also refers both to the transfer of an activity performed only by the public sector in the past, and to the return to the private sector of activities that were once in that domain but had subsequently been taken over by the government, either through nationalization or rescue from bankruptcy.

Privatization can be total or partial. It can be carried out either by direct sales to the private sector (to either domestic or foreign firms or individuals including employees) or through public stock offerings.

The process of privatization has often taken place concomitantly with deregulation. This involves the removal or simplification of government rules, entry regulation and other controls over market activities. By freeing markets governments leave regulation to competitive forces. In some cases governments have abandoned their monopoly on the delivery of certain services or products, yet continue to operate in the sector or industry side by side with private firms.

III. ARGUMENTS FOR PRIVATIZATION

A variety of reasons lead governments to privatize SOEs. Although their weight in different countries may vary considerably, privatization is often pursued to:

A. Decrease existing budget deficits

A main concern of developing countries in the 1980s has been to decrease large budget deficits and the inflationary pressures resulting from them. A main factor in increasing those deficits has been the need to subsidize mostly inefficient, non-competitive and distended SOEs. Privatization reduces budget deficits by a once-a-for-all increase in revenue from the sale itself and by a recurrent decrease in the need for the government to subsidize and cover losses incurred by SOEs.

B. Increase future government revenue

By transferring SOEs to the private sector, governments increase their future revenues either from the licensing and other fees for concessions or from taxes paid by privatized firms. Thus, SOEs which might have been a burden on government finance in the past may become a source of government revenue after privatization.

C. Reduce domestic and foreign debt

A main objective of privatization is to reduce foreign and domestic public debt, as well as debt servicing. In many cases privatization has been financed through debt-equity swaps. Since a swap reduces debt servicing requirements, it puts downward pressure on the budget deficit and decreases the need for future external and domestic sources of deficit financing.

D. Develop domestic capital markets

Public stock offerings of privatized firms can facilitate the development of domestic capital markets. The development of large institutional investors resulting from privatization of the social security system may increase savings and help develop an active secondary market for debt and equity instruments.

E. Revitalize the private sector

Privatization has been used as a way to promote productive investment in crucial sectors and to increase output and productivity. To revitalize the private sector, both domestic and foreign investment need to be encouraged. Privatization may help reverse capital flight. National investors who took their money out of the country because of risk or more profitable opportunities abroad may bring it back if privatization offers attractive possibilities.

Privatization may also attract foreign direct investment (FDI). In addition to capital, foreign investors may bring in new technology, management and special expertise that are an important ingredient in the revitalization of the private sector. Thus, in industries that require heavy capital investment and depend on innovation (telecommunications, airlines and transportation, for example) privatization may be a way to allow for the expansion of undercapitalized enterprises and to bring in appropriate technology.

F. Improve the long-run condition of workers

A revitalized and more efficient private sector may be expected to eventually absorb the workers that had to leave the public sector as a result of privatization. This could improve the long-run condition of workers since the private sector generally pays better salaries and offers better incentives and opportunities.

G. Penetrate foreign bond and equity markets

Financing is often a major constraint to the restructuring of SOEs. Restructured enterprises in the private sector, on the other hand, have wider options for financing. They not only have better access to domestic financial markets but are often able to float bonds in the international bond markets and to trade their shares or Anticipatory Deposit Receipts ("ADRs") in international equity markets.

H. Promote competition and efficiency

In some cases the objective of privatization and deregulation has been to eliminate state monopolies and monopoly rents by promoting competition. Privatization needs to avoid converting the public monopoly into a private one which can be just as distorting. With this in mind some countries break up a public monopoly before privatizing. If a private monopoly cannot be avoided, proper regulation is essential.

More competitive enterprises operating with higher capital intensity and better technology are likely to be more efficient: they can increase consumer welfare by producing goods or providing services at a lower cost. For example, a government concession for the provision of basic services such as water supply or sanitation could be given to a private concern on the basis of the greatest reduction in overall rates or the commitment to a certain level of investment necessary to expand or upgrade the service.

I. Improve social services

In many cases privatization of public social services is done with the main objective of improving their quality. Privatization of monopolistic services often include quality targets.

J. Address environmental concerns

In few cases, privatization could be undertaken to address specific environmental concerns. A large part of the population in developing countries, for example, is not connected to adequate water and sewerage facilities and privatization can address this environmental concern. Privatization can also be a way to attract investment into the development of environmentally sound energy sources, thus restricting the practice of many developing countries to burn fuelwood beyond sustainable levels.

IV. OPPOSING VIEWS

If privatization is not carried out in a sensible, well planned and efficient way it may lead to serious distortions and imbalances. Opponents of privatization fear that it might be a way to:

A. Sell national patrimony

Many critics of privatization see this process as a way to raise government revenues by selling national assets rather than by following the more unpleasant path of raising taxes (Cowan, 1990). Many object to governments selling their national patrimony to improve their finances.

B. Concentrate economic power

Others see this process as a way to increase or consolidate the concentration of power. Privatization could result in a heavy concentration of businesses in a small number of conglomerates (Shidlo, 1990).

C. Endanger vulnerable groups

Perhaps the most frequent criticism of privatization is that the government might leave the provision of basic services and employment in the hands of the private sector. Many fear that in this way privatization might hurt the most vulnerable sectors of the population.

D. Jeopardize productive capacity

Some also fear that the state, by giving up production in sectors such as steel, chemical and aluminum, crucial inputs for other industries, could endanger the productive capacity of the country. This may happen if the private sector does not run those intermediate industries properly.

E. Spur corruption

Another argument against privatization is that it may be a way in which corrupt government officials and private sector management can greatly profit. There is evidence linking privatization to corruption but the two are not necessarily related. Furthermore, there is also plenty of evidence about corruption of SOEs to favour particular groups. However, privatization often results in large transfers of money and privileges and hence create opportunities for corruption.

V. THE LATIN AMERICAN EXPERIENCE

A. Introduction

Privatization on a large scale started in Chile in 1974 with the specific objective of reversing the nationalization/statization process that had taken place during Allende's attempt to impose socialism in 1970-73. Throughout the 1980s, the adverse international economic environment and the dismal performance of many of the Latin American economies accentuated the need to rethink their overall development strategy and in particular the role of the public sector. By the end of the decade, many governments were pursuing privatization of SOEs -at least at the executive branch level- despite frequent and strong opposition from legislative bodies, academics and trade unions.

Restructuring of the public sector in Latin America was very much a pragmatic response to the tragic economic and social performance of the region's economies in the 1980s when:[2]

- Average income per capita in the region fell by 15%;

- Foreign debt amounting to over $400 billion peaked at over 4 times annual exports of goods and services in 1986; after averaging 30% of GDP in 1980-81, foreign debt fluctuated between 50 and 60% of GDP in 1982-89;

- Investment was generally low and in some countries did not even cover depreciation; after averaging 28% of GDP in 1975-81, it fell to 19% of GDP in 1982-89;

- As a rule, budget deficits were too large and measures to reduce them often resulted in lower levels of investment rather than increases in fiscal revenue;

- Inflation was too high in most countries and as a rule did not respond to the endless orthodox and heterodox stabilization programs that these economies had adopted over the years; five out of the six hyperinflationary episodes of the decade occurred in the region; the rate of inflation for Latin America as a whole was 1350% in 1989-90;

- On a combined basis, these economies became net capital exporters in 1983, and remained so throughout the decade; the net outflow of financial resources in 1983-89 amounted to $225 billion, representing about a quarter of GDP;

- The need to service foreign debt forced Latin American countries to increase exports; excluding Central America, the volume of merchandise exports rose by 85%, but because of weak commodity prices, export revenue increased by only 40%; the terms of trade deteriorated by 30%;

- Lack of foreign financing brought about a huge compression of imports, including essential capital goods;

- An estimated $120-$150 billion left the region as capital flight;

- Foreign investment flows to Latin America as a percentage of total flows to developing countries fell dramatically from 66% in 1980 to 28% in 1989; Latin America was the only region in the world in which foreign direct investment flows fell abruptly in nominal terms at the end of the decade (from $11 billion in 1988 to $8.5 billion in 1989);

- Physical and human infrastructure, particularly health and education, deteriorated to such an extent that deficiencies are still great today;

- Global productivity, which stagnated in the 1970s, fell in the 1980s (Massad, 1992);

- A historically bad income and wealth distribution became even worse during the 1980s: the poorest 25% of the population of six large metropolitan areas in the region lost nearly 10% of its real income during the period while the real income of the richest 5% rose by about 15% (Massad, 1992);

- A very large growth in population -from 150 million in 1950 to 450 million in 1990- contributed to a serious increase in poverty and the deterioration of the environment: by the end of the decade almost 200 million people -about 46% of the population- lived below the poverty line.

Thus, although by the end of the decade there was unquestionably a shift in ideology towards trade and investment liberalization and market-oriented mechanisms, privatization in Latin America became an important mechanism to overcome the appalling economic and social conditions described above.

The privatization process in Latin America has clearly differed from that in Asia and in the industrial countries in that it has taken place while these economies were going through comprehensive stabilization **cum** liberalization programs. This has made the divestiture process much more complex than it has been in other countries operating under more stable macroeconomic conditions. The Latin American countries have also had to face the following dilemma: should privatization lead the stabilization process or should it come after stabilization is on its way? If it did lead it, the price of assets would be low and the choice of buyers (and the technology they might bring in) would be limited by existing economic instability and the risk that the stabilization efforts would not succeed. On the other hand, a privatization scheme early in the stabilization program was indicative of an economic and political environment conducive to investment. To postpone it to a later stage could threaten the stabilization effort altogether. The different responses to this and other dilemmas faced by privatizing countries will be illustrated in the case studies below.

