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## Some lessons *of the Argentine* privatization process

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The reduction of the role of the State in the Latin American economies has become one of the central topics in the debate on the process of the economic and social restructuring of the region. Because of the magnitude and rapidity of its achievements, the programme carried out in Argentina in the early 1990s is seen as a paradigm which gives rise to reflection and offers a broad range of lessons for those countries seeking to maximize the social benefits that could be obtained from the privatization of public enterprises. From this point of view, the present article highlights some of the main macroeconomic repercussions of the privatization process (in the fiscal sphere, the external sector, the structure of relative prices, and investment), together with its effects on market formation and the strategies of the main business conglomerates of the country, the forms of public regulation of the privatized areas, and the limitations and shortcomings observed. It is concluded that the short-term emphasis of the process probably militated against the achievement of many of the proposed objectives and departed from the criteria that could be deduced from the incipient international experience in this field. The failure of the authorities to pay much attention to certain fundamental issues (the transparency of the process, the need to take measures to put the enterprises to be privatized on a sound footing before offering them for sale, the maximization of transfer prices, the exercise of regulatory powers, the competitiveness of markets and of the economy as a whole, the consolidation of reserves in oligopolistic markets, etc.) resulted in the process making only a marginal –if not a frankly negative– contribution to social equity in Argentina.

# I

## Introduction

In line with various efforts being made at the time in other countries, a new item was placed on the agenda of Argentine society in the 1980s: the "denationalization" of public enterprises.

Since the late 1970s, the international economy has witnessed a growing tendency to question many of the forms assumed by State regulation, especially as regards the public ownership of service enterprises, and above all such ownership of goods-producing entities.

Argentina has not been unaffected by this phenomenon. As early as the democratic government that was in office from 1983 to 1989, the first tentative efforts<sup>1</sup> were made to privatize some of the main public enterprises. These projects were blocked by the members of the main opposition party, who questioned the essence and form of the proposed privatization operations.<sup>2</sup>

Shortly after the present government took office in mid-1989, however, that same party won legislative approval—almost without opposition—for an ambitious privatization programme which was much wider and faster than the programme it had rejected a little earlier. From then on, with the enactment of Act No. 23696 on Reform of the State (August 1989), the role of the public sector in Argentina entered on a new phase, with the emergence of new markets for private activity and privileged areas with extraordinary quasi-rents and reserved market sectors.<sup>3</sup> With the adoption of this Act, practically all the enterprises producing

goods and services which belonged wholly or partially to the State became eligible for privatization.

Generally speaking, the first steps in this broad privatization programme suffered from various kinds of problems<sup>4</sup> which, in many cases, substantially altered the planned conditions and the ambitious original timetables. If there is one feature that distinguishes the Argentine process from the efforts being carried out in other countries at more or less the same time, however, it is the rapidity and extent of its achievements. Thus, between 1990 and 1991 the privatization process covered the national telecommunications and air transport companies, the State's share holdings in the petrochemical industry, the central and secondary areas of the petroleum industry, over a third of the national highway system, over 5 000 kilometres of railroads, etc. In 1992 and 1993 the privatization process continued, extending to important new sectors (especially in the field of energy) and consolidating its progress in others. Suffice it to note that the process covered the transport and distribution of natural gas, electric power (generation, transport and distribution), the National Water and Sanitation Company, various elevators in different ports, and the two integrated steelworks (SOMISA and Altos Hornos Zapla). At the same time, privatization was continued and intensified in the central and secondary areas of the petroleum industry (spreading to the refineries, oil pipelines, tanker fleet and other assets of Yacimientos Petrolíferos Fiscales (YPF)), while YPF itself was partially privatized, as also were railroad and subway lines, the road system and means of access to the capital, stock holdings in petrochemical industries, enterprises in the area of Defence, and other assets such as the main racetrack, the Liniers commodity market, over 800 units of real estate, etc.

Up to the end of 1993, this rapid and wide-ranging privatization programme brought in resources

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<sup>1</sup> These were the abortive efforts to privatize the State airline (Aerolíneas Argentinas) and the State telecommunications company (ENTEL).

<sup>2</sup> The Government's intentions covered various public enterprises. In reality, however, the privatization operations carried out during this period were limited to the sale of the State's share holdings in two petrochemical firms and the ex-SIAM welded pipe plant.

<sup>3</sup> This happened during the 1980s, in a sporadic manner, through the State's acceptance of responsibility for private external debt, industrial promotion, public-sector purchases of goods and services, etc.

<sup>4</sup> In addition to macroeconomic problems (high levels of inflation, severe fiscal imbalances, widespread uncertainty) there were also the problems of the deficient regulatory conditions, the need to fit in with the parallel negotiations on the external debt, and, in general, the natural inconsistencies due to the priority given to speed in the privatization process.

totalling over US\$15 billion, over one-third of which corresponded to the market value of the external and domestic debt paper capitalized in the various processes.

This structure of the income from the privatization process displays marked differences between two clearly-defined stages in the execution of the programme, both in terms of the methods and modalities used in each case and in respect of their functionality *vis-à-vis* the other public policies. Thus, in the first of these stages, extending up to the inception of the Convertibility Plan (April 1991), the repurchase of external debt paper accounted for more than 85% of fiscal income, whereas in the privatization operations carried out between April 1991 and December 1993 the capitalization of external debt paper did not even represent 30% of total income.<sup>5</sup>

Whereas in the first stage priority was given to global transfers, with hardly any attention being given

to the formulation of regulatory frameworks –a situation largely explained by the urgent political needs of the Administration–,<sup>6</sup> in the second stage the authorities also resorted, among other things, to the segmentation of enterprises that were to be privatized and the public sale of shares, while at the same time slowly progressing towards the regulation of some of the public services which had been privatized.

The functionality of the privatization process *vis-à-vis* the stabilization programme also took on a different dimension in this latter period. The leading features of this new functionality were the absorption by the Ministry of the Economy of the mission and functions of the former Ministry of Public Works and Services (which was responsible for most of the public enterprises subject to privatization), the improvement in the short-term fiscal situation, the maintenance of a fixed exchange rate, and the moderate recovery in investment.

## II

### The main macroeconomic effects

The implementation of the privatization programme undertaken in Argentina has undergone many changes of different kinds, thus giving rise to reflection about its fiscal impact and its effects on, *inter alia*, the external sector, the structure of relative prices, capital formation, and the regulation of oligopolies in the absence of anti-monopoly legislation.

#### 1. Fiscal aspects

The application of the privatization programme has had a substantial once-only fiscal impact in the form of the cash income received by the State for the transfer of enterprises or share holdings. At the same time, it has also introduced a new item in the form of the future tax income that will be generated by the payment of taxes –essentially profits tax– by the consortia which purchased the privatized firms.<sup>7</sup>

On the other hand, the State has ceased to receive various specifically assigned internal taxes –such as that corresponding to social security– which were included in the prices of certain public services. In

most cases, these “surcharges” were absorbed by the adjustments in scales of charges which accompanied the privatization operations and were thus ultimately transferred to the purchasers as part of their new scales of charges.

From the point of view of fiscal outlays, the State has benefited from the elimination of the operating deficits registered by many of the privatized public enterprises, as well as from the elimination of the service costs in respect of the external debt capitalized in the privatization operations. On the other hand, since in most cases the State assumed responsibility for the debts of the privatized enterprises,<sup>8</sup> this involved subsequent fiscal outlays in respect of payments of principal and interest (table 1).

<sup>6</sup> According to Gerchunoff (1992), “the changes had to be made one way or another; whether it liked it or not, the Government had to privatize”.

<sup>7</sup> With few exceptions, the privatized public enterprises either did not pay such taxes or did not make profits subject to profits tax.

<sup>8</sup> Although in practice the Treasury ultimately took over the debts contracted by public enterprises, the corresponding service costs and almost all the commercial debts were generally assumed by the enterprises themselves. In other words, instead of the previous unstable and heterogeneous situation the State simply absorbed those debts.

