

# CEPAL

## Review

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#### Notes and explanation of symbols

The following symbols are used in tables in the *Review*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank space in a table means that the item in question is not applicable.

A minus sign (-) indicates a deficit or decrease, unless otherwise specified.

A point (.) is used to indicate decimals.

A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.

Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.

Reference to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated.

Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates.

Individual figures and percentages in tables do not necessarily add up to corresponding totals, because of rounding.

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# Interaction between the public and private sectors and the overall efficiency of the economy

Juan M.F. Martín\*

The countries of Latin America are confronting the challenge of dealing with a restructuring of their economies on the basis of adverse conditions resulting from the crisis. Neither the neoliberal State nor traditional interventionism can perform the exacting task that the crisis situation and the need for transformation demand. On the contrary, what is needed is a joining of forces by the social and productive sectors which proceeds from the assumption that competition is not only internal but also international.

As shown by the successful experience of some countries of the developing world, the role of the State is crucial in this context, but it is necessary to change its traditional libretto: less regulation and more promotion of development. Greater decentralization of decisions would make it possible to expand the capacity for innovation. Thus, it would be desirable—for reasons of social rationality—to combine planning and the market instead of insisting that they oppose each other. Indeed, what is needed is to promote a new arrangement of public, State and private interests which will be more functional, so as to establish a virtuous circle of relationships. The reason is simple but powerful: the mixed nature of an economy is determined not only by the obvious coexistence of various forms of ownership but also by their interactions and articulations and by the modalities of functioning of the economy as a whole. The purpose is not the thoughtless dismantling of the present system of regulations and the State-controlled productive apparatus, but rather its rationalization—in a gradual and clearly understood manner—so as to improve the overall efficiency of the economy, in its public and private sectors.

In this context, the policy of public enterprises should be revised, to concentrate on strategic and priority activities at the macro level and to modernize their structure and regain the entrepreneurial spirit at the micro level.

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## Introduction

The expansion of the public-enterprise sector (PES), especially during the last two decades, has been a generally observed phenomenon in mixed economies, not only in the developing countries of the world but also in the developed countries.

One of the basic characteristics of the PES in the context of Latin American countries is its marked heterogeneity, with regard to the forms of juridical organization, to the asset structure of its enterprises, to the nature of the goods and services it provides and to the various markets and social needs towards which it is oriented, even including the actual history of the creation of each enterprise or its incorporation into the public sector. In reality there exist several parallel histories in the shaping of the PES which are governed by different rationales. For this reason, it is pointless to diagnose the problems of the sector without some reference to its heterogeneity, or to establish uniform policies for such a complex and diverse reality.

The PES has played a deliberate and decisive role in the consolidation of the independent national States of the region and their process of economic and social development. However, some national analyses agree in pointing to a growth of the PES during the past few years that was not necessarily planned; this growth has been the result of *ad hoc* solutions for problems of economic policy (for example, the incorporation of private enterprises which have gone bankrupt) rather than the consequence of a long-term orientation towards a growing nationalization of the economy.

When this result is understood in its entirety, the PES constitutes a complex and diversified technical, economic and financial conglomerate which is very difficult to manage and control effectively; some of the factors involved are: the difficulties encountered in administering conglomerates of large dimensions (public or private); the excessive demands made on disarticulated public apparatuses; and the difference between State ownership and the capacity for effective public management.

Furthermore, these conglomerates operate in the context of economies which exhibit visible

signs of overall inefficiency, both in the public sector and in the private sector, in a perverse circle of integration. Consequently, taking aim solely at the lack of efficiency in the PES does not seem the most satisfactory approach; it seems more appropriate to stress the need for increasing the overall efficiency (public and private) of the economy in order to improve its foreign competitiveness and to rationalize its internal functioning.

The difference between opinions and realities and the difficulties in understanding what is happening with State intervention in Latin America are due partly to the lack of a theory capable of explaining the real functioning of a mixed economy and providing a foundation for the design of policies and other measures for concrete action. The multifaceted nature of the

subject gives rise to many attempts at interpretation, generally contradictory to one another, and requires empirical methods of analysis. To a large extent, an understanding of State intervention must still be sought in social and economic practice, before the theories applicable to this subject are fully developed.

In this context there are three outstanding topics which are clearly interrelated. In section I we shall analyse the modes of interaction of the public and private sectors in the context of the mixed economies of the region. Next we shall review some basic elements for a reform of the PES (section II), and lastly, we shall examine the central characteristics of the programme of privatization (section III). In our final considerations we shall formulate some questions as the basis for our debate.

## I

### Interaction of the public and private sectors

A mixed economy may be characterized essentially by the coexistence of two basic organizational principles: i) the principle of the private economy, based on market relationships and with the profit rate as the main guide in the allocation of resources; and ii) the principle of the public economy, where the organizing principle that prevails is the allocation of resources through administrative provisions or processes of a political nature.

There are, in short, two different kinds of logic to govern allocation: one through the market, and the other outside of the market.

These two kinds of logic interact both at the microeconomic and at the macroeconomic level. The first type of interaction is found in mixed-ownership enterprises, in which private and public capital are articulated at the microeconomic level through a relatively broad range of modalities. At the macroeconomic level, on the other hand, both kinds of logic interact through a combination of many economic policy measures, partly created by demand and partly imposed. These measures, in turn, may be divided into anti-market policies (regulations of all kinds)

and pro-market policies (various measures for encouraging private activity).