B. Case studies

1. Chile

a) Initial conditions

As in other economies of the region, the import-substitution model of the Chilean economy and generalized price distortions led to inefficient, low-quality production and technical obsolescence. The economic situation in Chile was aggravated by Allende's experiment with socialism. By 1973, Allende's populist macroeconomic policies had resulted in inflation rates of over 400%, a fall in output of close to 6%, an unemployment rate of 5% with real wages falling by almost 40%, public sector expenditures amounting to 45% of GDP, a fiscal deficit amounting to 25% of GDP, dwindling international reserves and high protection with tariffs averaging 100% and rising as high as 750% for a number of products (Larraín and Meller, 1991; Lüders, 1993).

The government's role in **CORFO (Corporación de Fomento a la Producción)**, a state holding company created in 1939 to foster public and private production of copper, steel, coal, agricultural products, fertilizers and services such as electricity, transportation and communications, was greatly increased during Allende's period.[3] By 1973 **CORFO** was a huge holding company which had expanded from owning 46 firms and no banks in 1970 to controlling 488 firms (259 had been 'intervened' without the government acquiring the equity) and 19 banks (Edwards and Cox-Edwards, 1987). In 1973, operations of the public enterprise sector showed a combined deficit of over 12% of GDP (World Bank, 1992a).

b) Restructuring program

The structural reform program adopted after Pinochet's military coup included sweeping price and trade liberalization, promotion of the private sector and a diminished role of the government, not only in production but in its regulatory capacity as well. Privatization became a crucial element in the structural transformation of the Chilean economy.

The Chilean government began its privatization program in 1974, well before the Thatcher program in 1979, although she has been called "the mother of privatization policy"! The program was also more radical than the British one and it took place in a framework of overall economic restructuring. It was estimated that, after adjusting for the relative size of the two economies, Chile transferred more than twice the value of assets to the private sector than Britain, in about half the time (Business International, 1991).

The privatization process in Chile went through three distinct phases. During the first phase (1974-79), described by Lüders (1991) as "debt-led privatization", there was restitution to previous owners or reprivatization of firms that had been nationalized, expropriated or 'intervened'[4] by the Allende government. The government facilitated the purchase of SOEs by lending heavily to private groups ("**Grupos**"), guaranteed only by the SOE shares being divested, usually with a small down payment and up to twelve installments (Hachette and Lüders, 1993).

In 1981, legislation was introduced to create a private pension fund administration system (known by its Spanish acronym **AFP**), to be run by financial groups such as banks and insurance companies, in which each employee had to contribute 10% of his monthly income[5] (Christine, 1992).

The failure of the first attempt, aggravated by the sharp recession of 1982, laid the ground for the second phase (1985-87). This has to some extent become the model for later efforts in other Latin American countries. As pointed out by Business International, the government realized that undercapitalized state-owned enterprises purchased with state-financed debt had little chance of survival. The government therefore took the following steps:

- Preference was to be given to investors with sound financial credentials. Domestic and foreign corporate buyers had to use their own resources (no financing allowed);

- No single method of privatization was to be employed, with some companies sold directly to buyers, others auctioned in blocks of shares and others sold to workers and on stock markets;

- Rather than maximizing revenues from the sale of assets, efforts were made to spread ownership to as large a number of Chileans as possible, a policy referred to as 'popular capitalism';

- Great efforts were made to stimulate capital markets so that a large segment of the population could participate in the privatization process. The government encouraged workers to purchase stocks at a discount; gave loans with a maturity of 15 years at a 0% real interest rate and a 5% down payment to small investors; timely repayments of the debt were rewarded with a 30% discount and tax credits and the repurchase of shares at the minimum price paid was guaranteed at the time of retirement;

- The activities of **AFPs** were strictly regulated in spite of the fact that these funds were expected to play a crucial role in the process by providing capital for a wide-based ownership of private property. Their investment in private companies was limited to 5% except in privatized corporations where it was limited to 25%;

- Foreign investors and nationals with funds abroad were encouraged to participate through debt-equity swaps;

- Efforts were made to conduct the process gradually and in a flexible manner. First, the SOE would be turned into a legal entity and its shares would be traded in the stock market. Then 30% of the equity would be sold. After that, 19% more would be sold. Finally, with a further 2% sale, the corporation would pass into private hands.

c) Assessment

Starting in 1974, over 230 banks and firms that had been nationalized a few years earlier were privatized, together with some firms that had been originally created under **CORFO** (Business International, 1990). By 1978 **CORFO** controlled only 23 firms (11 of which were still going through the privatization process) (Edwards and Cox-Edwards, 1986).

The first phase of the privatization process was impaired by a number of problems. First, the price at which the private sector acquired the assets might have been too low given the uncertainty created by the new stabilization program.[6] Second, public assets were sold to 'groups' that relied too heavily on government loans for financing the acquired firms. Furthermore some of these groups were in an unstable financial situation even before the privatization took place; the government lent to them in spite of this. These highly indebted groups collapsed when domestic interest rates became exorbitantly high in the late 1970s and a deep recession followed in the early 1980s.

When many of the privatized firms failed during the recession their shares were taken over by banks (many of which were failing themselves) or by **CORFO**. Many of the principal commercial banks (which controlled the largest **AFPs**) and large commercial and industrial businesses were taken again by the government, and with them their holdings (Business International, 1990).

Many mistakes were made in the process of returning to the private sector companies that had been nationalized during Allende's government. This experience, however, was very valuabie in designing the second phase of privatization in the mid-1980s. Policy measures adopted during the second phase yielded many of the desired results. Measures to stimulate capital markets increased workers' shares dramatically in a short period of time. **AFPs** acquired large blocks of shares in major SOEs, particularly in utilities.

Debt-equity swaps were an incentive to investment. A large discount for Chilean debt at the time (60%), in conjunction with a domestic economic environment more conducive to growth, attracted both private and foreign investment and contributed to the cancellation of a large part of the external debt. For the period 1985-89, debt-equity swaps accounted for as much as 80% of total FDI. Chile attracted FDI in broad ranging sectors, particularly those relating to exports of natural resources (forestry, fish products, gold mining, etc.), traditional mining activities (copper) and service industries (finance, airlines, telecommunications, etc.). The surge of inflows through debt-equity swaps resulted in a share of FDI in Gross Domestic Capital Formation (GDCF) as high as 20%.[7]

During the second phase of privatization the government made a special effort to improve the distribution of property while at the same time searching for support for further privatization (Hachette and Lüders, 1993). The largest power company (**ENDESA**, with assets of $1.8 billion) and the steel company (**CAP**) were privatized during this phase with majority ownership eventually in the hands of employees of the company and the government. Control of the two largest pension funds (**Provida** and **Santa María**) was passed to foreign companies, although ownership of shares was diffused through popular capitalism.[8]

The main criticism of the second phase was the lack of transparency of the process and the perception that debt-equity swaps favored foreign groups over domestic ones. During the third phase of privatization at the end of the 1980s, the overall macroeconomic situation in Chile had improved significantly. Most SOEs were quite profitable. The government decision to privatize them was in line with its objective to limit its own role in the economy rather than with the need to solve its budgetary problems.

Opposition to privatization in general had been reduced by then since a large segment of the population had a stake in it. This phase, however, was criticized on the grounds that it affected companies that had been in the public sector for many years or decades (**LanChile** and **Telex Chile**), or those that had been created by the private sector and taken over by the government (Toso, 1991).

Many firms grew as a result of expanded investment and diversification of production after the privatization. The telephone company, for example, doubled its capacity in the five-year period after the sale. Paying electricity consumers were found to be better off as a result of the privatization, but those who were getting electricity through illegal connections before became worse off since private management reduced or eliminated this option (World Bank, 1992a).

Hachette and Lüders (1993) have found some evidence to show that change in ownership **per se** does not affect employment levels but that the drive to efficiency does. They have also found that privatization of housing and health services has improved the use of resources devoted to social services, reflected in either more services for the same amount of resources (housing) or better services (health and pensions).

During Pinochet's 16-year dictatorship, the government earned $3.4 billion from privatization and reduced the state's share in the economy by one third (Business International, 1990). While in 1973 the government controlled 85% of both the mining and the financial sectors, 40% of industry and 70% of telecommunications and transport sectors, by the early 1990s only the major state-owned enterprise **CODELCO** (copper), the mining company ENAMI, the oil company ENAP and 40-odd companies administered by CORFO remained in government hands (Toso, 1991; LAWR, February 3, 1994). Although the CORFO-administered SOEs[9] are highly unusual in that they are profitable ($42 million in 1993, more than double the 1992 figure), at least a 10% participation may be offered to the private sector with the objective of increasing "transparency" in their management (LAWR, February 3, 1994)

In May the remaining shares of **LanChile**, including the 24% still owned by **CORFO**, were put up for auction on the stock market. The sale is expected to bring in about $11 million, although the publicized goal of the privatization is to increase transparency (Business Latin America, May 19, 1994) in a competitive market.

The turnaround in the Chilean macroeconomic performance, resulting from almost 20 years of stabilization and structural transformation discussed above, has been remarkable. After the large imbalances at the end of Allende's period, the economy was brought into a path of economic growth with moderate inflation. Throughout the 1980s, the economic situation in Chile was significantly better than in any other country in Latin America. In 1981-90, GDP increased by almost 30%, as compared to 15% in Mexico and to a contraction of 13% in Argentina. Inflation was always below 30% and investment averaged over 16% a year.