<sup>5</sup> The privatization operations in the area of the petroleum industry mostly fell within the second stage and in all cases consisted of transfers and concessions paid for in cash.

TABLE I

**Argentina: Indebtedness of privatized public enterprises assumed by the National Treasury**  
(Millions of pesos)

Privatized enterprises	External debt	Domestic debt	Total
Yacimientos Petrolíferos Fiscales (Y.P.F.)	8 786.6	7.2	8 793.8
Ferrocarriles	1 971.8	585.8	2 557.6
Gas del Estado	1 892.8	387.3	2 280.1
Hidronor	1 485.3	2.9	1 488.2
Somisa	612.7	825.1	1 437.8
Agua y Energía Eléctrica	328.3	729.8	1 058.1
Segba	817.8	83.9	901.7
E.L.M.A.	406.3	329.9	736.2
Caja Nacional de Ahorro y Seguros	-	600.0	600.0
Aerolíneas Argentinas	421.3	6.4	427.7
ENTEL	269.6	26.4	296.0
Obras Sanitarias de la Nación	86.8	42.6	129.4
Encotesa	2.6	110.6	113.2
<i>Total</i>	<i>17 081.9</i>	<i>3 737.9</i>	<i>20 819.8</i>

Source: Prepared on the basis of the 1994 National Budget.

It may be inferred from the above considerations that, although certain approximations may be made in some concrete cases,<sup>9</sup> it is difficult to make a precise estimate of the overall fiscal impact of the privatization process. At the aggregate level, it may be said that in the short term the generalized privatization process had a positive effect on the fiscal accounts. After the exhaustion of this first impact, due essentially to the cash inflows and the elimination of the service costs of the capitalized debt, however, the public accounts have been increasingly eroded by the effect of certain items—such as the service costs on the debts absorbed by the State—which tend to outweigh this first positive impact in the medium and long term.

Beyond the fiscal effect in terms of income and outlay flows, mention should be made of other aspects directly or indirectly related to that impact. One of these is the increased value of the activities transferred to the private sector, in which generally speaking the current value of the future rents has proved to be significantly higher than the respective transfer

prices of the enterprises. In this respect, the undervaluation of the public assets which were privatized<sup>10</sup> was due to the speed of the processes and the lack of attention by the authorities to the restructuring of the enterprises to be privatized and to the need to put them on a sounder basis in technical, production, economic and financial respects.

At all events, leaving aside the question of the generalized undervaluation of State assets, the income from the privatization process was a key element in changing the financial situation of the public sector.<sup>11</sup> Indeed, the resources from the privatization process have played a leading role in the reordering of the fiscal accounts, especially in the early months of the Convertibility Plan, when they proved to be the main foundation for the necessary fiscal balance. Thus, in the last nine months of 1991, the income from privatization operations was nearly 80% of the total: a proportion which went down significantly in the following two years to 42.3% in 1992 and 20.9% in 1993 (table 2).

This smaller relative contribution by the privatization process to fiscal balance does not indicate a structural improvement which makes the fiscal sector less dependent on windfall resources, however. On the contrary, the trends in the public accounts display imbalances and shortfalls which raise serious doubts as to what will happen when the privatization programme comes to an end. Thus, as from the fourth quarter of 1992 and during the whole of 1993 there has been a deficit in the operating results of the Treasury, due to the relative stagnation of current income and the growing incidence of total expenditure, especially that in respect of payments for goods and services. The positive overall result has therefore been due to non-tax income: i.e., to windfall resources.

<sup>10</sup> In the case of ENTEL, for example, the imprecise valuations of the enterprise ranged from US\$1.9 billion (the price at which the company was transferred) to US\$3.5 billion, while many marginal oilfields (fields with a high gas/petroleum ratio) were transferred without placing any value whatsoever on their gas content.

<sup>11</sup> Although Decree No. 575/90 laid down that the resources from the privatization operations would be used for social expenditure, successive exceptions to this rule resulted, in practice, in the inoperancy of this provision. The Argentine case is a very typical example of the problem described by Devlin (1993), who, while stressing the importance of assigning the windfall resources from privatization to social expenditure, nevertheless notes that "... it may be difficult to make specific allocations in situations of generalized fiscal urgency".

<sup>9</sup> See, for example, the estimates given by Gerchunoff (1992) regarding ENTEL, high-traffic highways, and the petroleum reserves. These estimates, however, do not take account, for example, of the fiscal effect due to the State's absorption of the liabilities of the privatized enterprises or areas.

TABLE 2

**Argentina: National Treasury. Income and outlays during the application of the Convertibility Plan, second quarter of 1991 to fourth quarter of 1993**

*(Millions of pesos at February 1994 prices)*

	Total income	Current income	Other income	Total outlays	Operating result <sup>a</sup>	Total result <sup>b</sup>	Privatization operations	Percentage of total result corresponding to privatization operations
<b>1991</b>								
2nd quarter	3 094	2 508	586	2 547	-39	547	630	115.2
3rd quarter	3 866	2 579	1 287	3 497	-918	369	134	36.3
4th quarter	3 469	2 868	601	2 865	3	604	430	71.2
Last 9 months	10 429	7 955	2 474	8 909	-954	1 520	1 194	78.6
<b>1992</b>								
1st quarter	3 806	2 896	910	2 830	66	976	666	68.2
2nd quarter	3 277	3 025	252	2 769	256	508	152	29.9
3rd quarter	3 453	3 126	327	2 752	374	701	114	16.3
4th quarter	3 876	2 705	1 171	3 367	-662	509	208	40.9
Total	14 412	11 752	2 660	11 718	34	2 694	1 140	42.3
<b>1993</b>								
1st quarter	3 224	2 488	736	3 038	-550	186	4	2.2
2nd quarter	4 015	2 991	1 024	3 253	-262	762	226	29.7
3rd quarter	4 315	3 312	1 003	3 395	-83	920	155	16.8
4th quarter	4 116	3 131	985	3 160	-29	956	204	21.3
Total	15 670	11 922	3 748	12 846	-924	2 824	589	20.9

Source: Prepared by the authors on the basis of information from the Ministry of Finance.

<sup>a</sup> Current income less operating costs.

<sup>b</sup> Total income less total costs.

If these windfall resources are not matched by changes involving a reliable long-term improvement in the fiscal accounts, their effective impact will tend to be diluted by the persistence of structural imbalances and even by the implicit costs of the privatization programme itself.<sup>12</sup>

## 2. Effects on the external sector

In the short term, the capital income derived from the funds which the State receives in cash for the sale of its enterprises has a positive impact on the balance of payments. In the case of Argentina, this income was

of decisive assistance<sup>13</sup> in reversing a trend that had existed for over two decades: the permanent net transfers of capital to the exterior. Thus, in the three-year period 1990-1992, for the first time in many years, there was a net inflow of foreign exchange of the order of US\$15 billion (Argentina, Ministry of the Economy and Public Works and Services, 1993) which was a decisive factor in sustaining the exchange rate parity and offsetting the trade deficits registered in that period.

In this respect, information on the balance of payments capital account shows that the income associated with the privatization programme increased considerably during the period 1990-1992: according to official projections, this income will tend to

<sup>12</sup> This is reflected, in an as yet incipient manner, in the evolution and conformation of the pattern of expenditure of the National Treasury. Thus, for example, expenditure on goods and services doubled in only two years (1991-1993), so that its incidence in the total rose from 9.0% to 15.2%, accounting for nearly 80% of the growth in total expenditure.

<sup>13</sup> Another substantial proportion of the inflow of external resources was due to short-term movements associated with the existence of domestic dollar interest rates higher than those prevailing at the international level.

stabilize at around US\$4.7 billion in the two-year period 1993-1994, after which it will begin to decline rapidly as from 1995.