In the Latin American case, State intervention—and in particular, public production—has been based on two types of considerations, both of them related to the allocation of resources, but from different points of view. The first, of a more academic character and with a microeconomic and static focus, concentrated on correcting the so-called defects of the market; the second, more pragmatic and with a macroeconomic and dynamic focus, revolved around the role of the State in the process of capital accumulation.

The traditional theoretical approach to an economic analysis of public production is based on the propositions of the "welfare economy". As is well known, given a specific distribution of production factors, the competitive forces in a market economy would generate an allocation of resources which is efficient by Pareto's definition. There are a number of reasons why the system of market prices does not provide adequate signals for the efficient allocation of resources. In the context of this discussion,

attention should be given to two of these reasons: i) When there are yields which increase with the scale of production, for example in the distribution of electric power, and ii) the presence of externalities, as is the case with congestion in urban transit. The most common response to this situation in the economies of Latin America has been public production.

Consequently one of the theoretical justifications for public production is found in considerations of allocation efficiency; that is to say, it aims at achieving an efficient allocation of resources in the economy as a whole. In contrast, the argument in favour of private initiative rests on the role of incentives and restrictions created by competition in order to attain productive (or technical) efficiency of the enterprise (maximization of profits or minimization of costs for a given level of production).

The normative focus of public-enterprise economy implicitly presupposes the existence of production efficiency. The empirical relevance of this assumption is important, inasmuch as production efficiency is a necessary condition for allocation efficiency (Rees, 1984), which, as has been pointed out, is the basis for public production. The heterogeneity of the public-enterprise sector in the countries of the region makes it impossible to give specific answer, let alone a unique answer, to the question whether or not this assumption is valid. The danger posed to production efficiency by a possible difference between the actual modalities and the normative view of management was made clear long ago (Little, 1952). The central argument pointed to the complications of a context which made it impossible to define clearly the objectives of the enterprise and, at the same time, the difficulties in evaluating its management on the basis of results.

A public enterprise must satisfy three kinds of logic: i) that of an entrepreneurial entity; ii) that of an instrument of governmental policy; and iii) that of a productive unit subject to public evaluation (Martin, 1986). The frequent lack of agreement between the first two kinds of logic (maximization of profits as opposed to efficiency in attaining governmental objectives) helps to create an image of inefficiency of the public enterprise which is based on its financial deficit, or alternatively, on its need for compensatory tax resources. Parallel with this, the pres-

sure for reducing the public enterprise's expenditures results in a deterioration of the levels of service, thus damaging its valuation within the ambit of the third kind of logic (a productive unit subject to public evaluation).

In theory, a private enterprise is guided by a simpler logic, namely, maximization of the profit rate, and a clear indicator of its performance is the market value of its stock. Furthermore, competition in the product market punishes inefficient enterprises with bankruptcy, while competition in the capital market makes it possible to shift the guidelines of the enterprise before it reaches a critical point in its management.

However, the reality of the economies of the region does not agree with this model of market-imposed discipline. The lack of competition in product markets, the minimal number of enterprises quoted on the stock exchange, their relatively closed capital structure and the poor development, or indeed the speculative perversion of capital markets, reduce quite appreciably the pressure on private enterprise to attain efficiency in production and allocation.

This contrast between supposed incentives and real incentives, both in the management of public enterprises and in that of private enterprises, is a clear indicator of the deficiencies in the overall functioning of the economy. An explanation for it must be sought in the second viewpoint mentioned earlier: the role of the State in the process of capital accumulation.

The magnitude and rate of State intervention in the Latin American economies, beginning immediately after the Second World War—and in some countries, beginning some years earlier—was based on a fairly general consensus concerning the role that should be played by the State in the dynamization of the process of economic development. This model was based, on the one hand, on the State's capacity to finance its own expenditures and reallocate the flow of savings in the economy and, on the other hand, on a broad and consistent system of regulations.

This coherent combination of mixed production and regulations shaped a pattern of growth in which two economic factors became conspicuously dynamic: the State monopoly—natural and protected—and the protected private monopolies and oligopolies. In both cases, the lack of competition severely restricted incentives

for attaining efficiency in production and in the allocation of resources; similarly, it led —on the part of both State and private management— to a constant struggle for the appropriation of quasi-rents originating in reserved and incontestable markets.

In this context, the logic of public production and that of private production have interacted in a pattern of increasing conflict, especially since the crisis in this model in the early years of the past decade. i) In connection with entrepreneurs, we observe a dual attitude towards State intervention: their propensity to adhere to an ideological discourse that blames State intervention for most of their troubles and, on the other hand, their pressure on public resources to compensate for their lack of competitiveness, to increase their profits or to make up losses resulting from mistaken decisions. ii) On the part of public officials, we can also observe two types of attitude: their intention to transfer the modalities of private management mechanically to the public sphere, disregarding the differences in objectives and procedures that arise from the particular resource-allocation logic in each sector; and their insistence on imposing more far-reaching regulations because they regard the private sector as structurally and permanently too weak to exercise the entrepreneurial role, or inevitably perverse in its modality of operation.