In the 1990s, Chile is unquestionably on a path of sustainable development, with rapid growth during the last nine consecutive years and output doubling in the last two decades. In 1991-93, GDP increased by 8% a year with an average annual inflation rate below 15% and with rising employment and real wages. At the same time, during this period Chile has managed to bring approximately 1 million people above the poverty line (New York Times, April 4, 1993).

2. Mexico

a) Initial conditions

By the late 1960s, domestic and foreign private investment in Mexico was slowing down and protected oligopolies, which had achieved a strong market presence, had little incentive to keep on growing by means of higher employment and increased productivity. With a fast growing population, by the 1970s Mexico had to choose between two paths: to shift the development paradigm to an export-oriented strategy -as Korea did in 1965- or to continue with the same inward-looking model while increasing public spending to compensate for falling private investment. Mexico opted for the second path (Aspe and Gurría, 1992).

After maintaining an average growth rate of close to 6% with inflation below 5% from 1950 to 1970, inflation began to accelerate in the early 1970s. The public sector deficit increased from slightly more than 2% of GDP in 1971 to above 9% in 1976, financed by a combination of inflation tax and external borrowing. In 1976 the country faced its first serious financial crisis since 1940 and the first devaluation of the peso vis-à-vis the dollar in 22 years. The reform this crisis called for was postponed by the discovery of large oil reserves and the belief that the economy could grow even faster than in the past (ibid.)

In Mexico, although some SOEs had been created pursuant to the constitutional mandate to maintain public monopoly in strategic activities, the public sector expanded greatly during governments following populist macroeconomic policies. The number of

SOEs grew rapidly during the Echeverría administration (1970-76) and reached its peak after the nationalization of banks by López Portillo in 1982. Failing private sector firms were rescued with the objective of maintaining employment or for income redistributing purposes. While in 1970 there were 391 SOEs, by 1982 the number had climbed to 1,155 (Córdoba, 1992; Schneider, 1991; Bazdresch and Levy, 1991).

As a result of a combination of external and internal shocks such as lower oil prices, much higher real interest rates in the international capital markets, higher costs resulting from inefficiencies due to the import-substitution model, by 1982 Mexico was facing the worst crisis since the 1930s, aggravated by the interruption of international lending. The economy was at the beginning of a recession (with the fall in output accelerating to over 4% in 1993) and inflation was close to 100%. The budget deficit had reached 16% of GDP, with government transfers and subsidies to SOEs amounting to more than 3% of GDP (World Bank, 1992a).

b) Restructuring program

Since 1982 Mexico has been implementing rigorous stabilization and structural reform programs. President Salinas has acknowledged that the elimination of large macroeconomic imbalances during the De la Madrid Administration allowed his own administration to focus on the elimination of institutional distortions that inhibited the participation of civil society in the development process. The government decided that to make adjustments permanent it would be necessary to renegotiate the external debt and liberalize trade and financial flows, to reform the state, to privatize, shut down or transfer SOEs, and to put in place a fiscal reform that, while lowering tax rates to international levels, would stress compliance and eliminate special privileges. The reform of the state was not only aimed at increasing economic efficiency and promoting economic growth, but also had a strong social dimension (Aspe and Gurría, 1992).

Mexico started a gradual privatization program in 1984, liquidating first all non-viable SOEs; privatizing small- and medium-sized SOEs in competitive sectors from 1986 to 1988 and, only after finishing with these, starting the privatization of larger SOEs such as the national airlines, some of the most important mining and steel companies, the telephone company and the commercial banks. By February 1990, the government had agreed to the privatization or liquidation of 891 companies, and 691 of the privatizations had already been concluded (Córdoba, 1992). The strategy of privatization in Mexico was: to start small, learn-by-doing, and move on to larger and more complex transactions in less competitive sectors.

The radical reprivatization of the banking system announced in early 1990 took place in the context of an overall reform of the financial system. Deregulation of the system had started during the previous year, with the elimination of interest ceilings, the liberalization of reserve requirements, and the abolition of obligatory lending requirements for public housing and agriculture. Foreign participation in the privatization of banks and financial holding companies was restricted. Debt-equity swaps were not allowed. Banks were to be sold off to the highest bidder through sealed auctions. Industrial companies could not own banks. No individual could own more than 5%, or 10% with permission, of a bank's equity. Foreign shareholders could hold individually only 10% of the total shares of a bank and up to 30% as a group (Bacmeister, 1991; Fraser, 1992).

Mexico also privatized what remained in government's hands of the mass media, although most remaining restrictions on FDI in Latin America relate to this sector. It is now in the process of privatizing infrastructure.

In addition to privatization, recent industrial policy included the deregulation of key sectors such as ground and air transportation, telecommunications, fisheries, textiles, automobiles, foreign investment and technology transfers (Aspe and Gurría, 1992). More recently, in the framework of the overall financial opening up ("**Apertura**") resulting from NAFTA, Mexico will now allow foreign bank subsidiaries. In October 1994, the Finance Ministry announced the authorization to enter the Mexican market to a package of foreign financial firms which included 5 financial groups, 18 banks, 12 insurance companies and 16 securities houses.

c) Assessment

The most spectacular privatization in Mexico was that of the banking system. By July 1992 Mexico had privatized its 18 restructured banks for over $12 billion (see table 1). The privatization of banks was considered at the time to be "by almost all accounts outstandingly successful." The government had expected the banks to fetch a price equivalent to two times their book value on average, but in fact it sold them for an average of three times that value. The average price-to-earnings ratio of 14.75 obtained also surpassed all predictions (Fraser, 1992). A year later, however, it had become clear that the high prices paid by the banks were being translated into higher prices for their services and public complaints became vociferous.

It is expected that by mid-1995 foreign banks will add $1.2 billion in capital to the domestic financial system whose capitalization presently stands at $17 billion. More importantly, because of their corporate experience and lower operating costs, these banks are expected to increase competition and efficiency in financial intermediation as well as to deepen this in relation to GDP. Thus, the opening up of the financial sector is expected to accelerate modernization of this sector which started with the privatization of banks, and so improve the Mexican economy (Latin Finance, April 1994).

The decision of the government to privatize a media package of TV channels, the newspaper **El Nacional**, a wire service and a group of cinemas, has been rather unusual since the media remains overall a very protected sector in Latin America.

The privatization program in Mexico has also been unique in its emphasis on improving investment in infrastructure. After giving up its monopoly stake in **Teléfonos de México (Telmex)**, its inefficient telephone company, for close to $6 billion and investment commitments amounting to $14 billion over 5 years, the government is deregulating and privatizing motorways, ports, airports, power plants, water supply, distribution network and sewerage systems, and even prisons. Some argue that the deregulation of ports and transport has been one of the most important achievements of Mexico's modernization program which has allowed the government to bring in the needed technology and the private sector to pay the bill. The needs are huge. For example, only 71% of the population has access to potable water and only 47% to sanitation and waste facilities. The International Finance Corporation has estimated that about $90 million dollars will have to be invested in order to provide all Mexicans with water (Fernández, 1992; Edwards, 1993; Sedelnik, 1994). One in seven Mexican do not have running water and more than 27 million do not have sewerage facilities (Tovar, 1994).

Difficulties arose in the Mexican experience with privatizing infrastructure. First, private investors are not always willing to finance infrastructural projects in poor areas that, though they might have the greatest needs, can hardly afford expensive tolls or user fees. For example, a much needed Oaxaca-Mexico City motorway will have to be financed by the government (with proceeds from the privatization of state-owned TV channels). Second, this experience illustrates the difficulties for a country such as Mexico in which there still exist economic and political uncertainties, particularly with regard to the coming elections and the killing of the presidential candidate of the **PRI (Partido Revolucionario Institucional)**, to have access to long-term debt markets for project financing. Because of this, investors want to recoup capital quickly and charge unrealistic prices for their services. For example, motorway tolls at 13 cents a kilometer are five times higher than in the United States, which makes them prohibitive to many potential users (Fraser, 1993).

Contrary to many other countries where privatization has led to overall employment shedding, privatization in Mexico has increased employment in some sectors as a result of higher output (World Bank, 1992a). A study of 62 privatized petrochemical and auto-parts firms also shows that investments increased up to as much as 75% of gross sales revenues in a period of three years, improving financing, management and technology and reducing management staff but improving the compensation of the remaining employees (Megginson, 1992). The privatization program in Mexico has boosted efficiency and productivity. Both labor productivity and total factor productivity increased significantly in the privatization of the airlines; aggregate welfare has been found to be higher for many services (including the telephone company and the airlines) (Edwards, 1993; World Bank, 1992a).

Many attribute the overall success of the Mexican experience to the strategy of starting small and learning-by-doing before moving to larger and more complex situations. In 1982 there were 1,155 SOEs; by early 1993 only 213 remained in state hands. (Céspedes, 1993). Small sales proved to be rather easy and fast, involved little restructuring or post-sale regulation and were politically low-risk (World Bank, 1992a).

In 1982 Mexico declared its inability to pay its external debt, marking the inception of the debt crisis in Latin America. Ten years later its overall macroeconomic performance had improved significantly. Mexico's stabilization took place amidst efforts at strengthening the private sector. Deficit reduction accelerated with drastic cuts on taxes on production, capital formation and trade which reactivated growth and soon resulted in increased tax revenues (Malpass, 1993). Inflation fell from 100% in 1982 to 12% in 1992, while a stagnant economy in 1982 grew 3% in 1992. As a result of stabilization and privatization, which raised $20 billion in 1988-92, transfers and subsidies to SOEs amounting to slightly less than 13% of GDP in 1982 had been reduced to only 2.5% by 1991 (Aspe and Gurría, 1992). Public expenditure as a share of GDP, which reached 44% in 1982, had fallen to 27% in 1992 (Hussain, 1992). The consolidated public sector, which showed a deficit of 18% of GDP in 1982, had turned to a surplus of 1.5% by 1992 (Business International, 1991).