The main positive effect of the privatization process –the inflow of capital– is registered exclusively during the process of “denationalization” of public enterprises. As these are transferred to the private sector, however, another effect is generated on the balance of payments which is permanent and opposite to the above-named effect. This is the remittance of profits and dividends abroad by the consortia which purchased the privatized enterprises. From a medium-term standpoint, this has grown steadily since 1990, in line with the consolidation of the operations of the privatized firms (table 3).

This behaviour of remittances of profits and dividends tends to cancel out the initial positive effect of the privatization process on the balance of payments. As it is expanding in a domestic macro-economic and international financial context which is unfavourable to the remittance of profits abroad,<sup>14</sup> its most negative effects will only be registered in the

medium term, if there is a change in one or more of the factors in that context.

Another important effect of the privatization process on the balance of payments is due to the elimination of the service costs in respect of the external debt paper which was capitalized as part of the payment for the enterprises transferred to the private sector. Thus, up to the end of 1993, the total value of the State-owned enterprises privatized came to US\$23.16 billion if the repurchase of domestic and external debt bonds is calculated at their nominal value, but only a little less than US\$15.5 billion if they are calculated at their effective value (i.e., 66.9% of the first figure). The nominal value of the public debt paper repurchased under the programme came to US\$13.4 billion (i.e., 58.0% of the total income), while its effective value was US\$5.76 billion, equivalent to 42.9% of the nominal value (table 4).

The repurchase of external debt bonds had a significant initial impact on the cumulative debt (it is expected to exceed US\$20 billion by the end of the programme). The debt reduction due to the sale of public assets (a little over US\$11 billion) was equivalent to 19% of the total external debt as at 1989. However, this reduction was more than offset by the fresh indebtedness incurred during the period, so that there was a net increase of some US\$2.7 billion in the external debt between 1989 and 1992.<sup>15</sup> In other words, in spite of Argentina's incorporation into the Brady Plan, the evolution of the country's external indebtedness shows that the effect of the sale of public enterprises has been wiped out (table 5).

Underlying this net increase in external indebtedness is another phenomenon which will probably become even more noticeable in the future. This is the change in the structure of indebtedness which marks the beginning of a new cycle led by the private sector in general and the business groups which bought the privatized enterprises in particular. By way of example, the value of the negotiable obligations issued by private firms up to late 1993 came to US\$3 457 million, which represents an increase of US\$2 701 million during the year; at the same time, negotiable obligations authorized but not yet issued came to US\$705 million, while obligations requested but not yet authorized amounted to US\$1 700 million (table 6).

TABLE 3

**Argentina: Balance of Payments. Trends in foreign direct investment,<sup>a</sup> privatization operations and remittances of profits and dividends, 1988-1995**  
(Millions of dollars)

Year	Income		Outlays
	Foreign direct investment	Privatization operations	(Profits and dividends)
1988	1 147		-660
1989	1 028		-664
1990	333	1 703	-716
1991	465	1 974	-805
1992	2 852	1 841	-850
1993 <sup>b</sup>		4 647	-945
1994 <sup>b</sup>		4 718	-1 407
1995 <sup>b</sup>		3 896	-2 057

Source: Prepared by the authors on the basis of information from the Central Bank of the Argentine Republic and the 1994 National Budget.

<sup>a</sup> The capitalization of external debt paper in the various privatization processes is included under “Foreign direct investment”, while income from cash payments is included under “Privatization operations”.

<sup>b</sup> Official projections.

<sup>14</sup> Between 1990 and 1992 the 180-day LIBOR rate fell by 57% (from 9.22% to 3.95%).

<sup>15</sup> What is more, the public external debt, which is directly affected by the privatization operations, grew by US\$900 million.



TABLE 4

**Argentina: Financial results of the privatization programme, 1990-1993**  
(Millions of dollars)

	Cash	Debt paper		Liabilities transferred	Totals	
		Nominal value	Effective value		A <sup>a</sup>	B <sup>b</sup>
Telephones	2 279.0	5 029.0	1 257.0	-	7 308.0	3 536.0
Airlines	190.1	1 313.8	394.1	-	1 503.9	584.2
Electricity	1 283.1	2 543.5	1 836.0	460.7	3 826.6	3 579.8
Ports	13.3	-	-	-	13.3	13.3
Radio and TV	13.9	-	-	-	13.9	13.9
Petroleum	4 846.8	1 271.1	1 080.4	-	6 117.9	5 927.2
Gas	658.0	3 082.1	1 120.3	1 110.0	3 740.1	2 888.3
Petrochemicals	53.3	132.0	46.0	-	185.3	99.3
Shipyards	59.8	-	-	-	59.8	59.8
Steelworks	143.3	41.8	22.5	-	185.1	165.8
Real estate	130.9	-	-	-	130.9	130.9
Other	65.2	12.0	2.0	-	77.2	67.2
<b>Totals</b>	<b>9 736.7</b>	<b>13 425.3</b>	<b>5 758.3</b>	<b>1 570.7</b>	<b>23 162.0</b>	<b>15 495.0</b>

Source: Prepared by the authors on the basis of information from the Ministry of the Economy and Public Works and Services.

<sup>a</sup> Result of adding the nominal value of the capitalized debt paper to the cash receipts and the liabilities transferred.

<sup>b</sup> Result of adding the effective value of the capitalized debt paper to the cash receipts and the liabilities transferred.

TABLE 5

**Argentina: Trends in the external debt and interest payments, 1986-1992**  
(Billions of dollars)

Year	External debt			Interest paid
	Total	Public	Private	
1986	51.4	44.7	6.7	4.4
1987	58.3	51.8	6.5	4.5
1988	58.5	53.5	5.0	5.1
1989	63.3	58.4	4.9	6.4
1990	61.0	...	...	6.1
1991	63.7	...	...	5.6
1992 <sup>a</sup>	66.0	59.3	6.7	4.6

Source: Prepared by the authors on the basis of information from the ECLAC Office in Buenos Aires.

<sup>a</sup> Provisional estimate.

An analysis of the enterprises which have issued or are arranging to issue negotiable obligations makes it possible to estimate the degree of connection between this type of indebtedness and the privatization process. Thus, the consortia which purchased

privatized enterprises (Telefónica or Telecom, for example) and the firms which directly participate in some of them (Astra or Pérez Companc) account for the majority of the obligations issued (72%). The same is true of the negotiable obligations authorized but not yet issued, in the case of which the firms in question account for 71% of the total amount, and even more so in the case of obligations not yet authorized (91%) (Basualdo, 1994).

### 3. Effects on the structure of relative prices

The evolution of the real prices of the public services transferred to the private sector has given rise to substantial changes in the structure of relative prices of the economy. These trends have been further strengthened by their convergence with the policies of deregulation of markets and opening-up of the economy: the extent to which goods and services are tradeable abroad goes a long way towards explaining the behaviour of their respective prices.

TABLE 6

**Argentina: Negotiable obligations of the private sector at the end of 1993**  
(Millions of dollars)

Companies	Negotiable obligations			Total
	Issued	Authorized	Requested	
<i>In connection with privatization operations:</i>				
TELECOM	750		500	1 250
Pérez Companc	600			600
Banco Galicia	600			600
EDESUR		300		300
Astra			300	300
Acindar		200		200
Telefónica	150		500	650
Comercial del Plata			150	150
Siderca			100	100
Loma Negra	85			85
Bridas	85			85
IMPESA	60			60
TECPETROL	60			60
Others	86			86
Subtotal	2 486	500	1 550	4 536
<i>Others</i>	971	205	150	1 326
<i>Total</i>	3 457	705	1 700	5 862

Source: Prepared by the authors on the basis of information from the National Securities Commission.

