The Privatization Experience of Latin America

Sell-off helps fiscal stability

Mateen Thobani

Between 1985 and 1992, governments in the Latin American and Caribbean region privatized more than 2,000 publicly owned enterprises—including banks, ports, airlines, highways, retail shops, public utilities, and insurance companies. Chile and Mexico were among the first and most comprehensive. Their example was followed by Argentina, and soon most of the region had begun privatization programs.

In nearly all countries, the primary motivation for this sell-off was the fiscal and debt crisis. With the revenues from the sale of state enterprises, governments were able to significantly reduce the hemorrhaging of public resources. In fact, what distinguishes this privatization effort from those in most other regions is its success in generating large revenues from public enterprise sales.

The bloated state, corruption, and the obsolete private sector...

The size of the state-owned enterprise (SOE) sector grew steadily from the 1950s to the early 1980s. Governments argued that state ownership was an efficient way of addressing market failures and of maintaining control over strategic sectors, and an effective way of pursuing social objectives, such as providing “basic” goods and services at low prices and creating employment. Governments also said that a large public sector would increase public savings and reduce the vulnerability of the economy to external shocks. As a result, state enterprises spread beyond strategic sectors into competitive markets. Most SOEs were highly inefficient, and those with market power often abused it. Employment in SOEs was used as a major instrument for political patronage, bloating public sector payrolls.

In almost every country, the growth of SOEs was accompanied by massive regulatory legislation that severely restricted the freedom of the private sector. The authorities tightly controlled entry and exit in certain industries, regulated prices and quantities, thwarted business start-ups with endless bureaucracy, and applied labor laws that reduced labor mobility and competitiveness. The costs of this complex regulatory structure were enormous. The gains to those who could circumvent the regulatory maze and obtain industrial licenses and import permits promoted corruption, increased income inequality, and led to a growing underground economy. The private sector ossified as it became increasingly motivated by rent-seeking rather than profit-seeking.

Private Sector Development Department

Vice Presidency for Finance and Private Sector Development
<table>
<thead>
<tr>
<th>ARGENTINA</th>
<th>BOLIVIA</th>
<th>BRAZIL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program objectives/ rationale</td>
<td>By reorganizing, privatizing, or liquidating SOEs under economy and defense ministries, • Increase private sector participation • Reduce resource flows from treasury to SOEs • Enhance efficiency</td>
<td>• Eliminate the government’s role in production of goods and services in areas where the private sector has competence • Increase efficiency of investment • Avoid potential drain on treasury reserves</td>
</tr>
<tr>
<td>Privatization completed (end-1993)</td>
<td>The government sold SOEs (totally or partially) in telecommunications, oil and gas (YPF), railways, airline, petrochemicals, real estate, electricity generation, radio and TV, and water supply.</td>
<td>Between May 1992 and December 1993, the government sold or liquidated more than 30 small commercial enterprises. Only three had fixed assets valued at more than US$9m.</td>
</tr>
<tr>
<td>Use of proceeds</td>
<td>US$11.1bn for debt reduction and US$8bn in cash contributions to the treasury</td>
<td>Privatization law stipulates that all proceeds are to be used for social sector projects.</td>
</tr>
</tbody>
</table>

More recently, however, divestiture policy has been based on objectives of efficiency, productivity, and new investment. Therefore, privatization was expected to result in lower prices, improved service delivery, and better product quality. Policymakers have also seen the rapid sale of SOEs to a large and diverse group of new owners as a way of ensuring an irreversible reduction of the public sector.

**Across the region**

Chile divested more than 90 percent of its SOEs, more than 500 firms, in two rounds, the first in the mid- and late 1970s, and the second in the mid- and late 1980s. In Mexico, the privatization program began slowly in 1983 but accelerated after 1988, and about 90 percent of the SOEs have now been divested. Mexican government proceeds from privatization have totaled about US$22 billion. The main remaining SOEs include the large petroleum company, PEMEX; some communications firms, including a major newspaper; an insurance company; a power company; development banks; and isolated industrial firms that did not receive satisfactory bids when offered for sale.

Argentina’s privatization program began in late 1989. By December 1993, the program had contributed to a debt reduction of US$11.1 billion, about 40 percent of (post-Brady) total commercial bank debt outstanding. The cash realized amounted to almost US$8 billion. The sale of a telecommunications firm accounted for almost half the total, and the state oil company, YPF, accounted for 17 percent. Brazil’s program is proceeding...
In first round (1974):  
- Maximize government revenues  
- Reduce size of government  
In second round (1984):  
- Spread ownership  
- Reduce importance of government

In first round (1974), 470 firms, or 82% of SOEs, were privatized, including banks and manufacturing enterprises. In second round (1984), 80 firms were privatized, for a total of 96% of SOEs.

<table>
<thead>
<tr>
<th>CHILE</th>
<th>MEXICO</th>
<th>PERU</th>
<th>VENEZUELA</th>
</tr>
</thead>
</table>
| In first round (1974):  
- Improve public sector finances  
- Develop an efficient productive base  
Privatize all SOEs by mid-1995, selling to experienced operators who will quickly improve performance and inject new capital  
- Transfer to private sector all SOEs without an evident public policy objective  
- Salvage airline from bankruptcy  
- Expand and improve telephonic service (Reform program and privatization stalled in 1992/93.) |

In second round (1984), 80 firms were privatized, for a total of 96% of SOEs.  
- Spread ownership  
- Expand and improve telephonic service  
- Reduce importance of government  
- Reduce size of government  
- Maximize government finances selling to experienced operators  
- Salvage airline from bankruptcy  
- Expand and improve telephonic service (Reform program and privatization stalled in 1992/93.)