Stabilization, privatization and the prospects of NAFTA attracted large flows of FDI. In 1991-92 Mexico received over $10 billion of FDI, which represented close to 40% of total flows to Latin America. Much recent FDI has gone into restructuring the motor-vehicle industry as well as various services such as tourism and telecommunications.

The performance of the Mexican economy in 1993, however, was mixed. Although inflation fell to 8%, the lowest known by most Mexicans, it was accompanied by sluggish growth (1%) and rising unemployment. The latter was related to a small contraction in private consumption and an increase of 3% in private investment, as compared to a 20% growth in 1992. **Banco de México** attributes the lethargy of the economy to investors' caution in light of the uncertain fate of NAFTA until it was ratified and to the fact that economic restructuring, in particular the trade liberalization started two years earlier, takes time before its fruits are seen and often results in job displacement and other distortions before firmer growth consolidates (Business Latin America, April 18, 1994; ECLAC, 1993). In 1994 the Mexican economy is expected to have grown 2.5% to 3%. The new government has announced plans to embark on an ambitious new privatization and foreign borrowing program with the objective of raising over $5 billion to stimulate infrastructure investment and help finance the country's large current account deficit which might reach $28 billion in 1994. The government expects that this decision, in conjunction with a 15% devaluation of the currency on 20 December, would strengthen the confidence of foreign investors in the country eroded by deepening political tensions in the southern state of Chiapas and killings of political figures. The attraction of more capital inflows seems to be a main macroeconomic challenge in the coming year (Bardacke, 1994; Business Latin America, October 3, 1994; Bardacke and Fidler, 1994).

3. Argentina

a) Initial conditions

In the 1980s Argentina alternated between periods of deep economic crisis and unsuccessful stabilization. GDP per capita plummeted by over 25%, savings and investment plunged from 23% to 8%, and consumer prices increased annually by 450%, with two bouts of hyperinflation. From being one of the richest countries in the world in the latter part of the nineteenth century, with income per capita comparable to that of France and Germany, Argentina had fallen by the end of the 1980s to 70th place.

President Menem took over in July 1989, his predecessor, Raúl Alfonsín, having stepped down six months before the end of his term. Menem inherited an overregulated and highly indebted economy which had become increasingly marginalized from international trade and financial flows. In 1988, SOEs had losses amounting to $5.5 billion, which represented more than half of export earnings. Out of a labor force of about nine million, two million were directly employed by the government and another million indirectly through suppliers (Business International, 1991).

Although President Alfonsín had made plans for privatization during the last two years of his mandate he did not have the political clout to carry them out. He has nevertheless been given credit for introducing the topic into the national debate. As part of the Austral Plan, SOEs were allowed to increase what they charged for their services directly rather than relying upon government subsidies. Public services became more expensive, in spite of a decline in quality due to a lack of investment and technology. Opinion polls showed that during the congressional debates over privatization in 1987 and 1988, a majority of the population favored the sale of SOEs to the private sector[10] (ibid., 1991).

b) Restructuring program

From its inception, the Menem Administration started with a most ambitious program to:

- Reform the structure and the role of the public sector;

- Privatize its largest, mostly inefficient, bloated and money-losing SOEs; and

- Improve resource allocation through the operation of competitive and deregulated markets.

Starting privatization with the largest SOEs is not simple. It involves complex financial arrangements, the need to have a regulatory system in place and usually sensitive labor shedding. The government decided to do this at the beginning of its term in office, based on two main beliefs: first, that privatization would signal its commitment to create appropriate investment conditions; and second, that the privatization program would have more political support during the 'honeymoon' period.

The principal instrument of the privatization program was the Public Sector Reform Law (23.696 of August 1989). To facilitate the privatization, this law granted the Executive the powers to absorb the companies' liabilities, to allow the capitalization of domestic and foreign debt for the payment of goods, and to implement systems of shared ownership with employees (Rocca, 1991; Bour, 1993). Since then, new legislation has been enacted, among other things, to allow privatization in new areas; to increase private participation in previously privatized firms; to transfer personnel to privatized firms; to regulate the use of foreign debt instruments and to specify increases in capital and technology. In 1991 three notable regulatory changes were enacted, the most important of which was Law 23.966, Sec. 31, providing that 30% of the gross proceeds from the privatization of SOEs or public services would be used to finance the National Social Security System.

Stabilization and structural reform got a new impetus in April 1991 with the adoption of the Cavallo Plan, also referred to as the Convertibility Plan. This made the **austral** fully convertible at a fixed rate of 10,000 **australes** to the dollar (In January 1992 four zeros were dropped off the **austral,** which was then renamed the **peso**, worth $1). By law the monetary base had to be 100% backed by gold and foreign currency reserves. The Act also banned indexation in any contract. In October 31, 1991 President Menem issued what became known as the "Super Decree" that, once ratified by Congress, resulted in major reforms to deregulate the economy, including the deregulation of production, trading, labor relations and professional activities.

By July 1990 the government had identified 236 enterprises in which the public sector had total or majority ownership and which generated over 40% of public sector current and capital expenditure (Rocca, 1991). In September 1992 President Menem announced that by December all SOEs would be transferred to the private sector, and that the state would only provide health, education and security services.

c) Assessment

Privatization in Argentina has ranged widely, encompassing a large number of sectors and industries. In some cases, public assets were transferred to the private sector and in others only the service was privatized in the form of a concession to private operators for a certain number of years. Argentina inaugurated its privatization program with telecommunications. The telephone company had been created with British capital in 1886 and purchased in 1929 by the International Telephone and Telegraph Corporation (ITT), which maintained a quasi-monopoly of services in the country. The government bought the rights and assets of the company in 1946 and created **Empresa Mixta Telefónica Argentina**, which was restructured in 1948 as the **Empresa Nacional de Telecomunicaciones (ENTel)**. The company was sold in November 1990 for $214 million in cash, a $2 billion reduction in the face value of Argentina's foreign debt and the commitment of buyers to invest $5 billion in capital improvements over a 10 year period. Original commercial bank lenders participated through debt-equity swaps.[11] Because of the heavy commitment to future investment, advisors to the government on this deal believed, at the time the privatization was planned, that it would never take place without the incentive of the swap to commercial banks (World Bank, 1992a; Herrera, 1993).

The first two privatizations, those of **ENTel** and **Aerolíneas Argentinas**, the national airline, led to price increases for their services that, although allowed under the sales contracts, provoked public complaints. A year after privatization, the installation of a phone cost over $1,000, the transfer of a number about $400 and long-distance calls were significantly above international rates (Latin Finance, September 1992). Since then, this problem has led not only to a strengthening of the regulatory framework but also to the selection of future bidders on the basis of guarantees to charge the lowest prices for their services (World Bank, 1992).

Privatization in Argentina has had a large negative impact on employment in the short-run. For example, a third of the 8,000 personnel of **Obras Sanitarias de la Nación (OSN)**, the water/sewerage facility, left **OSN** through a plan of voluntary retirement before the company was privatized (Latin Finance, November 1991). The **Sociedad Mixta Siderúrgica Argentina (SOMISA)**,[12] the largest steel company, was also one of the most important employers, directly employing 12,000 to 15,000 people in 1990 and indirectly affecting thousands more. The company required about 2.5 times the world average man/hours to produce a ton of steel. To make the company more attractive to prospective investors employment was brought down in six months to 6,000. These reductions were costly, however, because they were implemented through early retirement and other generous compensation (Mooney and Griffith, 1993).

With the privatization of gas and electricity Argentina became one of the few countries to privatize all of its public services. The provision of basic services such as water, sewerage, gas and electricity, practically non-existant in poor neighborhoods, is expected to improve as a result of privatization. Amadeo (1994) reports that over the next five years, thirteen million people will have coverage of water and sewerage; something unheard of during the seventy years when the public sector provided the service.

Privatization has also had a significant impact on equity markets. The privatization of **ENtel** resulted in an increase of 470% in market capitalization during 1991.[13] Monthly traded volumes increased from an average of $66 million in 1990 to $380 million in 1991. Total market capitalization reached $20 billion (15% of GDP) in 1992 as compared to only $3.5 billion (5% of GDP) in mid-1980s. The Merval Index which measures the performance of firms accounting for 85% of total trading, showed returns reaching 412% in dollar terms. Market performance reached a peak during the first days of June 1992 and a dollar return of 230% in June 1991-June 1992. A market fall followed in the second half of the year in spite of strong macroeconomic performance because of investors' concerns about the appreciation of the peso (Moreno & Domínguez, 1992).

Privatization has resulted in intra-Latin America FDI. For example, the **SOMISA** steel mill (renamed **Aceros Paraná**) was bought by a consortium led by Argentina's **Techint**, including **Usiminas, Companhia Vale do Rio Doce (CVRD)** of Brazil and **Compañía de Aceros del Pacífico (CAP)** of Chile.