There are a number of cases of adjustments which easily exceed the growth rate of most of the other prices in the economy.<sup>16</sup> Furthermore, especially in the energy area, there has been a growing dispersion of price structures, with considerable differences in the real evolution of the prices of the various services.<sup>17</sup>

The establishment of a new structure of relative prices which tends to favour the private areas supplying services at the expense of the sectors producing non-protected tradeable goods is reflected in the patterns of behaviour of the various economic activities. In this respect, a study by the Argentine Industrial Union (Coloma, 1993) reveals that both in terms of the evolution of their sales and, above all, the respective profit margins, the enterprises with the best performance indicators are those which have been privatized, while the producers of non-protected tradeable goods are those which display the highest

levels of relative deterioration, whatever the variable considered (the enterprises producing naturally or legally protected goods are in an intermediate situation).

It should be noted that in all the areas where the consortia which purchased the privatized enterprises have decisive power in the fixing and updating of prices, the State not only transferred the respective assets but also the capacity to influence the structure of relative prices of the economy. In other words, there was a shift in the market mechanisms<sup>18</sup> and, at the same time, in the official side's attitude to the possibility of applying public policies to regulate or induce certain private activities. The transfer of a normal economic policy instrument also implies the transfer to certain segments of the private sector (which enjoy naturally or legally protected oligopolistic or monopolistic positions through the existence of reserved markets) of much of the regulatory power

<sup>16</sup> In some cases (such as ENTEL or Aerolíneas Argentinas) the adjustment in scales of charges took place before the transfer to the private sector, as a way of attracting potential buyers, and there were even contractual guarantees in respect of real prices, while in others (electricity, gas) the biggest relative increases took place after the service enterprises in question came under private management.

<sup>17</sup> Generally speaking (especially in the energy field), the increases in prices for big users have tended to be well below the average levels and even further below the rates for household users.

<sup>18</sup> For example, although in a few cases (gas, electricity) "cross-subsidies" are explicitly prohibited, the absence of regulatory mechanisms or at least of minimum criteria in this respect rules out all possibility of restrictive action. Indeed, the possibility of signing specific contracts between the supplier enterprise and the users of the services makes it perfectly feasible, when both firms belong to the same conglomerate, to resort to transfer prices.

over markets which play a leading role in determining the competitiveness of the economy as a whole.

#### 4. Effects on investment

According to the objectives of the privatization programme, the stimulation of capital formation is at once one of its main foundations and one of the basic results expected, in view of the disinvestment observed in most of the enterprises eligible for privatization.

There are two main components which should be identified here: on the one hand the capital formation that the purchasing consortia would effect (partly under formal undertakings), and on the other hand the potential multiplier effect of this capital formation.

With regard to the first of these, the estimates which have been made reveal that the effect on aggregate investment has been only modest. Considering the capital formation deriving from a broad group of privatized areas (gas, telephones, electricity, railways, subways, roads, ports, and water supply and sewerage), the resulting aggregate investment is estimated at a little over 2% of GDP up to the mid-1990s, stabilizing thereafter at around 1.5% until the end of the decade (FIEL, 1992). At the same time, according to official estimates, the investment commitments in public enterprises which were privatized or granted as concessions would be around 1.0% of GDP in 1994, going down in 1995 to only 0.8% of GDP (Argentina, Poder Ejecutivo Nacional, 1993). According to official projections, these amounts of investments would amount to an annual average of close on US\$2.6 billion in the three-year period 1993-1995: a figure equivalent to only two-thirds of the average annual capital formation of the public enterprises during the three-year period 1980-1982 and only 54.6% of that corresponding to the three-year period 1986-1988 (FIEL, 1992).

Although investment in the privatized areas was below the average levels of most of the 1980s, however, it was slightly higher than the low levels registered in the years immediately before the process. This is explained, on the one hand, by the acute and generalized disinvestment of the public enterprises in the latter period and, on the other, by the need to rehabilitate and maintain the privatized services.

In this sense, in the short term there is a positive impact on aggregate investment, but its local multiplier effects are reduced by the high proportion of equipment purchased abroad (as for example in the case of telecommunications) and are restricted to a limited number of sectors of activity.

Finally, since the most dynamic activities in terms of sales and profitability are those protected from external competition and the recently privatized service enterprises, capital formation tends to reproduce and consolidate this same configuration. In this context, there is little incentive to invest in most of the goods-producing sectors in view of the options offered by the privatization of public enterprises, much of the services sector, and, in general, activities associated with goods and services not tradeable abroad. Consequently, as far as the international competitiveness of the Argentine economy is concerned, it can only be hoped that in the course of time the improvements in the productivity of the privatized enterprises will be transferred, through reductions in costs, to the rest of the economy and especially to the sectors producing exportable goods.

#### 5. Effects on the oligopolization and conglomeration of the economy

Another salient feature of the privatization programme is its role in promoting the concentration and centralization of capital. In most of the privatization operations carried out in the country, the form of the invitation to make bids itself favoured the presence of only a few bidders, and this was further strengthened in most cases by the coordination and lobbying of business groups in respect of their own offers. This led, on the one hand, to marked concentration of the ownership of the "denationalized" enterprises and areas in the hands of a small number of big economic agents,<sup>19</sup> and, on the other, to the survival and strengthening of legal monopolies and oligopolies, with the consequent consolidation of protected markets, on conditions which ensured little or no business risk, and with broad freedom to fix prices. In this respect, compared with the experience of other countries, it may be noted that there was little concern by the authorities to promote the spread of property through the capital market.<sup>20</sup>

<sup>19</sup> These were mostly the same conglomerates of national and foreign capital which, in previous years, had internalized the transfers in those areas sporadically favoured by public policies (industrial promotion, assumption of external indebtedness by the State, State purchases, etc.).

<sup>20</sup> On the contrary, in most cases very high minimum levels of net worth were fixed for receiving authorization to participate in the bidding, or else similarly high levels were one of the main requirements for pre-qualification or purchase. In other words, the net worth of the potential buyers became the main barrier governing entry into the market for the privatization of public enterprises.

This heightening of the process of concentration of capital associated with the privatization of public enterprises also reflects the consolidation of a trend which goes back to the mid-1970s: association of big local economic groups with foreign-owned companies. Such associations generally include the following elements: big Argentine-owned conglomerates which provide management and domestic lobbying capacity; foreign or local banks and public contractors which have capitalized external or domestic debt paper, and certain transnational corporations which generally provide technological and management capacity and experience.

In other words, the forms assumed by the various privatization processes – net worth requirements, technical requirements, rapidity, importance of lobbying power, etc. – have facilitated and even caused the adoption by the main local conglomerates of strategies which fit in with the growing polarization of economic power. In this respect, a by no means exclusive list could be made of the corporate strategies adopted for the acquisition of most public sector assets:

i) There were economic groups which, through one of their subsidiaries, acquired public enterprises or State share holdings in firms operating in the same sector of activity as themselves (concentration). This is so, for example, in the case of the Indupa group and its purchase of shares in Petropol S.A. and Inducor S.A.; the Garovaglio and Zorraquín groups' participation in Polisur S.A., or the Techint conglomerate's purchase of the majority of the shares in SOMISA. The same thing occurred in the privatization of areas of petroleum activity, most of which came into the hands of the main firms in this sector.

ii) There were business conglomerates which acquired public enterprises or services, or obtained concessions in respect of them, in order to achieve directly or indirectly a greater degree of vertical or horizontal integration. There are many examples of this: the Techint and Acindar steel companies, which integrated the production and distribution of electricity and gas (fundamental inputs for their production activities); the main edible oil companies (Bunge y Born, Cía. Continental, La Plata Cereal, La Necochea Quequén, etc.), which did the same in respect of railways and port facilities; the cement oligarchies, in respect of railways; the former suppliers of ENTEL, when that company was privatized (the Pérez Companc group (PECOM-NEC) and the Techint group

(Telettra and Italtel)); the oil companies, which came into control of refineries, distilleries, oil pipelines, port facilities, tanker fleets, etc.

iii) There were economic groups which were actively and extensively present in the various privatization processes (diversification and conglomeration). Typical examples are the Pérez Companc group (electricity generation and distribution, transport and distribution of gas, activities in the petroleum sector, refineries and distilleries, railways, telecommunications, etc.) or the Cía. General de Combustibles group (electricity generation, petroleum and distillery activities, railways, telecommunications, water supply and sewerage, etc.). Table 7 gives a summary of the consortia in which some of the main conglomerates operating in the country are active participants.