Any of these positions can unquestionably be supported by experience: it is possible to argue about the "failure of nationalization", just as it is valid to speak of "the nationalization of failure". However, the point is that unless this situation of conflict and mutual distrust is overcome, the work of development and democratic coexistence is less likely to succeed. In short, we must build the bridges that will enable us to span the gaps that each position insists on creating (ILPES, 1985). In this connection, it is relevant to remember that relations between the participants in the two sectors have become less and less secret in the modern economy; consequently, the importance of negotiation has increased.

It is probably time for a *new agreement on limits* between the public and private sectors, but is beyond doubt that there is an urgent need for *agreements on frontier integration* (with priority among them being given to an agreement on technological innovation and another on the

flow of reciprocal financing). The reason is simple: the mixed nature of an economy is determined not only by the obvious coexistence of different forms of ownership but also, and primarily, by their interactions and articulations and by the modalities of functioning of the economy as a whole. Within a democratic framework, both the possible new treaty and the above-mentioned agreements should be widely discussed and open and above-board.

The unprecedented challenges posed by the crisis require different solutions today; in particular, we must attain greater overall efficiency and make the productive structure more flexible in order to maximize its capacity for long-term adaptation to unfavourable changes and to the opportunities that a volatile and turbulent external framework also offers. Thus the task of development requires facing the connection between entrepreneurship and government as a subtle challenge to work of social concertation. Only an authentic entrepreneurial force (private and public) can serve as a leader capable of bringing about the changes that will be needed to modernize the productive apparatus; only governmental leadership, with a long-term vision, can distinguish the risks of technological dependency and reduce them through a development policy that has the approval of society as a whole (ILPES, 1987).

In this connection, the countries of the region are facing the challenge of an offensive carried on with conspicuous persistence by international financing organizations and other external observers, which stresses the need for privatization (Aylen, 1987). This proposal for a change in direction has entered the area of internal discussion in several countries of the region and has found a favourable echo in some national entities. Others have questioned either the foundations, the magnitude or the rate of the proposed change in direction.

Although a dogmatic and indiscriminate application of this position must be opposed, there are two good reasons why the problem should be carefully analysed in the context of each national situation: one reason, which is political in nature, is that the idea that everything must be created or resolved through State initiative is contradictory to the very concept of a mixed economy; it results in passive and dependent social behaviour bearing little relation to

reality and to undesirable reductions in the creativity, initiative and responsibility of the various national entities; the other, of a technical nature, rests on the fact that the combination of functions performed by the governmental sector constitutes a very complex and diversified productive, economic and financial conglomerate and that, in addition, it has some perverse articulations with the private sector and imposes upon the government a set of demands which exceed its available supply of real creative, negotiating, organizational and financial resources.

There is also a more pragmatic reason: in the countries of the area, governments have adopted or are considering actions to redefine the relationship between the public and private sectors, within a framework of sharp controversy or

uncertainty concerning the possible results. Unquestionably a serious effort of imagination and initiative must be made in order to find acceptable and viable solutions. In section III we shall consider the arguments and the recent experience of privatization programmes.

It should also be pointed out that even if major successes are achieved in the process of privatization, transfer of management or decentralization, it seems realistic to believe that a broad public sector will continue to exist, and this fact will make it necessary at the same time to continue and intensify the effort for modernization and improvement of the economic and social performance of the public sector, a subject which will be discussed in the next section.

## II

### The reform of the public-enterprise sector

In the Latin American experience, with national variants, the PES has been shaped predominantly in the so-called ministerial-supervision régime. This structure had as its purpose the attainment of the objectives fixed in the constituent document of each enterprise, harmonizing its management with the policy and programming established by the government for the sector in which it was active, and the granting of the administrative, operational and financial autonomy necessary for efficient management.

In addition, the integration of the sectoral ministries into a National Planning System was aimed at making the activities of each ministry, including its associated entities, compatible with the more general objectives of development policy.

However, this formal design disregarded a fundamental question in the analysis of the problems of organization and management of the public sector: the fact that public enterprises exist in the political space of the interests associated with a specific governmental policy.

This omission was based on a concept of the State and society that was distorted by formalism and was inconsistent with the complex nature of

reality. It presupposed a monolithic view of the State apparatus, corrupting both its real relations with civil society and the characteristics of the process of public-policy formation within the State bureaucracy.

The State apparatus is not the result of a rational process of structural differentiation and functional specialization, nor can its development be mechanically adapted to a planned and coherent design. To the extent that its various centres of decision divide their loyalty among proposals, interests and projects of different kinds, there is a compromising of the homogeneity of policies, the overall coherence and coordination of decisions and the capacity to plan and decide on long-term questions. That is to say, the nature of the public productive apparatus and its actual administrative organizations are affected by the vicissitudes of a constant struggle within the bureaucracy, which in turn reflects other adversarial relationships in society.

The relative lack of success of those forms of supervision and control may be attributed to a number of factors. Almost all of them are related in one way or another to the greater technical

and political power of enterprises in comparison with the authorities responsible for their supervision and control. Thus, in view of the inability to evaluate the merits of the enterprises' performance, these tasks relate primarily, and often exclusively, to formal aspects. Consequently the focus of control is shifted to the legal and formal plane which characterizes the budgetary control of public administration and remains centred in a purely bureaucratic sphere.

In general, different aspects of supervision and control that affect a particular area of the enterprise (personnel, prices, financial resources, etc.) are exercised by different entities, leading to the so-called problem of multiple ownerships. When supervision and control —functions assigned to a number of different organs of the central government— lack the necessary co-ordination to take account of their interactions and to give consistency to their development as a function of time, this may result in situations which are unmanageable from the standpoint of the unitary logic of the public enterprise.