The privatization process is also leading to social security reform. The pension fund system, modeled after Chile's, is based on obligatory contributions of all workers above 18 years of age. Contributions will be deposited in Individual Capitalization Accounts, which will be managed by pension funds administrators **(AFPs)**. It has been estimated that within 10 years, pension funds should have an equity of about $40 billion (Fernández, 1992). By mid-1994, 21 private groups with foreign participation that have formed **AFPs** will be competing for a market estimated at $3 billion a year. **Banco de la Nación**, a SOE, has formed an **AFP** which will act as pace-setter offering a maximum monthly pension of $1,900 to contributors earning $3,300 a month. In comparison, the state guarantees a minimum of $140 a month (Business Latin America, 28 April 1994).

Privatization of the airline company illustrates the danger of getting the "wrong" foreign partners in terms of the capital, technology and management they are expected to bring into the company. This privatization also underlines the importance of devoting enough scrutiny to potential domestic buyers, raises questions on the desirability of foreign SOEs as buyers and shows the danger of ending up with a private monopoly. A major buyer in the privatization of **Aerolíneas Argentinas** was the **Pescarmona** group that, by being in the travel and tourism business, had detailed information on **Aerolíneas**, its competitor in the domestic market (Business International, 1990). With the purchase of **Aerolíneas** by the owner of the domestic airline (**Austral**), the domestic airline sector became for some time a monopoly.[14] The major stockholder (49%) and operator of **Aerolíneas** was Iberia (the Spanish national airlines), after SAS (the Scandinavian airline) backed out. **Aerolíneas** lost $25 million in 1991 while it was being privatized.[15] Nearly four years after the sale of **Aerolíneas** began and merely four months after it was completed, the government had to raise its previously reduced stake in the company from 5% to 33% because the airline's domestic investors were not able to increase the capital requirements of the company (Recio, 1992). In April 1994, Iberia has agreed to inject $500 million into heavily loss-making **Aerolíneas**, thus raising its share of the company to 85% and reducing that of the government back to 5%. Of these, $100 million will be used for new investment and the rest to repay debts.

After the bad experience with **Aerolíneas**, all consortiums bidding for the national oil monopoly, **Yacimientos Petrolíferos Fiscales**, boasted of their expertise in the oil field, as well as their capital resources and a commitment to develop their activities (Recio, 1992). The privatization of **YPF** has been unique in that no other Latin American country has yet sold its state oil company.[16] As pointed out by the New York Times (June 28, 1993), "Historically, state energy companies have been considered the crown jewel of any Latin America government -the patrimony of its history and the ultimate financial refuge from the pressures of international bankers and other foreign interests that threaten national security." **YPF** was in itself 'unique' in that it had lost $6 billion in the 1980s. After losing close to $600 million in 1990, **YPF** earned $260 million in 1992 and over $500 million in 1993, and earnings are expected to reach $1 billion in 1994. In the process of making the company more attractive for privatization, employment was cut from 50,000 in 1990 to 10,000 in 1993. A new pipeline to Chile, to be completed by 1994, will open a large new market and has added to projected earnings.

The sale of 45% of **YPF** in the form of 160 million shares for $3.04 billion made it the largest privatization in Latin America at the time and one of the largest public offerings of stock. Argentines reacted enthusiastically to the sale with four times more buy orders for the stock than had been expected. It is estimated that well over 1 million Argentines will own **YPF** stock. The government planned to use 60% of the cash to pay off debts to retirees. The other 40% was distributed to the six provinces that had ownership of **YPF** and to some of its creditors. The government offered to exchange certain bond issues held by pensioners and other investors for **YPF** stock at a 15% discount. If the stock sale and debt retirement were combined, the total value to the government would have been well over $4 billion. Argentine investors held about 31% of the shares, the government 20%, the provinces 11%, **YPF** workers 10% and foreign investors 28%. Because shareholders are such a dispersed group, with no real dominant player among them, some observers expect that they will not be able to exert any significant pressure on management and question to what extent the government has really released control of **YPF** (ibid.; Nash 1993).

A worrying feature of the privatization process in Argentina is that it has so far concentrated even more wealth in a few groups. Until 1993, sales had been dominated by 18 firms -7 domestic and 11 foreign- which together accounted for 60% of the total value of sales. Argentine firms accounted for 40% of the total but only 7 of them accounted for 32%. In the future, wider-share holdings by domestic investors are expected to result from the planned public offering of the government's minority interests in privatized companies (**"Programa de Participación Compartida"**) (World Bank, 1993).

The turnaround in the macroeconomic performance of the country as a result of stabilization and structural reform has been dramatic. During the first two years after the Convertibility Plan was adopted in March 1991, cumulative real growth was 16% and inflation fell to 18%, with wholesale prices rising by only 3%. The consolidated fiscal balance (which excludes the quasi-fiscal balance) moved from a deficit of 16% of GDP in 1989 to a surplus of 0.2% in 1992. Overall tax collection (both national and provincial) improved significantly from 18% of GDP in 1990 to 29% in 1992. International reserves doubled from $6 billion in 1990 to over $12 billion in 1992. Investment reached 20%, a historic high for Argentina. As a demonstration that growth-oriented policies are feasible and in particular that sound money can restore the country's growth potential, some observers note that Argentina surpassed the IMF's 1992 fiscal targets by expanding its economy rather than through contraction (Kudlow and Malpass, 1993, Artana and López Murphy, 1993; de la Balze, 1993).

The economic expansion will somehow decrease this year after the rapid growth of 1991-93 but inflation continues to fall and now exhibits the lowest rate in Latin America (5% in 1994 as compared to 7% in 1993). With interest rates rising in international capital markets, Argentina will receive lower flows than in recent years ($10 billion in 1994 as compared to $18 billion in 1993). This will be compensated, however, by large increases in private pension funds, which from mid-1994 to mid-1995 will encompass domestic savings estimated at over $3 billion.[17] Investment in 1994 is expected to increase to 20% as compared to 14% in 1993, mainly as a result of increases in private investment in infrastructure and telecommunications and public investment in social programs in poor provinces. Foreign firms, encouraged by years of stability and growth, are attracted to the country for the first time (Toyota, RJR Nabisco, Procter & Gamble, Toys-R-Us and Wal-Mart) or are coming back (General Motors and Johnson & Johnson). As a result, FDI is expected to more than triple this year to $2 billion. (Business Latin America, May 9 and 16, 1994; Financial Times, May 13, 1994). In October 1994 the economy minister announced that by the end of 1995 "all business activity in the scope of the federal government will be transferred to the responsibility of the private sector" (Sedelnik, 1994).

While Menem's economic program has been successful overall in attaining macroeconomic targets and the turnaround has been labelled "the most dramatic in the developing world" (Kudlow and Malpass, 1993), adjustment has been particularly harsh on low income people and unemployment has reached a record 10% (LAWR, April 28, 1994). As a result, the government has been under increasing pressure to augment social spending and to create jobs. This could put pressure on the stabilization program. Failure to do so, however, could have serious political implications.

C. Overall comparisons

The privatization schemes in the three countries show some common features and some notable differences. The program in Argentina, for example, had some features in common with that of Chile (i) it covered a wide number of sectors and industries, some of which were previously not open to FDI; (ii) it treated foreign and domestic investment equally (the only exception was the mass media where foreigners could not control TV, newspapers or radio) and (iii) it allowed for debt-equity swaps. In contrast to that of Chile, privatization in Argentina (i) took place under a democratic government and (ii) had a higher investment risk given the large disequilibria in the early stage of the program.

The privatization strategy of Argentina, however, was completely the opposite of that of Mexico. Mexico stabilized first and privatized later, through a gradual process in which there was divestiture of small firms in competitive sectors first, and only after a learning-by-doing experience the larger firms in oligopolistic sectors were sold off. Argentina made privatization a main element of its stabilization program, and chose to privatize the largest firms first as an indication of its commitment to the program.

Policies toward natural-resource monopolies have differed in the three countries. While Argentina has privatized its oil monopoly, Mexico still holds on to its own and Chile has maintained control over the large copper corporations.

Privatization in Argentina and Chile differed from that of Mexico, which opted for a much more restrictive treatment of foreign investment, and did not allow for debt-equity swaps except during a brief period in 1986-87 and a much more limited program in 1990. As a result, the share of privatization in total FDI inflows in 1990-91 was only 17% in Mexico but 54% in Argentina, the latter figure increasing to 78% in 1992. In Argentina, debt-equity swaps in privatizations have reduced the face value of outstanding commercial bank debt by 20%. From 1989 to early 1993 divestment of SOEs made possible the write-off of $12 billion worth of internal and external debt plus about $1.1 billion worth of liabilities (World Bank, 1992a; LAWR, 1993). Debt-equity swaps decreased not only foreign debt but also the burden of debt servicing.

Though Mexico did not allow privatization to be financed through debt-equity swaps, it attracted new equity flows into the country either from foreign investors or repatriation of domestic capital. Mexico has used some of the proceeds of privatization to buy back debt, however. Although appealing, this option is not always available since a large debt overhang is often a deterrent to investment in SOEs (World Bank, 1992a).

As we mentioned earlier, investment was extremely low in many Latin American countries and, through the restructuring process, governments sent a strong message to interested parties that they were creating an environment conducive to both domestic and foreign investment. Restructuring has also been a way to obtain higher efficiency/lower cost services. The transformation of inefficient service-rendering SOEs into efficient, profitable ones has only been made possible by the private buyer bringing in either capital, new technology, management or some special expertise. Two additional factors have been more realistic prices as a result of price liberalization and better inputs resulting from trade liberalization.

Many of the privatizations that took place in Latin America, however, have been criticized on the ground that the private parties did not necessarily have the credentials to make production more efficient. This criticism has been particularly strong in the case of privatizations in which the buyer has been a foreign SOE, a common feature of some Latin American privatizations.