This list of corporate strategies adopted in response to the privatization programme clearly shows that the growing oligopolization and conglomeration of the Argentine economy and the consolidation and preservation of reserved markets with oligopolistic quasi-rents are among the main effects of the implementation of that programme.<sup>21</sup>

Above and beyond its macroeconomic and social connotations, the above phenomenon introduces additional rigidities and limitations into the sphere of the privatized areas or markets, such as: i) increased risk of capture or cooptation of the regulatory bodies; ii) serious distortion of socially efficient resource allocation through the incorporation of market flaws which are reflected, for example, in price-fixing policies (use of transfer prices between suppliers and consumers belonging to the same business group); iii) the generation of new barriers to entry into the privatization market, in addition to those due in most cases to the inherent nature or regulatory frameworks of the privatized activities or areas; and iv) erosion of already low levels of competition.

In short, the lack of official concern for broadening the ownership of privatized enterprises has resulted in additional effects of capital concentration which at the same time militate against the competitive evolution of the markets affected by the privatization processes.

<sup>21</sup> This programme tends to consolidate certain patterns of corporate behaviour which are increasingly at variance with risk investments, the incorporation of technical progress, innovation, improvement of management standards, etc.

TABLE 7

**Argentina: Presence of the main economic groups in the privatization programme, by sectors of activity**  
(Millions of dollars)

Economic groups	Electricity	Natural gas	Petroleum	Railways	Telephone services	Manufacturing	Others
Pérez Compané	<ul style="list-style-type: none"> <li>• Central Costanera (generation) 90.1 million</li> <li>• TRANSENTER (high-tension transmission) 234.1 million</li> <li>• EDESUR (distribution) 511.0 million</li> </ul>	<ul style="list-style-type: none"> <li>• Transportadora Gas del Sur (transport) 356.2 million</li> <li>• Distribuidora de Gas Metropolitana (distribution) 300 million</li> </ul>	<ul style="list-style-type: none"> <li>• Central Areas:               <ul style="list-style-type: none"> <li>• Puesto Hernández (240.8 million)</li> <li>• Santa Cruz II (141.6 million)</li> </ul> </li> <li>• Secondary Areas:               <ul style="list-style-type: none"> <li>• 11 areas (70.2 million)</li> <li>• Campo Durán refinery (64.1 million)</li> <li>• San Lorenzo distillery (12.2 million)</li> <li>• Patagónicas marine terminal (10.1 million)</li> <li>• Oleoducto del Valle (oil pipeline) (77.0 million)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Ferrocarril Pampeano (concession of 5,287 km)</li> </ul>	<ul style="list-style-type: none"> <li>• TELECOM Argentina 677 million</li> <li>• Telefónica Argentina 794 million</li> </ul>		
TECHINT	<ul style="list-style-type: none"> <li>• EDELAP (distribution) 139.0 million</li> </ul>	<ul style="list-style-type: none"> <li>• Transportadora Gas del Norte (transport) 210.2 million</li> </ul>	<ul style="list-style-type: none"> <li>• Central Areas:               <ul style="list-style-type: none"> <li>• Tordillo (100.9 million)</li> <li>• Aguague (143.7 million)</li> </ul> </li> <li>• Secondary Areas:               <ul style="list-style-type: none"> <li>• 10 areas (39.5 million)</li> <li>• Patagónicas marine terminal (10.1 million)</li> <li>• Oleoducto del Valle (oil pipeline) (77.0 million)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Ferrocarril Pampeano (concession of 5,287 km)</li> </ul>	<ul style="list-style-type: none"> <li>• Telefónica Argentina 794 million</li> </ul>	<ul style="list-style-type: none"> <li>• SOMISA (integrated steelworks) 147.2 million</li> </ul>	<ul style="list-style-type: none"> <li>• Various national highways (concession)</li> <li>• Ingeniero White port grain elevator (concession)</li> </ul>
ASTRA	<ul style="list-style-type: none"> <li>• EDENOR (distribution) 427.9 million</li> </ul>	<ul style="list-style-type: none"> <li>• Distribuidora de Gas Metropolitana (distribution) 300 million</li> </ul>	<ul style="list-style-type: none"> <li>• Central Areas:               <ul style="list-style-type: none"> <li>• Vizcachas (174.0 million)</li> <li>• Santa Cruz II (141.6 million)</li> </ul> </li> <li>• Secondary Areas:               <ul style="list-style-type: none"> <li>• 6 areas (24.9 million)</li> <li>• Oil tanker fleet (41.8 million)</li> <li>• Campo Durán refinery (64.1 million)</li> <li>• Patagónicas marine terminal (10.1 million)</li> <li>• Oleoducto del Valle (oil pipeline) (77.0 million)</li> </ul> </li> </ul>				
Compañía General de Combustibles (Soldati Group)	<ul style="list-style-type: none"> <li>• Central Guemes (generation) 86.2 million</li> </ul>	<ul style="list-style-type: none"> <li>• Transportadora Gas del Norte (transport) 210.2 million</li> <li>• Distribuidora de Gas Metropolitana (distribution) 300 million</li> </ul>	<ul style="list-style-type: none"> <li>• Central Areas:               <ul style="list-style-type: none"> <li>• Palmar Largo (36.0 million)</li> <li>• Santa Cruz I (55.0 million)</li> <li>• Aguague N.O. (143.7 million)</li> </ul> </li> <li>• Secondary Areas:               <ul style="list-style-type: none"> <li>• 3 areas (1.3 million)</li> <li>• Interpetrol (marketing company) 8.7 million</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Ferrocarril Pampeano (concession of 5,287 km)</li> <li>• Delta - Borges branch line (concession)</li> </ul>	<ul style="list-style-type: none"> <li>• Telefónica Argentina 794 million</li> </ul>	<ul style="list-style-type: none"> <li>• Dock Sur distillery 11.7 million</li> <li>• San Lorenzo distillery 12.2 million</li> </ul>	<ul style="list-style-type: none"> <li>• Ingeniero White port grain elevator (concession)</li> <li>• National drinking water supply and sanitation services (concession)</li> <li>• Channel 11 TV (concession) 8.2 million</li> </ul>
SOCMA (Macri Group)		<ul style="list-style-type: none"> <li>• Distribuidora Gas del Centro (distribution) 138 million</li> <li>• Distribuidora Gas Cuyana (distribution) 122 million</li> </ul>	<ul style="list-style-type: none"> <li>• Central Areas:               <ul style="list-style-type: none"> <li>• Palmar Largo (36.0 million)</li> </ul> </li> <li>• Secondary Areas:               <ul style="list-style-type: none"> <li>• 9 areas (18.5 million)</li> <li>• Campo Durán refinery (64.1 million)</li> </ul> </li> </ul>				<ul style="list-style-type: none"> <li>• Various national highways (concession)</li> <li>• Northern access system (concession)</li> </ul>

### III

## Rationality in the privatization and regulation of public services

This section will deal with two closely associated matters. On the one hand, some issues connected with the economic rationality of the privatization programme will be analysed; on the other, an assessment will be made of the characteristic features of the exercise of regulatory powers over privatized public services.

### 1. The "limited" rationality of privatization operations

Generally speaking, the arguments used to justify a privatization policy are based on the conviction that free competition is an efficient mechanism for resource allocation in and for markets. In the case of naturally monopolistic markets, such as the majority of public services, it is assumed that a suitable system of regulations and/or subsidies will give rise to efficient microeconomic behaviour under a system of private ownership and management.