The difficulties in the functioning of this model of the relationship between the PES and the central government have been aggravated in recent years by two facts: the aforementioned process of sharp growth of the PES in almost all the countries of the region, and the economic crisis which has afflicted the Latin American countries since 1981-1982 and whose most obvious manifestation is the problem of foreign debt.

The economic crisis had a significant effect on the relations between the PES and the central government. With a greater or lesser degree of alteration in the formal organization of this relationship, public enterprises were subjected to strong financial controls centred in the responsible authorities of the government's macroeconomic policy. The establishment of these controls, whose rationale is based on the attainment of external adaptation and internal stabilization, through either simultaneous or successive processes, had serious consequences on the performance of public enterprises, in some cases even involving the cost of operation and the maintenance of its installed capacity.<sup>1</sup>

Operationally, the basic trend was aimed at the programming and follow-up of the annual

financial flow of the enterprises. Specifically, with regard to expenditures, limits were placed on investment, other capital expenditures and debt servicing (amortization and financing charges), as well as on personnel expenses. On the income side, an attempt was made to control the use of the enterprises' own resources, those derived from fiscal transfers and from internal and external credit operations.

Some of the problems encountered with this type of control of public enterprises are worth identifying: i) the financial nature of the control predominates over the economic concept; thus, for example, criteria of the social or macroeconomic profitability of investments are usually not examined; ii) the approach of the control system is basically annual, which is contrary to the physical reality of investment projects and, at the same time, to an ordered programming of operations; iii) procedures for the control of expenditures tend to be applied uniformly, either through indiscriminate budget cuts or through the quarterly or monthly rationing of financial disbursements; iv) while the budgetary process is not integrated (the budget of the PES, the fiscal, foreign-exchange and monetary budgets) and only some of its parts are subject to legislative approval, the attainment of the macroeconomic objectives results in high costs to the less flexible budgets; and v) a control system centred in the agencies responsible for macroeconomic policy constitutes, from the standpoint of institutional organization, a framework for a conflict of interest with the sectoral ministries on which public enterprises are functionally dependent.

To the extent that this type of control is imposed abruptly and without an overall strategy—but also in a particularized manner—for the restructuring of the PES, it ends by closing the vicious circle that affects the performance of the public enterprise (Ayub and Hegstad, 1987).

<sup>1</sup>In this connection, it should be recalled that although one cannot ignore the need to raise the level of governmental performance and to adopt a practice of austerity in public management, the possible giantism in public deficits is due in large measure to an impact retransmitted inwards from the foreign-debt front, which therefore cannot be solved merely by imposing drastic restrictions on governmental expenditure (Costa-Filho, 1987).

The experience of recent years has also revealed a reduction in the degree of autonomy of governments which design and execute public policies, thus affecting the capacity of national societies for organized collective action (ECLAC, 1988). It is essential that the vulnerability produced by the crisis should not distract the attention of Latin American countries from the future; this requires a significant conceptual and technical renovation of planning (ILPES, 1987).

With regard to the PES, it is necessary to shift the focus of attention, as well as to solve an important problem. In the recent past, efforts have been concentrated on the question how public enterprises should be controlled, restricted and utilized. Today the priority focus should be different: how to revivify the fading spirit of enterprise. In the central government this means developing a greater strategic capacity to administer a complex of considerable magnitude for industrial production and for furnishing services. In enterprises this requires emphasizing efficiency and maintaining the pressure on costs.

But it is also necessary to solve another problem: the system of relationships between enterprises and the central government. The inefficiency in some public enterprises is not exclusively due to internal factors; in many cases it is associated with the institutional and legal structure, as well as with the informal practices of the system that delimits and conditions the action of enterprises.

The previously mentioned heterogeneity of the PES discourages any attempt to formulate a general strategy for bringing about the necessary changes; this is even more true when we consider the variety of situations which, in this aspect as in others, exist in the economies of the region. Nevertheless, three possible components that may be of interest have been identified (Boneo, 1986).

In the first place, the reform process should be based on negotiation and harmonization rather than on formal hierarchical principles and the nominal distribution of authority. A necessary condition for this is greater transparency of the functioning of the system, which, among other things, requires giving priority to information systems, substituting quality and usefulness for quantity and irrelevance. One use-

ful procedure for initiating such a social and institutional practice is a simplified version of the programme agreement. On the basis of a few fundamental agreements, the procedure could evolve towards a more global, multiannual and public concertation. In accordance with this modality, the managers of each enterprise would increase their forecasting capacity and their flexibility with regard to policies on production, employment, prices and investments. The central government, for its part, would ensure greater efficiency in the attainment of its objectives and would also evaluate compliance with the enterprise's guidelines on the basis of result indicators, as the counterpart of greater entrepreneurial autonomy.

In the second place, negotiating procedures should be reinforced by a clear and explicit system of incentives and sanctions related to the fulfilment of the agreed goals. For this reason, the programme agreement between the enterprise and the central government should be accompanied by a strategic plan for the enterprise, including its restructuring if necessary; the plan should make it possible to disaggregate the global aims and assign internal responsibilities, so that graduated action can be taken at the responsible level in the event of unjustified failure to achieve the agreed goals. Similarly, it would be desirable to introduce a system of incentives linked to increments in productivity and other indicators of the enterprise's performance.