The reasons for privatizing SOEs in Latin America have been similar to those in other developing countries, but the socio-economic problems facing Latin America at the time made some of the objectives even more valid and urgent in the regional context. By selling many of the inefficient, highly subsidized SOEs and by reprivatizing firms that had earlier been in private hands, some governments reduced a serious drain on their resources.

Although carefully planned adjustment programs <u>can</u> protect the poorer sectors when this is politically and socially desirable, Chile, Mexico and Argentina have followed rigorous stabilization and structural reform programs, and have all had high negative social implications, at least initially. It is important to emphasize, however, that even when the cost of adjustment may be high initially, the cost of <u>no adjustment</u> is significantly higher. It has been estimated that Brazil, for example, lost $500 billion in the 1980s, one and a half times its GNP, as a result of lack of adjustment. Lüders has made this point by comparing Chile to Peru, which rejected adjustment for a long time, and in which the social costs suffered by the population were significantly higher than if it had adjusted (ICEG, 1993).

Divestiture in Latin America (as in other developing countries) has been hampered by the paucity of domestic savings, the shallowness of stock markets and the scarcity of managerial skills. At the same time, privatization itself has helped to promote capital markets.

Privatization in Latin America has often been facilitated by recent attempts at regional integration. Current programs of integration are more likely to succeed than those of the past since they are taking place in a framework of overall liberalization of the world economy. The prospect of larger markets and cheaper inputs is indeed an incentive to private investment. Proposed schemes of regional integration, however, have made difficult the privatization of certain companies, such as the steel monopoly in Argentina, which will have to compete with more efficient Brazilian firms for the domestic market when the **Mercado Común del Sur (MERCOSUR)** becomes fully operative.

VI. OBSERVATIONS FROM THE LATIN AMERICAN EXPERIENCE

Many things can be learned from the Latin American experience with regard to the desiderata for a successful privatization process and the dangers involved in doing it wrong. The experience of these countries makes it quite clear that there are certain conditions which, if present, facilitate the process, but if not, can make it quite difficult, and in some cases even impossible. The breadth and nature of the program, as well as the sequence and speed with which it has been carried out, has been greatly influenced by a number of factors. The following factors can make privatization successful in the long run:

A. Political viability

Since privatization is just as much a political process as an economic one, the government first needs to decide whether or not to enter into it by assessing the short- and long-term political implications that its decision may have. Martínez (1991) interpreted the uneven progress of privatization in Latin America as the result of differences in perceived political costs. He pointed out that in Chile the privatization process moved expeditiously because it was administered by an unelected military government that did not have to concern itself excessively with political repercussions and did not have to make concessions. He noted that in Mexico the **PRI** has had complete control over Mexican political affairs for seventy years and, even though it had recently been facing stiffer opposition, it has remained sufficiently strong to assume the political risk involved. In 1991, Martínez argued that in countries such as Peru, Colombia, Venezuela, Brazil, Argentina and Uruguay, political power was more balanced and hence there was less room for risk-taking. He concluded that, as a result of the political situation, the privatization process in these countries would be either more tortuous or more limited. The experience of Argentina since then, however, has certainly not conformed to this pattern. On the contrary, the rapid pace of privatization has proven that privatization is also politically feasible in a democratic regime, with a strong and charismatic leader, particularly when extremely unfavourable economic conditions have convinced the majority of the population of the need to change the **status quo**.

Regardless of the existing political situation, before a government decides to privatize it has to evaluate whether it has the political clout and legal authority to implement a privatization program. In many Latin American countries the constitution reserves certain priority sectors for exploitation by the state. For example, the Mexican constitution provides that the oil industry must always be in the hands of the state, the Brazilian constitution reserves certain mineral sectors to the state and the Costa Rican constitution calls for state ownership of public utilities.

At the same time, the process has to be politically viable so as to minimize the risk for investors. Investment will not be forthcoming if the possibility that the process may not be completed (or that it may be reversed in the future) is lurking in the background.

B. Public support

The experience of Latin America shows the difficulties of privatizing if the program lacks public support, as was clearly the case in Uruguay and Venezuela (Naim, 1993). To maximize public support the process needs to be open, transparent and free of corruption. The level of openness, expediency and fairness of the privatization process has been a key indicator, not only for potential investors, but also for the public of the serious commitment of the government to the privatization process.

With the long tradition of statism and a welfare system in Latin America, the public is not likely to support privatization unless it understands the reasons for it and is aware of its possible benefits and costs. Thus, once the privatization program is adopted, an important factor in its successful implementation has been the ability of the government to 'sell' it to the public. The 'selling' is necessary primarily because of two reasons: first, to minimize the practical opposition from trade unions, employees, management, government suppliers and others ideologically and pragmatically opposed to it; and second, to attract the appropriate type of prospective investors, both domestic and foreign. In this regard, an educational campaign and a marketing effort to familiarize those affected by privatization with the potential benefits that they may derive from it has often facilitated the process. Mitrani (1991) has recommended the use of professional communicators to sell the program and has warned against exaggerating the benefits of privatization, since unfulfilled expectations could quickly turn the public against the program.

C. Role of government for successful privatization

Even when the objective of privatization is to reduce the role of the public sector in production and distribution, governments have a prominent role to play in ensuring that privatization is successful. For this governments need to ensure that the following conditions are met:

1. Appropriate macro- and micro-economic framework

Without an environment conducive to growth, investors -be they domestic or foreign- are not likely to invest. It is therefore very important that governments adopt macroeconomic and microeconomic policies designed to create the appropriate conditions under which the private sector can thrive. The government should eliminate institutional constraints to competition, since privatization is more likely to yield solid and rapid economic benefits in competitive (particularly tradeable) sectors such as industry (textile, steel), airlines, agriculture and retail operations. Privatization seems to yield more immediate and large benefits if the overall policy environment is market-friendly. In unfavorable country conditions, where the private sector is small, capital markets undeveloped and foreign investors show no interest, the sale of enterprises, even in competitive sectors, has been more difficult (World Bank, 1992).

2. Clear rules of the game

Governments need to establish an equitable and predictable legal and tax system, strong and reliable institutions and a fair judicial system. Clear rules of the game decrease the risk to investors and facilitate privatization.

3. Adequate regulatory framework

Governments need to establish an appropriate regulatory framework for cases in which regulation cannot be left to the market. The government needs to ensure that the regulatory framework for a free-market economy is put into place prior to, or concurrently with, a privatization program.[18] Regulation to protect consumers is particularly important in privatization of enterprises in non-competitive sectors -usually large SOEs operating as natural monopolies (telecommunications, utilities, infrastructure, etc.). Regulation should promote efficiency, be predictable and fair to both investors and consumers of regulated services and be susceptible to administration at a reasonable cost (Mitrani, 1991b).

The experience of Latin America shows, however, that to develop an adequate regulatory capacity is a complex process that might take a number of years. In Argentina, for example, as of March 1993, only one new regulatory agency was working (in telecommunications) and it was dependent on a consultancy firm and a consumer group to do much of its work (World Bank, 1992).

4. Good use of privatization proceeds

For privatization to be successful in the long run, part of its proceeds needs to be used to accelerate human development in areas such as education, public health, water supply and other social services. As the experience of East Asia has shown, investment in human capital is a critical element in economic and social development (World Bank (1990), UNDP (1990, 1991, 1992, 1993)). The need to facilitate social services for destitute and marginalized sectors of the population may be of decisive political importance. The experience of Latin America with restructuring has shown that the lack of safety nets for the most vulnerable groups may eventually be politically explosive and endanger the medium-term prospects for economic reform programs.

Governments should also use part of the proceeds from privatization as well as their regulatory framework for the preservation of the environment, particularly in areas in which private investors cannot be attracted. Policymakers need to be convinced that without special efforts and measures to protect the vulnerable sectors of the population as well as the environment, economic and social development, and therefore political stability, will not be sustainable.

5. New ways of social participation

The reform of the state needs to introduce new means for social participation, that is to involve communities in activities from which they have increasingly been marginalized. In this regard the National Solidarity Program in Mexico is certainly a move in the right direction. Putting families to work together in different towns with the engineering skills of university students and government assistance of $1 billion (amounting to only 0.4% of GDP), the program, in only 6 years, has achieved remarkable results: 8 million people were provided with drinking water; 6 million with health services; 11 million with electricity and 1.5 million with education. The improvement of the fiscal position of the government has strengthened its capacity to provide basic social infrastructure, health and education, public safety and the administration of justice. Social spending, which accounted for 32% of the total and 6% of GDP in 1988, had increased by 1992 to 44% of total spending and 8% of GDP, which in **peso** terms translated into a 60% increase in real terms (Aspe and Gurría, 1992).

D. Desirable investors

To be successful privatization has to attract the most desirable buyers. This is only possible with a rational, well structured and coherent program, carried out by qualified and able professionals with good public relations and marketing techniques. Mitrani (1991) argues that governments should not improvise and that they should seek expert technical and financial advice, since, without it, they will not be able to foresee the myriad of complex issues, plan the process and structure an attractive deal. More troubling, governments may have to make constant changes in the rules of the game, which undermine political support and investors' confidence. He recommends that, to be able to select the most desirable buyer, the entire privatization process should be entrusted to one strong and highly qualified state agency and that the ideal body should be credible and have the ability to (i) obtain public support; (ii) balance conflicting interests; (iii) tackle the problems rather than elude them and (iv) deal with interest groups.