In reality, however, the assessment of the efficiency of any organization will depend essentially on the definition of the goals and restrictions governing its operations. Replacement of the goal of "social welfare" with the objective of the private maximization of profits will bring complications, since the final results are not independent of the process of interaction of the economic agents involved (see Coloma, 1992; a more comprehensive model may be found in Piffano, 1991).

Thus, for example, it is possible that in a public enterprise where decision-making power is concentrated in the hands of government agents seeking to maximize the surplus for consumers, the level of prices will tend to be below that of another enterprise where the managers "associate" with external suppliers or syndicated authorities.

From the microeconomic standpoint, it is expected that the decisions of professional managers who are encouraged to maximize the profits of private shareholders should result in reduction of the degree of inefficiency. In fact, however, efforts to

improve the productivity of organizations supplying services usually begin with staff cuts, changes in the profile of qualifications of the staff who are kept on, and the introduction of a more competitive and "client-oriented" culture. Only afterwards are investments made in fixed production assets. These changes, however, only ensure a relative improvement on the previous levels of service. In order to come closer to the standards of "best international practice", two other conditions are required: effective regulatory bodies, and investors who are willing to take the risks involved.

The macroeconomic rationality of privatization operations is undoubtedly very closely linked with their effects on economic growth and income distribution (Canovesi and Rozenwurcell, 1991). Generally speaking, the privatization of public enterprises will only raise the growth rate of the product if the global investment rate is raised too. In the case of Argentina, however, the necessary investments were financed mainly from the windfall profits generated by the fixing of prices higher than those compatible with ordinary levels of profitability. As a function of the social pattern of consumption of public services, improvements in the growth rate would thus be due, in the final analysis, to regressive changes in income distribution.

It is also generally assumed that public investment is less efficient than its private counterpart, since it is frequently distorted by extra-economic pressures. There is no proof, however, that in the Argentine economy the propensity to reinvest behaves in accordance with the theoretical model (Azpiazu, Vispo and Fuchs, 1993): the income from the frequent systems of cross-subsidization has not generated the same proportion of domestic saving and, in the final analysis, has not resulted in equivalent increases in the stock of productive capital.

At the same time, in view of the economic and social structure of the country, the far from Schumpeterian attitude of its business class (Nochteff, 1993) and the special features of the Argentine privatization

process, the first consequence of a scheme of this type would be greater concentration of economic power. The functionality of this centralizing process has not been demonstrated by the authorities, which therefore run the risk of suffering some loss of credibility and social support for the process of change.<sup>22</sup>

## 2. Some features of the regulation of natural monopolies

Just as economic theory recognizes the existence of market flaws and problems of public intervention, so it also identifies the risks associated with the regulation of privatized public services. Out of the various factors mentioned in such theory, we will analyse only two which display a certain mutually-reinforcing relationship.

### a) *Non-symmetrical access to information*

These problems of non-symmetrical access to information belong to the type of problems tackled by the theory of the principal-agent dilemma, and arise when the critical data are difficult to obtain. The supervising agent—in this case, the regulator—must design systems of incentives which ensure, at the lowest possible follow-up cost, that the information supplied is reliable and that decisions are in line with the agreed objectives. Generally speaking, the regulators too will suffer from some degree of non-symmetrical access to information on the profitability of investments, the effects of the incorporation of new technologies, efforts aimed at minimizing costs, the calculation of subsidies which will guarantee a certain amount of socially optimum services, and other aspects.<sup>23</sup>

<sup>22</sup> A policy of atomization of ownership, such as that used in Great Britain, reduces the validity of these doubts founded on principles of long-term efficiency and social equity. If, on the other hand, a concentrative strategy is adopted, this reduces the transparency of markets and encourages diversification and oligopolization.

<sup>23</sup> In the case of Argentina, the regulatory bodies' capacity for follow-up and negotiation was severely restricted during the privatization processes themselves. In this period there were cases of interruption, disconnection, and on many occasions "privatization" and dismantling of important historical records containing basic information in such areas as energy, transport and ports.

Although the prime responsibility of regulatory bodies is usually concentrated on following-up the prices and quality of the agreed services, in the case of natural monopolies (telecommunications, drinking water, gas, etc.) big capital investments are often needed, and these too must be supervised.<sup>24</sup> Many of these investments will constitute an "entry barrier" to new bidders. The State must ensure both the satisfaction of future demand and a reasonable degree of technological updating.<sup>25</sup>

In order to monitor the execution of investments it is also necessary to have the appropriate information at hand. Every scheme has its own special features: if a certain level of profitability is allowed in regulating the supply of services, this will encourage over-capitalization in order to increase profits, but on the other hand, if an adjustment formula is used based on the price index less a correction factor, this will result in lower service quality and under-investment.

The problem is even more complex when multiple products are involved or price frameworks are established for the future, since the regulator cannot observe many of the variables directly. In these cases, it is hard to avoid the emergence of situations of discrimination and possibly of cross-subsidies.

Finally, while economic theory only takes account of "non-symmetrical access in good faith" due to the technical complexity of the activities dealt with, the Argentine case involves a broader phenomenon which could be termed non-symmetrical access to information due to the "renunciation" of the State.<sup>26</sup>

<sup>24</sup> It should be recalled that one of the central justifications for the privatization process was the insufficiency of public investment in service systems. These systems displayed serious deterioration due to inadequate maintenance, and in some cases they were near the end of their useful life (certain drinking water mains) or needed to make the transition to a new generation of technology (digital telephone exchanges).

<sup>25</sup> The question arises, for example, of the long-term consequences of fixing electricity prices (that is to say, the prices charged by the least efficient thermal generator) on the basis of marginal cost estimates which do not guarantee the big investments needed in order to cover the growth of demand beyond the year 2000.

<sup>26</sup> As, for example, the inability to monitor the fulfilment of the current regime for the motor industry or the possession by private agents of the urban real estate registers for the Federal Capital, with details of the zoning that governs the possibility of commercial exploitation (the master copy of these registers "disappeared" in a fire).

b) *Co-optation of the regulatory agent*

Another critical point in a regulatory system is the nature of the relationship between the regulatory agents and business. In these cases, frequent interaction between the two sides may make the regulator more permeable to the interests of business firms. The official's term of office, his salary level, the prospects of obtaining a high position in the sector subject to regulation and other aspects decisively affect the degree of independence of the regulator and, ultimately, the effectiveness of the regulatory system.

Likewise, the officials of regulatory bodies may be sensitive to pressures from high political circles of the government which appoints them. In this respect, and especially in view of the hastiness and makeshift nature of some of the privatization operations carried out in the country, the regulators' authority has been weakened by prior decisions aimed at satisfying government political objectives.

In general terms, it seems desirable that regulatory mechanisms should maintain the highest possible credibility and that the discretionary leeway allowed to the regulatory agents should be limited by a legal framework which provides for adequate means of inspection and penalties. Since the regulation of privatized public services raises complex problems in both conceptual and practical terms, it is essential to have clear legislation and a suitable technical team empowered to collect the necessary basic information in order to act in an independent manner. If the condition of the independence of the regulators from both business interests and government officials is not met, then the system will continue to depend on decisions associated with particular political projects and yet another of the requirements for a "rational" privatization programme will be ruled out.<sup>27</sup>

In short, in the light of the conditions identified by Devlin (1993), it may be concluded that the Argentine privatization process has not been notable for its transparency. Thus, no mechanisms have been introduced which reduce the non-symmetrical nature of the regulators' access to the information they need.

<sup>27</sup> There are many instances of this two-sided co-optation: for example, the attempt to make use of the fund for the stabilization of the spot price of electricity in order to apply these resources to infrastructural works in a province intervened by the federal government was approved by the Electricity Regulation Board (ENRE).