In the third place, in most countries of the region a governmental agency of some kind has been established to supervise all public enterprises or groups of such enterprises. In the context of the foregoing propositions, these agencies should become the focal point of negotiations between the government and the enterprise and should thus acquire influence over both of them. Their basic task would be to provide leadership and to give consistency to the negotiating process, to verify that the agreements are being complied with and to supervise the system of incentives.

Lastly, it should be emphasized that an overall but particularized strategy for the rationalization of the PES may include among its components the decision to concentrate govern-

mental efforts in areas regarded as having high priority. Thus, it is not uncommon to find the announcement, and in some cases the execution, of denationalization programmes with different

amplitudes and different degrees of intensity. Privatization, the most controversial component of these programmes, will be analysed in the next section.

### III

## Basic characteristics of privatization programmes

Privatization is a burning issue, and like most issues of this kind, it has been more diligently advocated or attacked than understood. Nevertheless there is a growing body of analytical and empirical research that analyses privatization from a more objective point of view and makes it possible to identify some of the economic impacts of the process. Although the discussion was initially centred on the exchange of assets between the public and private sectors, the analysis of its practical application has expanded the range of subjects under discussion so as to approximate the changing pattern of relationships between the two sectors.

The reasons for the general concern about this subject are clear, and although they vary from country to country, some common basic questions underlie the comparative analyses. Three of these should be emphasized: i) the imbalance in public financing, aggravated by the restrictions of the recent past and by the continuing growth of demands and costs; ii) concern over the quality of public management, which has been negatively influenced by the vested interests of corporate groups and by the rigidity of central bureaucracies in adapting and responding to periods of rapid change; and iii) the demonstration of obvious instances of overall inefficiency in the economies of the region and the need to improve their external competitiveness and rationalize their internal functioning.

From this point of view, greater decentralization of decisions may be viewed as one of the ways to mobilize resources through new procedures and to overcome deficiencies in management and, on the other hand, as a hope for improving the prospects of adaptation to change and to innovation. Nevertheless, it must be

pointed out that in this approach the deficiencies of the public sector are perceived with much more clarity than the real and effective opportunities afforded by the private sector; that is to say, a concrete image of the public sector is contrasted with a rather idealized vision of the private sector.

The basic modalities for privatization which will be reviewed below exhibit reasonably well-defined features, but their application—in different national contexts—will inevitably be varied and evoke growing attention and concern about its effects. It could hardly be otherwise, since this involves nothing more nor less than managing the balance between the public and private poles of mixed economies.

### *1. Objectives*

On the subject of privatization a significant list of objectives has gradually been accumulated. Some of these objectives are: a) improving the level of economic performance of enterprises, which includes increments in their productive and allocation efficiency; b) finding solutions for the difficulties involved in the relationships between the agencies of the central government and the public enterprises; c) generating fiscal income through the sale of productive assets; d) promoting greater dissemination of stock ownership: democratization of ownership, or people's capitalism; and e) reducing the power of the various groups which exert corporate pressures on the public enterprise (suppliers, contractors, bureaucrats and trade unions).

All of these objectives have been assigned to privatization programmes, especially in those countries in which more effective progress have been made (in this context, see Waters (1987)

for the United Kingdom and CORFO (1985) for Chile). It should be pointed out, however, that this multiplicity of objectives is not an unequivocal indicator that the policy of privatization, as carried out in practice, follows any very sophisticated rationale; on the contrary, such multiplicity reveals the lack of a clear and solid analysis of its purposes and effects. Rather, as has been clearly indicated by Kay and Thompson (1986) in their analysis of the British experience, this is a policy in search of its rationale.

There are three reasons for this characterization: first, growth by aggregation would indicate that any additional objective that appears desirable or attainable is incorporated into the list; second, the lack of an explicit analysis of the compromises between objectives which are actually or potentially in conflict; and third, the fact that privatization in practice clearly shows that the objective of economic efficiency has been subordinated to the objective of generating fiscal resources<sup>2</sup> and redistributing assets,<sup>3</sup> but especially to that of giving reality to the decision for privatization when this has been announced. In this connection, useful illustrations may be found in an analysis of experience with the privatization of several major enterprises in various developed countries, as presented in Cointreau (1986).

## 2. Instruments

As mentioned earlier, the subject of privatization was initially centred on the interchange of assets between the public and private sectors. Gradually the subject has been expanded to take account of the changing pattern of relationships between the two sectors. In accordance with this greater scope of the concept of privatization, there has also been an increase in the number and type of instruments considered, which may be classified into three groups:

- a) *Sale of assets*: the exchange of private financial assets for public productive assets;

- b) *Deregulation*: a collection of measures for introducing greater competition into markets which have previously taken the form of legal monopolies, or into those which constitute technical monopolies;
- c) *Concession contracts*: actions designed to introduce competition through the market into situations in which there is no market competition.

The privatization of certain enterprises may also be based on combinations of these basic instruments, as will be seen below.

- a) *Sale of assets*. This has been the instrument most widely used in ongoing privatization programmes. Such a sale is carried out through three types of procedures: the offer of stocks at a fixed price, generally in a sequence of partial operations on the stock exchange; the opening of bids for the purchase of successive packages of stocks; and direct negotiation between public authorities and investment groups, which are chiefly foreign groups.