In a successful privatization, public assets must be sold to the best prospective investors which, as we have said before, are not necessarily those that offer the highest price or the most attractive financial package. Obtaining the highest price might not be optimal since a high asset price is likely to be translated into a higher price for the service rendered. This has clearly been the case with the privatization of banks in Mexico and that of the telecommunications and the airline companies in Argentina.

Other desirable features of prospective investors have often been the potential of the buyer to bring in top-notch technology and management as well as their capacity to expand services in the future. At the same time, however, the price has to be perceived as fair so as to avoid political opposition. This was not the case in the early phase of the Chilean process.

E. Foreign Direct Investment

Privatization in Latin America has in some cases attracted large flows of foreign direct investment (FDI) to the restructuring countries. In others, FDI has resulted from debt-equity flows. In addition to issues raised by FDI under conventional circumstances, FDI related to privatization has led to certain consequences which are peculiar to this type of investment. Policymakers and investors need to be aware of these issues, many of which are determined by country conditions and their need to promote FDI, and should be prepared to deal with them in a pragmatic way. The most relevant are the following:

1. Access to crucial sectors

Through the privatization process foreign investors have access to crucial productive and service sectors that were previously considered 'strategic' and for that reason seriously restricted or entirely closed to FDI. Deregulation and privatization of sectors such as telecommunications, transportation, mining, the airline industry, the health care system and even petrochemicals and oil could have serious future repercussions in terms of availability, quality and price of the products or services provided. At the same time, foreign investors have had opportunities they never dreamed of before, and this was an important factor in reversing the downward trend in FDI to the region.

2. Joint ventures with domestic partners

Foreign investors have often needed to form joint ventures with domestic partners, such as banks and local companies, to be able to operate successfully in the host country. In these ventures the comparative advantage of foreigners has been the capital or the special technology or expertise they may bring into the country, and that of domestic firms their knowledge of and connections with the local business environment.

3. Relations with host government

Negotiations necessarily take place between the host government and the foreign investor. This often makes the investment decision, financial strategy, labor and pricing policies of foreign investors quite different from the case in which they are setting up new investments or buying out from other private owners, in which case the host government will not necessarily be involved.

4. Thorny labor issues

Many of the privatized SOEs in Latin America were highly inefficient and part of this inefficiency was the result of an excessive number of employees (in some cases, however, the government reduced the number of employees prior to the privatization to make the restructured enterprise more attractive to prospective investors). A foreign investor has to deal with the problem of excessive employees, since one of the generalized conditions has been that buyers maintain a large proportion of the labor force, at least for a certain period of time. There is also the possibility that during the time the privatized enterprise is forced to keep a larger than optimal labor force, foreign expertise might help train those extra workers who would eventually be laid off. In any case, thorny labor issues have often resulted from the privatization process.

5. Sharing decision-making

In the operation of a privatized firm, the foreign investor has had to share decision-making with employees and management, who might have acquired a significant share of the enterprise, and/or with the government if the privatization was partial.

6. Financial issues

In the case of privatizations that allow for partial financing through debt-equity swaps, the discount at which foreign debt is sold on the secondary market has lowered the cost of investment and made it more attractive. It has thus made profitable some marginal investments, which would not have occurred without this incentive. On the other hand, although it has reduced foreign indebtedness and the debt servicing burden, it might have decreased inflows of FDI (and therefore the supply of foreign exchange) that might have come into the country anyway in the absence of this incentive.

F. Fair distribution of gains

Ideally, successful privatization would improve wealth and income distribution. At any rate, it should certainly not worsen it. In Chile, for example, the successful privatization phase was associated with what became known as "popular capitalism", which as we said earlier, implies the diffusion of ownership facilitated by "soft loans" so that a large proportion of the population feels that it has a stake in the process, making it politically palatable.[19] In the case of Argentina, on the other hand, the process seems to have concentrated even more wealth in a few groups, at least initially. If not corrected, this is likely to turn the public against privatization.

VII. CONCLUDING REMARKS

A. The challenge ahead

In spite of a dismal economic performance and the often made claim to the contrary, the 1980s were not a total "lost decade" for Latin America. Despite the tragedy of economic mismanagement, significant advances were made in the process of democratization and in the realization that economic reform was essential. Indeed, by the end of the decade all countries except Cuba had renounced autocratic governments, improved their human rights records and forsworn inward-looking strategies. Furthermore, many of them had already embarked on serious stabilization **cum** structural reform programs to address their many economic imbalances. These programs often included privatization, the deregulation of markets as well as the sweeping liberalization of trade and investment policies, all in an effort to integrate the Latin American economies into the world economy. Most countries in the region had -although to different degrees- adhered to a new development paradigm in which the market, the private sector in general and the foreign sector in particular, were to play a crucial role.

In an unfriendly international environment, restructuring in Latin America has been particularly stressful. The new decade did not start well in the international context -with world GNP completely stagnant in 1991 for the first time in the post-war period and world trade growing slowly.[20] Nonetheless, there was a quick turnaround in key variables in Latin America. After a decade in which investment fell sharply and income per capita decreased in almost all countries of the region, economic activity grew close to 4% in 1991 and income per capita showed the first improvement in four years. At the same time, inflation was abruptly reduced and hyperinflationary situations were eliminated, with average inflation falling from 1,350% in 1989-90 to 196% in 1991.

Economic reform in many of these countries has created an environment much more conducive to investment and growth. As a result of stabilization policies based on restrictive monetary policy and the use of the exchange rate as a nominal anchor, domestic interest rates became increasingly high. With interest rates falling in international capital markets, many countries in the region attracted unprecedented amounts of foreign capital and so reversed capital flight.[21] Mainly due to these factors, the Latin American region registered at the beginning of the 1990s the first positive net transfer of financial resources since 1983, amounting to $10 billion in 1991, $33 billion in 1992 and $36 billion in 1993 (UN, World Economic Survey, 1994).

In spite of the many encouraging signs, there are still many factors that raise serious concern. In 1992-93, net transfer of resources continued to grow and average annual growth of GDP increased to 3.1% but inflation was still as high as 600%. Investment, growth and the fall in inflation and fiscal deficits was very uneven from country to country. In many of them, growth had yet to resume. Brazil, which was the engine of growth in Latin America in previous decades, has lagged far behind in this regard,[22] as have Peru and Nicaragua. Brazil was also the exception to the abatement in inflation. On the contrary, inflation rose from 500% in 1991 to 2,300% in 1993. This has only recently changed with the adoption of the Real Plan in which the **cruzeiro** has been pegged to the dollar. President Cardoso's recent electoral triumph is credited to the success of the Real Plan which he put in place as finance minister of the outgoing government.

In conjunction with the liberalization process that has been taking place in the region for some time, the net inflow of financial resources has appreciated the real exchange rate in many countries and resulted in a massive increase in imports. Furthermore, because of high domestic interest rates, a large proportion of capital inflows has been largely speculative and flows could be quickly reversed if any political instability or uncertainty is perceived. This could also happen if interest rates continue to increase in international capital markets, as has been the trend recently.

More worrying, social conditions in many countries are becoming explosive. The most vulnerable groups in Latin America saw their economic and social conditions deteriorate greatly in the 1980s, along with unprecedentedly high rates of inflation, devaluation, capital flight, plummeting investment in social and physical infrastructure and the general economic mismanagement of most economies. Both the destitute groups and the environment suffered greatly as a result of the deterioration of human and physical infrastructure and large cuts in public investment. Poverty has been both a cause and an effect of environmental degradation. At the same time, however, the poor and the environment have also been hurt the most by economic stabilization and restructuring programs- including privatization- which typically result in higher unemployment and reduced government services and investment in the short-run. It is for these reasons that governments have a crucial role to play in activities that cannot be delegated to the private sector, but that are nevertheless essential for the success of these programs.

The challenge for the region as a whole in the second half of this decade is to put in place a policy mix of many interrelated elements, the most important of which are the following: the consolidation of peace and democracy and the promotion of human rights; the strengthening of national institutions, including in particular the judiciary; the reactivation of investment and technological development; the attainment of price stability; the avoidance of balance of payments crises; the improvement of income and wealth distribution; the alleviation of poverty; the efficient use of natural resources and protection of the environment for future generations and the promotion of human development.[23]

B. Three groups of countries

The challenge ahead will obviously differ from country to country. There are at least three categories of countries in Latin America in this respect. The first group includes Chile, Mexico, and Argentina, which have gone through rather successful stabilization **cum** restructuring programs in which privatization has played a major role, as the case studies analyzed in this paper have shown. Successful reform has put these countries back on a path of stable growth and they can now afford to make a special effort at improving the social well-being of those segments of their population that live in poverty.

Although it is quite clear that the social cost of the lack of adjustment in the 1980s was much higher, there is enough evidence to show that adjustment programs have imposed a disproportionate burden on the poor. It is for this reason that countries that have succeeded in putting their economies back on a path of stable growth should now strive to improve social conditions and promote human development activities through a re-examination of budget priorities. Chile, for example, which was the first country to resume healthy growth with price stability, has, over the last three years of the Aylwin Administration, brought an estimated 20% of the total population (approximately 1 million people) up from below the poverty line. Poverty alleviation is also a top priority of President Frei's program and his target is to bring an additional 1.2 million people out of poverty by the year 2000. This is a welcome development in a region in which about 200 million still live in poverty. Social inequality is a threat to political stability and sustainable development. In contrast to Chile, Venezuela, which experienced high rates of growth in 1991-92 with little improvement in the social condition of large segments of its population, lived through two attempted coups and the impeachment of President Pérez. In 1993, when the country had fallen once again into stagflation, President Caldera was elected after a populist campaign. This experience points to the fact that only by making a special effort to improve the social condition of the majority of the population can countries move to a path of sustainable development with political stability.