Nor has the republican principle of giving full publicity to government actions been respected, since access to the concession contracts and the official decisions of the various bodies (documentation which is of great importance in view of its potential for "interpreting" the framework legislation) continues to be restricted for the public and even often for the representatives of various government bodies.<sup>28</sup>

3. **Bodies responsible for supervising privatized public services**

The regulatory functions of the State are defined as the set of attributions and instruments needed for the follow-up and supervision of compliance with rules imposed for the good of the community (environmental control, road safety, etc.), including monitoring of the provision of public services transferred to the private sector. These regulatory functions cannot be delegated, since they are designed to safeguard the common good.

In Argentina, regulation was often implicitly delegated to the firms and bodies responsible for the provision of the services in question, thus giving rise to a rather unclear system of responsibilities. It was only with the privatization of public services that the explicit institution of regulatory bodies, designed to protect the rights of the consumer and, where possible, promote competition, appeared on the Argentine economic institutional scene.<sup>29</sup>

a) *The regulatory bodies*

To date, the bodies responsible for the regulation of privatized public services constitute a collection of unconnected experiences at different stages of progress. A preliminary listing of the processes in terms of their degree of maturity and the level of effectiveness attained is as follows:

<sup>28</sup> An example of this is the effort made by the Ministry of the Economy to prevent the General Accounting Office from supervising the newly privatized firms.

<sup>29</sup> In reality, the regulatory system has various components: the framework legislation, specific legislation for the most important services, the corresponding regulations for the application of this legislation, the concession contracts (practically inaccessible to the public), and finally, the bodies set up to implement the State's supervisory powers. For reasons of brevity, the contents of the various laws will not be analysed in this paper, which will confine its attention to the current capacities and effective limitations of these bodies.



i) *Bodies with formal regulatory capacity.* These bodies are the National Telecommunications Commission (CNT), the Electricity Regulation Board (ENRE), the National Gas Regulation Board (ENARGAS), and the Tripartite Sanitation Works and Services Board (ETOSS).<sup>30</sup> The CNT was set up in 1990 and has the biggest operating resources (a budget of 44 million pesos (dollars) and a staff of nearly 100). It corresponds to the first stage of the privatization process, which was characterized by improvisation and efforts by the government to gain political credibility.<sup>31</sup> It was only after two years, during which the Commission remained officially intervened and without a definitive structure, that the regulations for the basic telephone service were approved (these regulations seek to check some common practices of the companies holding the concessions, such as billing for services that were never provided). The establishment of ENRE and ENARGAS has suffered serious delays, and right from the start heavy political pressures have limited the autonomy declared in their respective terms of reference. Their boards of directors and technical management staff were only completed more than a year after the respective concessions began to operate, and as at the end of 1993 their effective monitoring capacity was still dubious. Both of them have had to intervene in conflicts with social repercussions (such as the massive disconnection of illegal consumers in low-income areas), but some of their decisions were reversed by the Executive. Furthermore, as a result of investigations into the quality of the services provided, these bodies have imposed fines on private distributors (although these fines were very small and were only paid under protest) and have ordered the return to consumers of payments due to over-billing.

ii) *Bodies without effective regulatory capacity.* These are bodies which were legally established but do not have an adequate structure or do not enjoy autonomy because they come under the administrative authorities originally entrusted with the privatization process.

This group includes the National Postal and Telegraph Commission, which is responsible for an enterprise which has not yet been privatized; the National Rail Transport Commission, which is to supervise the concessions granted in that area; the National Railway Regulation Commission, which is empowered to act in conflicts among users, the State and the railway operators; the Commission on Highway Concessions, which comes under the former Department of Roads and Highways, and the National Motor Transport Commission, which comes under the Ministry of Transport.

iii) *Areas without regulatory bodies.* To a large extent, conflicts of interest have prevented the establishment of regulatory bodies in the fields of air transport, the petroleum refining and marketing and gas distribution sector, multimodal transport in Greater Buenos Aires, ports and navigable waterways, and other areas.

In general terms, both the legal structure of the regulatory frameworks and the formal attributions of the respective bodies seem to have incorporated the recommendations derived from international experience (calls for fair and reasonable scales of charges; defence of users' rights, free competition and efficiency, etc.). Furthermore, the organizational structures of the bodies have been designed by international-level consultancy firms, salary scales are in line with the functions discharged, management and technical posts must be filled through public competition, and reasonable rules on incompatibility have been applied.

However, all these conditions make little sense in practice when they are not backed up by the detailed conditions of the contracts, and it is in this aspect that there are still serious doubts. The ultimate effectiveness of regulatory bodies depends largely on their independence of the concession-holders and political officials, their credibility in the eyes of society, and the supervisory measures adopted.

#### 4. The lessons of the first years of operation<sup>32</sup>

In Argentina, regulatory bodies have been organized for each privatized service or enterprise,

<sup>30</sup> In this latter case, it was only early in 1994 that steps were taken to fill the necessary technical posts.

<sup>31</sup> It may be noted that none of the markets corresponding to the other privatization operations of this first stage (highway toll concessions, sale of petroleum areas and air transport) has a specific regulatory framework.

<sup>32</sup> For details of international and Latin American experience, see OECD (1993) and Rausch (1993).

but independently of each other and subsequent to the granting of the concessions and the consequent transfer of assets. This strategy has had various consequences:<sup>33</sup>

i) *Policy inconsistency.* An example of this is that the regulatory bodies for gas and electricity are completely dissociated from one another, thus complicating the tasks of medium- and long-term investment planning, design of policies for energy substitution and rational use of energy, etc. Moreover, such an important source of income as petroleum has no specific regulatory body or regulatory framework.<sup>34</sup> The same kind of problems may emerge in time in connection with the various forms of land transport.<sup>35</sup>

ii) *Deficient coordination of information.* Another of the negative consequences of the successive and disconnected establishment of the regulatory bodies is that the State loses the possibility of maintaining a centralized and readily accessible store of information. This problem is further compounded by the varied jurisdictional nature of the regulatory functions.

iii) *Professional suitability of the new techno-structure.* The nominations and appointments to management posts in the regulatory bodies have not been the result of clear competition. Sometimes this means that those appointed are not the most suitable candidates, but rather representatives of various power groups or agents.

iv) *Equivocal legal status.* As many of the concession contracts antedated the detailed regulatory legislation, any change could be considered as an alteration of the rules of the game, thus depriving the government authorities of bargaining power. This can give rise to eminently technical arguments between the regulatory bodies and the concession-holders, and frequently to verdicts based on political considerations at the various levels of the Executive. When this happens, the autonomy of the regulatory bodies is weakened and the process of co-optation of the regulators is facilitated.

v) *Little evidence of defence of users' rights.* An example of this was the attempt to present condominiums with a single global bill for drinking water supply, which would have significantly reduced the administrative costs of the water companies (by presenting only one bill instead of many), as well as solving problems of arrears of payment, since if the water were cut off, this would affect all the users in the building, and the cost of collecting or paying off the amounts owed by debtors would be paid by the neighbours. The political authorities finally intervened by postponing the implementation of this practice, thereby committing a *de facto* and *de jure* violation of the terms of the concession, which did in fact authorize this practice. It may be noted that the clause in question came from the regulations of the former National Water Supply and Sanitation Service, although it had not been applied in the past.

Generally speaking, suitable conditions for clear and effective regulation do not appear to exist, since the regulatory bodies were not established before the privatization operations were effected, a new independent technical structure has not been established, the system is not clear and easily understandable to users, and penalties are not applied automatically, but rather on a "consensual" basis.

In short, the rationality of the Argentine privatization programme has been significantly limited in at least two respects. Firstly, because certain critical assumptions on microeconomic behaviour (the propensity of the agents favoured by the programme to make reproductive investments from their profits) are not being fulfilled, and secondly, because the non-market mechanisms needed to get closer to optimum solutions under conditions of the monopolistic supply of services are not yet operating.