The first procedure requires fixing a price; this task is not a simple one, because the shares offered are often those of enterprises which produce goods without any obvious private equivalent, or because there is no commonly accepted reference pattern. Although the economic principle that should guide the fixing of the price is simple (the present value of the prospective profits that can be made from the assets), its application runs into serious difficulties in practice. For this reason, in an analysis of recent experience with the transfer of assets, one factor that stands out is the relationship between the price at which the shares are acquired and various indicators of their probable value.<sup>4</sup>

Without disregarding the controversy generated by the choice of a pattern of reference for such comparisons, almost all analysts agree that there is a definite tendency towards undervaluation, particularly when the sales are made during

<sup>2</sup>For a critical evaluation of the fiscal effects of privatization, see Mansoor (1987).

<sup>3</sup>In this context we should distinguish between effects on the distribution of assets and other impacts on income distribution (Vernon, 1988).

<sup>4</sup>In the case of Chile the sale price has been compared with the book value of the shares and with other methods of asset valuation (see tables 3 and 4 in Errázuriz and Weinstein, 1986), and in the case of the United Kingdom the reference pattern used has been the registered value in stock-exchange operations once the quoting of the shares on the open market has been permitted (see table 3 in Kay and Thompson, 1986). Very substantial discounts are found in both cases.

periods of economic recession. However, there is disagreement on the question whether this is unavoidable, or even desirable. In any case, it is also evident that governments consider other aspects when they fix prices for the sale of shares (Vernon, 1987). One of these considerations consists in making sure that the shares offered for sale will in fact be placed on the market, and for this reason there is a general tendency to establish prices which are low in comparison with the possible objective criteria. The motives for this procedure are complicated: one reason is an attempt to avoid in this way the negative repercussions of a failed offer, but another goal is the gradual consolidation of a demand for subsequent offers. In any event, it may be concluded that the undervaluation of public property generates extraordinary benefits for those who are in a position to acquire the shares.

An alternative to fixed-price sales is public bidding, with a minimum price, in order to generate offers for the acquisition of packages of shares. In reality, in those cases in which the asset-transfer procedures are more open, bidding has been one form of governmental reaction to criticism based on the low sale prices of the assets.<sup>5</sup>

The need for new inputs of capital that is being experienced by many public enterprises—a need increased by the fiscal restrictions imposed by the external crisis of the 1980s—together with the reduced size and development of local long-term capital markets, provides the foundation for a third procedure consisting in direct negotiation with foreign investment groups, both public and private. As is well known, the outlook for an increase in direct foreign investment in the region is dim, even starting from the present low levels; this is why it is useful to offer effective incentives that can attract investment. As a general principle, it would be desirable that operations carried out by this modality should be arranged as part of a national policy for foreign investment.

<sup>5</sup>In the case of the United Kingdom the use of this procedure has resulted in much smaller discounts, although it is also true that in some cases the authorities have not received sufficient offers to acquire all of the share package being bid on (see table 4 in Kay and Thompson, 1986).

The bases for the recent agreement between Aerolíneas Argentinas and the Scandinavian Airlines System seem to point in this direction. The probable transfer of 40% of the Argentine company's assets is part of a more extensive negotiation which includes capital inputs, renovation of equipment, modernization of company management and access to new markets.

A different situation is found in the case of the operations carried out under a régime for converting the foreign debt into share participation, which is becoming more widespread in the countries of the region, although with different characteristics (Lahera, 1987). Where the conversion is channeled towards existing public assets, a situation which is possible in some countries of the region but not in others, the result may be unfavourable to the country's interests. In some of these operations the foreign partners do not bring in any fresh capital, new technology or new markets for obtaining foreign currency. In actuality, all that happens is that existing assets are transferred at low and strongly subsidized prices.

Lastly, attention may be drawn to the particular case of sale at zero price, which is the donation of part of the State's share capital to broad social groups with low income. This proposal (Gerchunoff and Guadagni, 1987) seeks to reconcile the democratization of ownership with economic efficiency in denationalization programmes, on the basis of a combination of private management (private risk investors and minority investors but with control of management) and non-State public owners (dispersion of majority share ownership in order to ensure that the controlling capitalist group will aim at the maximization of dividends and not only at its own profits).

b) *Deregulation.* A recent highly systematic review of international evidence on the comparative performance of public and private enterprises (Domberger and Piggott, 1986) concludes that competition plays a more important role than ownership in the promotion of productive efficiency. Thus any possible differences in performance are directly related to the restrictions imposed and the opportunities afforded by a competitive framework in the product and capital markets. From this point of view, competition in the product market is conceived of as a

mechanism for detecting inefficiency (bankruptcy) and competition in the capital market makes it possible to restore the efficiency that has been lost. In order to enable both mechanisms to function, the privatization efforts should be preceded—or at the very least, accompanied—by deregulation programmes; otherwise the transfer of assets from the public to the private sector will not necessarily bring greater productive efficiency. This position is, of course, contrary to the view of those who maintain that the privatization process, in and of itself, will automatically lead to greater liberalization and flexibility of the economy.

The recent discussion on deregulation emphasizes the importance of removing barriers to entry as a prerequisite for increasing real or potential competition in markets. In the past the policy of regulation was based on the economic theory of market organization, which emphasizes internal conditions; this theory takes account of the different degrees of competition between enterprises that already exist in the market being considered. These internal conditions include both structural components and aspects derived from the behaviour of companies: market structure, differentiation of products, discrimination in prices, differences in costs, information leaks, strategic planning, etc.