The second group of countries includes those that have not yet succeeded at macromanagement of their economies. The immediate concern of policymakers in these countries should be the elimination of large macro-and microeconomic imbalances and the restructuring of production so as to reactivate investment, technological development and growth with price stability, while avoiding balance of payments crises. Economic growth is unquestionably a necessary condition for development although not a sufficient one. Control of inflation should be a top concern since it will clearly benefit lower income groups, even if stabilization and structural reform programs have other negative social effects, particularly on employment. Brazil, Peru, Venezuela and Nicaragua, although each is experiencing very different macroeconomic performance, fall within this broad category. Privatization is starting to play a critical role in most of these countries.

There is a third group of countries which has been rather successful in stabilizing without much structural change. These countries have improved public sector management without massive privatization. The absence of large macroeconomic disequilibria in the first place resulted in a lack of political support for privatization programs. Uruguay[24] and Costa Rica clearly fall within this category. In these countries social development levels were also well above the average for Latin America as a whole. Nevertheless, promises to slow the pace of economic change and do more about social development levels were critical in the elections of President Figueres in Costa Rica and President Sanguinetti in Uruguay. Economic reform including privatization is likely to proceed slowly. In both countries, it has been the strong middle class that has suffered the most from instability in the 1980s and from adjustment in the 1990s. To avoid political instability and brain drain, policymakers in these countries should also reallocate expenditure so as to improve employment opportunities, particularly for the young.

To sum up, the experience of Latin America indicates that unless there is better governance and accountability, social conditions are taken seriously into account and corruption decreases, economic reform in which privatization plays a critical role will not succeed in the long run because it will not be politically sustainable. The unpopularity of many of the Latin American leaders of the 1990s has been a reflection of people's unhappiness with corruption and social injustice. Although the achievements of economic reform, including privatization, have been impressive in terms of macroeconomic stability, greater efficiency and openness, policymakers need to take these other dimensions seriously if they want reform to be long-lasting. To use the advice of The Economist, Latin American policymakers should not "let a fiesta become a fiasco" (17 July 1993).

Notes

[1] In Latin America, this term has been used interchangeably with "destatization" in Brazil, "disincorporation" in Mexico, and "de-monopolization" in Uruguay. To "restructure" or "divest" a public enterprise is sometimes used as an equivalent to "privatizing" it. Divestiture, however, implies a transfer of assets whereas restructuring may not.

[2] Except where otherwise indicated, data are mostly from the United Nations Economic Commission for Latin America and the Caribbean (ECLAC). Data on FDI are from UNCTAD, Division on Transnational Corporations and Investment. Other data sources are listed in the bibliography.

[3] "Chileanization" of copper, however, had already started in 1967 under Frei (Larraín and Meller, 1991).

[4] This took place mainly in the manufacturing sector. The Allende government resorted to a law dating back to the 1940s in which companies could be 'intervened' and placed under state administration, whenever labor disputes occurred (Larraín and Meller, 1991).

[5] Contrary to the U.S. and European models, the Chilean model was mandatory.

[6] In February 1991 **CORFO** claimed that it suffered losses of $2.2 billion because companies were sold below book value. Defenders of the privatization claim that they were sold at market value and argue that even in 1991 shares of the power company **(ENDESA)**, for example, privatized during the second phase, traded at less than half of book value (basically because the company continued to be perceived by investors as inefficient) (Business Latin America, February 18, 1991). It is interesting to note, however, that Hachette and Lüders [1993] argue that granting credit allowed the Government to charge higher prices for SOE assets than they would have otherwise.

[7] For comparison purposes, the share of FDI in GDCF for the region as a whole increased from 4% in 1975-79 to 7% in 1990-91.

[8] Privatization of the social security system gave rise to **AFPs** through whose purchases in the stock market 3.4 million savers (out of a labor force of 4.6 million people) had indirectly become owners of privatized firms by 1989 (Rocca, 1991).

[9] These include giants such as the Colbún-Machicura hydro-complex, the state lottery and others such as the Iquique free zone, several regional power distributors and firms in mining, rail transport, shipping, wheat marketing, etc.

[10] In Uruguay, a much more conservative nation than Argentina in many ways, people reacted very differently to the prospect of privatization. When asked whether they were happy with the services provided by SOEs, an overwhelming majority said they were not. However, when asked whether the services should be privatized, a large majority said they should not. This is understandable if we consider that Uruguay's labor force is highly dependent on government jobs and its overall economic situation had not been as unstable as Argentina's.

[11] By pricing the swap through an auction rather than a case-by-case negotiation as in Chile, the government was able to appropriate a larger share of the discount (World Bank, 1992a).

[12] **SOMISA** was owned by the Ministry of Defense because steel was considered vital to military and national interests.

[13] Although more than 600 companies were quoted in the Buenos Aires Stock Exchange in the early 1960s, because of the sharp macroeconomic instability of the 1970s and 1980s, only 187 were listed at the beginning of 1990 (Moreno and Domínguez, 1992).

[14] A new carrier **(Lapa)** started competing with **Austral** and as a result air fares in several domestic routes have fallen by 20-30% (Business Latin America, October 3, 1994).

[15] This has led the government to reduce companies' losses and controversies before privatization in the future.

[16] Breaking a 20-year taboo, Venezuela's new government has announced on April 27, 1994 the opening of its oil industry without limitations, to private enterprise, national and foreign. This would require congressional approval of changes to a 1975 law that created the oil company, **Petróleos de Venezuela, S.A.**, as a state monopoly (New York Times, April 28, 1994).

[17] Once the private pension system is functioning, however, government revenue from social-security contributions will fall accordingly. To keep fiscal balance may require budget cuts which will be difficult in light of the 1995 elections (Business Latin America, May 9, 1994).

[18] This includes the deregulation of prices; elimination of restrictions on trade, investment and foreign exchange; regulation of stock markets to protect investors; protection of intellectual property rights and reform of the judicial system to improve its efficiency and credibility (World Bank, 1992).

[19] Critics of this approach argue that it might not fulfill its purpose since beneficiaries are likely to sell their shares immediately for a lower than market price because they need the money; there are many ways, however, in which this can be discouraged (Martínez, 1991).

[20] World output grew at 0.6% in 1992 and 1.5% in 1993. World trade which grew at about 8% in 1988-89, grew between 3% and 5% in 1990-93.

[21] While FDI flows to a few countries grew significantly in 1989-92 (58% in Brazil, 104% in Mexico, 142% in Argentina, 248% in Chile and 370% in Venezuela), foreign portfolio investment to the region grew spectacularly in the latter part of the period from 1.4 billion in 1989 to $153 billion in 1992 (close to 1000% growth) (World Bank, Debt Tables, 1992-93). FDI more than doubled from $8.6 billion in 1990 to $17.7 billion in 1992 and it is expected to have grown rapidly in 1993-94 as well.

[22] After stagnating in 1991-92 Brazil seems to be back on a path of growth (4.5% in 1993 and is expected to grow 5% in 1994). The 1994 Brady Plan debt agreement has renewed interest on the part of foreign investors and has been a boost to growth.

[23] With regard to the latter element it is encouraging that the World Bank has increased its lending for human resources from 10% of total lending in 1987 to 25% in 1991-92. About half of the loans from the Interamerican Development Bank are for social development as well.

[24] Despite a referendum in December 1993 that rejected privatization of the telephone company and other major SOEs, limited privatization is taking place in banking, the national airline and infrastructure.

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ANNEX I

Table 1

PRIVATIZATION OF MEXICO's BANKS

Bank	Date	Price $m	Sold %	Buyer	Price/ book	P/E
Mercantil	10 Jun 91	237	77.2	Grupo Financiero Probursa	2.66	12.73
Banpaís	17 Jun 91	181	100.0	Grupo Financiero Mexival	3.03	17.73
Cremi	24 Jun 91	248	66.7	Empresarios de Jalisco	3.40	21.86
Confia	5 Aug 91	294	78.7	Abaco Grupo Financiero	3.73	12.85
Banorie	11 Aug 91	74	60.0	Grupo Financiero Margen	4.00	23.46
Bancreser	19 Aug 91	140	100.0	Grupo led by Alcántara	2.53	12.12
Banamex	26 Aug 91	4430	70.7	Grupo Financiero Accival	2.62	11.14
Bancomer	25 Oct 91	2798	56.0	Grupo Financiero Monterrey	2.99	15.67
BCH	8 Nov 91	287	100.0	Grupo Del Sureste	2.68	22.31
Serfin	26 Jan 92	1272	51.0	Grupo Financiero Obsa	2.69	14.77
Comermex	9 Feb 92	884	66.5	Grupo Financiero Inverlat	3.73	20.61
Somex	1 Mar 92	613	81.6	Grupo Financiero InverMéxico	4.15	21.22
Atlantico	29 Mar 92	480	68.5	Grupo Financiero Bursátil Méx	5.30	17.85
Promex	5 Apr 92	351	66.0	Finamex	4.23	16.45
Banoro	12 Apr 92	372	66.0	Estrategia Bursátil	3.95	11.28
Banorte	15 Jun 92	570	66.0	Maseca	4.25	12.62
Internacional	29 Jun 92	295	51.0	Prime	2.95	12.32
Bancen	6 Jul 92	279	66.3	Grupo Financiero Multiva	4.65	10.85

Source: Fraser (1992).