<sup>33</sup> Although these problems were in a sense to be expected, in view of the context which preceded the privatization operations and the haste and broad scope of the process, the possibilities of correcting the shortcomings will be significantly reduced after the expiry, in the middle of the next period of government, of the possibility of initiating legal actions that alter the present system. From then on, there is a serious risk that the regulatory style of co-optation on two fronts will become consolidated.

<sup>34</sup> Indeed, the central government has not been able to prevent increases in the local prices of fuels. The only tool available for checking these oligopolistic practices would appear to be the precarious Act on the Defence of Competition.

<sup>35</sup> This problem could be avoided by, for example, the establishment of a centralized "superbody" which would obviate over-specialization by the regulating official and reduce the possibilities of co-optation. In an economy in which the main business conglomerates also dominate the privatized public services sector, and in the absence of strict anti-monopoly laws, such a structure would in fact be essential.

## IV

### Summary and conclusions

In terms of economic, political and social relations, the privatization programme carried out in Argentina up to the end of 1993 has brought changes of a structural nature and provided many lessons on the successes and errors, the social costs and benefits, and the advantages and disadvantages of undertaking such a broad and rapid programme.

Quite apart from the differences that may be seen between the privatization operations carried out up to 1991 and those effected in the two-year period 1992-1993, the Argentine denationalization programme has distinctive features which differentiate it from other international experiences of the same period.

In this respect, the speed at which the operations were carried out is undoubtedly the most salient feature. In little more than three years, the authorities transferred to the private sector almost all the public enterprises producing goods and services, which together generated nearly 8% of GDP and around 20% of total investment in the country.

This great speed, and the emphasis on a short-term approach, initially made it possible to turn around the public sector's critical financial situation. Furthermore, the capitalization of a large amount of external debt paper improved both Argentina's position in the various areas of external debt renegotiation and the institutional relations with local economic groups.

By giving priority to speed, however,<sup>36</sup> this approach militated against the achievement of some of the objectives originally declared, and it also went against many of the recommendations that were beginning to emerge from the incipient international practice in this field. Thus, a number of objectives were not attained, and sometimes the achievements were less than those that could have been reached with a better-organized and more gradual privatization programme.

<sup>36</sup> In the words of Gerchunoff (1992), "the urge to improve the Government's image in the eyes of the business community" impelled and hastened "its privatization activities". In reality, as has become clear in recent years, this attitude of the government, and hence also of the top business circles, has played a leading role in seeking the necessary political, institutional and corporative support in order to facilitate (or even shore up) the present government's economic and social policy.

In the following paragraphs, some of the declared objectives are compared with the real results obtained:

i) *Stimulation of investment in the privatized enterprises, with its consequent multiplier effects*: the contractually committed investments are minimal and, in view of the shortcomings and limitations of the regulatory framework, difficult to monitor; where there is no effective commitment, capital formation has reached only insignificant levels, and even then these scanty investments have mostly been spent on the purchase of imported equipment.

ii) *Definitive solution of fiscal imbalances*: in most cases, the initial positive effect will be wiped out in the medium and long term; the generalized undervaluation of the assets transferred has reduced the income received by the government; the tax exemptions and benefits granted to some of the consortia which purchased the privatized enterprises reduce fiscal income; the absorption of almost all the liabilities of the privatized enterprises means that there will be future fiscal outlays in respect of principal and interest payments, etc.

iii) *Significant reduction in external indebtedness*: beyond the short term, the effect of the capitalization of external debt paper has been more than offset by new external indebtedness both by the purchasers of the privatized enterprises and by the public sector itself.

iv) *Incorporation of modern management techniques, with improvement of business efficiency and of the quality of the goods and services supplied to the community*: for the moment, the relative improvements in the performance of many of the privatized enterprises are only due to the serious deterioration suffered by those enterprises before they were transferred to the private sector.

v) *Global changes in the rules of the game*: there has been a further strengthening of the power of the same economic agents who grew in the past thanks to such measures as industrial promotion, assumption by the State of the private external debt, and public-sector purchases of goods and services, and there has been an increase in their lobbying power and their

influence on relative prices and the distribution of wealth. Thus, rather than helping to give rise to a new business class with more enterprising features, public policies in general –and the privatization policies in particular– have helped to consolidate the market power of a few business conglomerates, mainly located in sectors producing non-tradeable goods and services.

Furthermore, there has been a flagrant failure to take account of some issues of crucial importance for achieving the social benefits which could theoretically result from a selective and gradual policy of privatization of public enterprises. Examples of this are the lack of concern for putting the enterprises to be privatized on a sound footing before their sale; the scant attention paid to the need to regulate certain privatized areas; the transfer and further consolidation of oligopolistic or monopolistic reserved markets; the establishment of conditions ensuring low or non-existent business risks; freedom to fix the prices and scales of charges of various public services; the transfer to a handful of economic agents of power to regulate markets; abrupt changes in the relative prices of the economy, to the detriment of consumers and of the sectors producing internationally tradeable goods; the scant interest shown in organizing competitive bidding with a considerable number of bidders and the fixing of “entry barriers” based on the wealth of the potential bidders; and the further heightening of the process of the concentration and centralization of capital.

There have also been shortcomings as regards public regulation, especially in the case of “natural monopolies” and areas and sectors where a highly oligopolistic structure has become consolidated. Among these shortcomings, special mention may be made of: i) the formulation of regulatory frameworks and the establishment of the respective regulatory bodies *after* the transfer of public enterprises to the private sector; ii) the adoption of provisions tending to preserve the monopolistic or oligopolistic nature of the enterprises privatized. Even though there may be clauses limiting the duration of these rights, the relative bargaining power of the parties when the contracts come to an end will not be such as to favour the State, as long as the weakness of the regulatory bodies and their co-optation by the economic agents they are supposed to regulate persists; iii) the frequent reformulation of rules laid down before the privatization process, which adversely affects the

public credibility of the regulatory system and may run counter to prior rights whose renegotiation would almost certainly be to the disadvantage of the State; iv) the scant protection afforded to consumers in the face of the oligopolistic practices of the consortia which purchased the privatized enterprises;<sup>37</sup> v) the establishment of formal anti-monopoly requirements which, however, in practice can be easily evaded without risking any penalty,<sup>38</sup> and vi) the absence of rules guaranteeing the independence of the regulatory bodies with respect to private companies which acquire privatized firms or areas.

The Argentine experience also raises some queries about the heavy concentration of ownership of the privatized enterprises in a few big economic groups;<sup>39</sup> within this context, the growing bargaining power of the conglomerates weakens the State in its role of promoting better links and relations within society as a whole.

Finally, what has been done in Argentina in the field of the privatization and regulation of public services is virtually in contravention of the best practices in this respect.<sup>40</sup> Thus, most of the other experiences of privatization point to the conclusion that once the political decision to privatize all or some public enterprises has been taken, it is necessary to apply a gradual approach, with criteria in terms of the time sequence which make it possible to harmonize and optimize multiple short- and long-term objectives, the recognition right from the start of the need to restructure the enterprises to be privatized and put them on a sound business footing so as to maximize the value of their assets, and the prior formulation of regulatory frameworks which guarantee the greatest possible social benefits.

(Original: Spanish)

<sup>37</sup> An example of this is the behaviour of the YPF S.A. company, whose predatory and anti-competitive practices have proved to be impossible for the Government to check with the instruments at its disposal.

<sup>38</sup> The most flagrant example of this is the acquisition by Acindar of part of the equity of the former Somisa, thus infringing the condition laid down in the privatization process that two local steelmaking firms could not form part of the same consortium.

<sup>39</sup> It has even happened that, after being favoured by the “entry barrier” represented by the fixing of minimum levels of corporate wealth for eligibility to participate in the bidding, some big firms forming part of the purchasing consortia have subsequently transferred their share holdings, thus obtaining huge financial benefits in a very short space of time.

<sup>40</sup> See, *inter alia*, OECD (1993), Devlin (1993) and World Bank (1988).

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