This debate has recently been enriched by the theoretical proposition of contestable markets (Baumol *et al.*, 1982). This proposition emphasizes the importance of external conditions as a potential source of competition; that is to say, it stresses the influence that may be exerted on established enterprises by the possibility that new enterprises will enter the market. In the absence of non-recoverable costs—the value of investments that cannot be recovered when production ceases—the removal of barriers to entry will ensure quasi-competitive behaviour, even in the case of some natural monopolies, since if the monopolist generates opportunities for excessive profitability, his position will become vulnerable to the entry of potential competitors.

Although the assumptions on which the contestable-market proposition is based gave rise to extensive debate (see Shepherd, 1984), it suggests possible new orientations for regulatory policy. Thus the relevant criterion would be

not the number of enterprises and their respective market quotas but the facility with which potential competitors may enter and leave the market.

However, beyond theoretical possibilities, the tangle of interests created around a specific configuration of the regulatory system constitutes a formidable obstacle to any increase in productive efficiency achieved through greater competition or challengeability of markets. As has been correctly pointed out (Gerchunoff and Guadagni, 1987), in modern economies there exists a genuine market which confronts the demand and supply of regulations and around which both private and public interests are articulated.

Of course, what is at issue here is not the thoughtless dismantling of the regulatory system but rather its gradual rationalization, as openly as possible, in order to promote greater overall efficiency of the economy. Moreover, this task should not be looked at with an ingenuous concept that would disregard the existence and possible realignments of the groups of vested interests, but it is nevertheless necessary to shape a more functional articulation of interests for the establishment of a virtuous circle in the State-public-private relationship.

c) *Concession contracts.* The third type of instrument consists in the granting of rights to the production or distribution of goods and services in market situations characterized by the absence of competition, as is the case, for example, with natural monopolies. As has already been pointed out, this instrument was devised in order to introduce competition through the use of the market when there is no competition in the market. Although originally enunciated during the past century, this instrument was postulated more recently (Demsetz, 1968) as a possible alternative either to public production or to the State regulation of private producers. From the point of view of its application, we may distinguish between two criteria for seeking offers, in competitive bidding for the concession: i) a lower unit price for the production or distribution of the goods or services, and ii) a greater fixed sum for the concession.

In the first case, that of a Demsetz auction, competition between the bidders, in so far as there is no collusion, will reduce the profit rate to

its competitive level, when the offered prices approach the marginal cost of production. In other words, the adoption of this criterion would avoid the allocation inefficiency of natural monopolies, provided that the auction is truly competitive.

The second criterion would grant the concession to the producer offering the greatest fixed sum. Since the adjudication grants monopoly rights, the bids in this case would come close to the present value of the flow of net profits obtainable during the period of the contract plus the assets recoverable at its termination. Consequently the application of this criterion would increase fiscal income (a market configured as a monopoly is more valuable than a competitive market), but this would be at the expense of efficiency in the allocation of resources.

The system of concession contracts is more appropriate in circumstances in which the governmental authorities want to control the characteristics of the services or goods to be produced, and also in those cases in which explicit public subsidies are contemplated in its financing. The concessions for ground transport services in the United Kingdom and air transport services in Australia constitute recent examples of the application of this instrument.

However, the desirability of such a practice—from the governmental point of view—depends on a number of factors (Domberger, 1986), among which we may mention the following: i) the bids must be competitive and possibilities for collusion must be carefully watched; ii) the contracts must specify precisely and unambiguously the characteristics of the bid; iii) the optimum duration of the contract should reconcile the conflicting interests of the authorities and the concession holder; iv) the adoption of a regulatory framework should make possible the follow-up and evaluation of the contractor's performance in order to prevent in good time any deterioration in the quality of the service or goods; and v) the criteria for the transfer of assets upon termination of the concession should be clearly established.

### *3. Interaction between objectives and instruments*

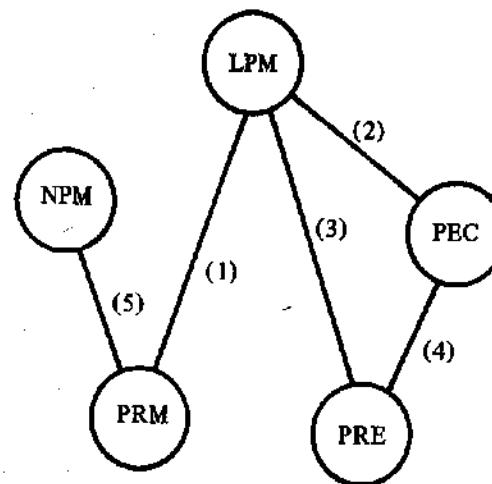
Table 1 presents in summary form the probable effects of each of the instruments on the various

objectives assignable to privatization programmes, in the extended sense indicated above.

On the basis of the effects identified in table 1, we can establish alternative trajectories (Gerchunoff and Guadagni, 1987) for privatization programmes which, at least in part, enable us to expect heterogeneity in the public-enterprise sectors in the countries of Latin America.

In this connection we should distinguish three basic situations within the PES: i) natural public monopolies (NPM); ii) legal public monopolies (LPM); and public enterprises in competitive markets (PEC). In the case of the private sector we can make a distinction between private monopolies (PRM), generally of a technical character because of the reduced dimensions of protected markets, and competitive private enterprises (PRE). In figure 1 we show alternative trajectories in the search for greater overall efficiency of the economy.