Not available 1984–89: US$1.6bn in 191 sales  
1990: US$3.2bn in 89 sales  
1991: US$10.8bn in 66 sales  
1992: US$6.2bn in 18 sales  
Not available 1984–89: US$1.6bn in 191 sales  
1990: US$3.2bn in 89 sales  
1991: US$10.8bn in 66 sales  
1992: US$6.2bn in 18 sales  
Not available 1984–89: US$1.6bn in 191 sales  
1990: US$3.2bn in 89 sales  
1991: US$10.8bn in 66 sales  
1992: US$6.2bn in 18 sales

Not available 1984–89: US$1.6bn in 191 sales  
1990: US$3.2bn in 89 sales  
1991: US$10.8bn in 66 sales  
1992: US$6.2bn in 18 sales  
Not available 1984–89: US$1.6bn in 191 sales  
1990: US$3.2bn in 89 sales  
1991: US$10.8bn in 66 sales  
1992: US$6.2bn in 18 sales  
Not available 1984–89: US$1.6bn in 191 sales  
1990: US$3.2bn in 89 sales  
1991: US$10.8bn in 66 sales  
1992: US$6.2bn in 18 sales

More cautiously but has generated sizable revenues. During 1990–93, twenty-four companies were privatized, mainly in the steel, petrochemicals, and fertilizer sectors, with proceeds totaling about US$6.5 billion. In Venezuela, eighteen firms were privatized between 1990 and 1993, generating about US$2.5 billion in cash; US$1.9 billion was from the sale of a single telecommunications firm. By the end of 1993, Peru had privatized twenty firms, including banks, mining and petroleum enterprises, and miscellaneous manufacturing and transport firms, generating US$522 million in cash and US$715 million in investment commitments. Earlier this year, it sold a 35 percent share in its two telephone companies for US$1.4 billion and received an assurance of additional new investment of about US$600 million. In Colombia, four previously nationalized banks and twenty-one firms have been privatized, with operations generating US$600 million. Although Bolivia has thus far sold or liquidated only thirty small SOEs, for US$10 million, a 1992 law allows for privatization of all SOEs other than those in mining and hydrocarbons, and the present government is now privatizing seven major SOEs. Under the Nicaraguan program begun in 1991, 289 of the 351 SOEs acquired during the previous administration were sold, liquidated, or returned to their original owners. It is expected that the rest will be sold shortly. The telephone company is also being offered for sale, and steps are under way to divest the state power and oil companies. The Jamaican program is moving along, with twenty-four SOEs sold and thirty-three at advanced stages of sale. In Belize, the privatization
strategy has achieved the total or partial privatization of SOEs in the banana industry and in the telecommunications and power sectors. Revenues from the sale of a 51 percent share in the telecommunications enterprise alone were equivalent to 4 percent of GDP. When Trinidad and Tobago began its privatization process in 1988, it had eighty-eight SOEs. By the end of 1993, nine of these had been privatized and sixteen had been liquidated. Ten more are in the process of being privatized.

Privatization has moved very slowly in some countries. In Uruguay, the privatization process was halted in December 1992, when the sale of the national telecommunications company was rejected by referendum. In Guyana, the privatization process has been stalled since the change of government in 1992. In the Dominican Republic, Paraguay, and some Central American countries, there has been virtually no privatization.

Dedicated revenues

The bulk of the proceeds from privatization have been earmarked for reducing public debt in most countries. In Mexico, all the proceeds from privatization were used to buy back internal public debt, and the annual savings from the reduced interest payments have been used to finance targeted poverty alleviation programs. Argentina has used about 60 percent of its privatization proceeds to reduce debt and has not earmarked the remainder. In Brazil, the privatization proceeds have been used principally for reducing federal public debt but also for social programs. In Colombia, more than half the proceeds have been used for external debt prepayments and overdue pension payments. Peru and Venezuela have not used sale proceeds for debt reduction, but have earmarked most for social projects. In Nicaragua, it is expected that proceeds from the proposed telecommunications sale will be used to aid in resolving outstanding property claims.

Revenue expectations were usually met or exceeded. In some cases, however, as in Argentina, Brazil, and Chile, the process came to a temporary halt or proceeds were not as large as expected. Where the privatization effort faltered, the most important causes were legal and constitutional impediments to privatization and the lack of a clear regulatory framework setting the rules of the game and establishing the institutional capacity to ensure that players adhere to the rules (see box above).

Strategy

Debates about real and financial or macro and micro sequencing that have occurred in some countries and among some World Bank staff have been considered largely irrelevant by policymakers in Latin America. Where programs have faltered, the main reasons are that policymakers failed to:

- Establish a regulatory framework and resolve constitutional and other legal constraints to privatization at the outset.
- Find ways to reduce political opposition, particularly when divesting large, “strategic” SOEs—for example, by distributing shares to broad segments of the population.
- Ensure that privatization is carried out in an open and transparent manner—important for reducing political opposition.
- Make the objectives of privatization clear and rank them.
- Promote investor interests to generate multiple bidders, both foreign and local, to improve the government’s bargaining position, and to avoid impressions of “giving away the store.”
- Spend the necessary resources on management consultants and lawyers to adequately prepare SOEs for divestiture.