Figure 1



Trajectory (1) corresponds to the least desirable situation, but it is one of the most frequent in recent privatization programmes (Kay and Thompson, 1986). It involves the transfer of public productive assets to the private sector, and with it, the transfer of their monopolistic income. The attractive feature for governments is the generation of initial fiscal resources, although this is evidently in conflict with the flow of public resources in the medium and long terms and with distribution objectives concern-

Table 1<sup>a</sup>

	Increase in efficiency		Fiscal income	Governmental control	Distribution of income		Pressure groups
	Allocative	Productive			Assets	Profits and dividends	
A.1 Sale of assets (monopolistic enterprises)	No	Yes	Yes	Regulatory framework required	Depends on the sale procedure	Depends on the regulatory framework	No
A.2 Sale of assets (competitive enterprises)	Yes	Yes	Yes	No	Depends on the sale procedure	No	—
B.1 Deregulation (with sale of assets)	Yes when the market is competitive or challengeable	Yes	Yes but less than in A.1	No	Depends of the sale procedure	Yes	Yes
B.2 Deregulation (without sale of assets)	Yes when the market is competitive or challengeable	Yes when losses are not assumed by the Treasury	No	No	No	Yes	Yes
C.1 Concessions (Demsetz auction)	Yes when the system of bidding is competitive	Yes depending on contract incentives	No	Authority for follow-up and control of the contract	No	Yes	Yes
C.2 Concessions (monopolistic-profits auction)	No	Yes	Yes	Regulatory framework of the contract	No	Depends on the regulatory framework	No

<sup>a</sup>Expanded from table 3 in Domberger and Piggott, 1986.

ing the ownership of assets. This modality requires the public sector to organize a regulatory framework; in this connection, it should be noted that in the great majority of cases the reason for public production has been that it is so difficult to exercise an effective regulatory function (Boneo, 1985). In theory, the transfer should be reflected in greater productive efficiency, but international empirical evidence is not conclusive in this respect (Shirley, 1983). The effects on prices and wages depend on the degree to which possible increases in productive efficiency are translatable into lower prices and gains in productivity are translatable into higher wages.

Trajectory (2) implies essentially the deregulation of legal public monopolies and requires public enterprises to operate in more competitive or challengeable markets. To the extent that the government does not cover any possible operational losses of the enterprises, this would create incentives for an increase in productive efficiency, in addition to the greater efficiency that may be expected in the allocation of resources.

Trajectory (3) also consists in the deregulation of legal public monopolies, but in this case it is accompanied by the transfer of public productive assets to the private sector. It is in fact convenient to visualize this trajectory as a second stage of the preceding one (Brittan, 1986).

Trajectory (4) corresponds to the privatization of public enterprises that operate in competitive or challengeable markets. The private enterprises that were nationalized because of precarious economic or financial conditions are obvious candidates for reprivatization according to this trajectory. It should be noted, however, that in some cases the continuation of public enterprises in competitive markets with the participation of private enterprises may be indispensable for the preservation of this market structure (Ayub and Hegstad, 1987). Moreover, there are cases, such as that of Brazil, in which public enterprises in competitive markets operate at high levels of efficiency, both in production and in allocation (Oliveira, 1985), and therefore it is not justifiable to privatize them on the grounds of efficiency. What is indeed important, however, is that the enterprise should preserve the autonomy necessary for attaining its commercial objectives.

Lastly, trajectory (5) consists in the concession of production or distribution rights for goods and services as an alternative to public production in a natural-monopoly situation, the foundations of which have been reviewed recently (Roth, 1987). In this modality the critical points seem to lie in the viability of the establishment of detailed and precise contracts for the operation of the concession and in the actual capacity for follow-up and control by the governmental authorities and the users.

## IV

### Final considerations

In conclusion, and as the basis for a debate, it seems appropriate to present the following reflections:

1. The Latin American economies exhibit visible signs of overall inefficiency, both in the public and in the private sector. In this context: a) the inefficiency of public enterprises should not be regarded as axiomatic; where it exists, it is often caused largely by structures that are inappropriate and therefore correctible; b) the assumption of greater efficiency in private

enterprises is likewise not universally valid, at least in the real situations of the countries of the region; and c) important advantages can undoubtedly be found in both, but the stress should be placed on their positive interaction in the context of mixed economies, competitive abroad and articulated within the country.

For these reasons, we should combine deregulation operations with asset-transfer operations, on the basis of criteria of social rationality, and the transfer of assets should be part of an

extensive and careful programme of rationalization of the PES.

2. Privatization—in the extended sense used here—has burst upon the Latin American scene like a power-packed idea fraught with ideological symbolism, but one on which a rational discussion in the concrete context of each country has not yet been formulated. We must emphasize the need for prudence in visualizing, and especially in administering, the change that this implies; it may lead either to a broad democratizing experience or to a violent movement towards the concentration of power

and wealth and to the weakening of national frontiers as barriers to open transnationalization.

3. Another factor which must not be ignored is that the rationalization of the PES and the denationalization policies that may accompany it are long-term processes and, moreover, have consequences in this same time frame. For this reason, a minimal consensus must be achieved in order to ensure its continuity in time. This, in turn, requires extensive, informed and open debate.

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