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in Latin America**

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Privatization in Latin America

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FOREWORD

Privatization in Latin America is the fifth book of a series published under the Centers for Research in Applied Economics Project sponsored by the Inter-American Development Bank. In keeping with the centers' objective of addressing the major economic and social problems affecting Latin America and the Caribbean, this volume examines the effects of privatization on efficiency, distribution of ownership, and overall performance of Latin American economies.

This book examines the diverse privatization experiences of Chile, Mexico, Colombia, and Argentina. Each case study carries with it specific lessons on transfer of ownership issues and the various costs and benefits of privatization. Evident from all four studies is the need to combine privatization with other reform measures such as price liberalization, openness to foreign investment, and simplified regulatory procedures. Without a stable climate for business and a sound financial system, the benefits from privatizations cannot be achieved fully.

These studies are most timely. Never before in the history of the region has privatization been embraced so wholeheartedly or pursued with such vigor. Even in such sectors as petroleum and mining, which traditionally have been protected as strategic and vital interests, the role of the state has come under serious scrutiny over the last few years. As a majority of state-owned enterprises continue to mount enormous losses, it is becoming increasingly obvious that the drain they exert on public finances is no longer allowable.

Yet privatization goes beyond mere fiscal considerations, as this book seeks to show. In fact, although short-term budgetary relief can be expected from the sale of public enterprises, policy makers would do well to resist the temptation of reaping quick government revenues, focusing instead on the broader implications for the economy as a whole. When executed properly, privatization facilitates more efficient markets, better regulatory practices, greater productivity, and healthier financial systems.

Whatever a country's motives for privatizing might be, certain conditions simplify the process and spread the benefits more equally among the entire population. For example, experience has shown that the gears of divestiture turn more efficiently when responsibility is consolidated within a single agency capable of seeking potential buyers and making sales. Also, because labor's cooperation is vital to the eventual success of the restructured enterprises, including workers in divestiture profits is important for ensuring a successful privatization process.

By divesting unprecedented amounts of public capital, Latin American policy makers are signaling their serious commitment to reform. Indeed, the message is getting through not only to their own populations, but also to the entire global community. By placing such an emphasis on private ownership and competition, governments are acknowledging openly that the key to economic progress lies within entrepreneurship and the sound business principles employed by the private sector. The corollary to this policy approach is that increased productivity and efficient management are the only realistic strategies for survival in increasingly competitive global markets. And while privatization alone cannot guarantee a successful reform program, it is certainly an appropriate step toward comprehensive structural adjustment.

Nohra Rey de Marulanda, Manager
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CONTENTS

Chapter One

| | |
|--|---|
| A Comparison of Privatization Experiences: Chile, Mexico, Colombia, and Argentina | 1 |
| <i>Manuel Sánchez</i> | |
| <i>Rossana Corona</i> | |
| <i>Luis Fernando Herrera</i> | |
| <i>Otoniel Ochoa</i> | |

Chapter Two

| | |
|--|----|
| Five Cases of Privatization in Chile | 41 |
| <i>Dominique Hachette</i> | |
| <i>Rolf Lüders</i> | |
| <i>Guillermo Tagle</i> | |

Chapter Three

| | |
|--|-----|
| The Privatization Process in Mexico: Five Case Studies | 101 |
| <i>Manuel Sánchez</i> | |
| <i>Rossana Corona</i> | |
| <i>Otoniel Ochoa</i> | |
| <i>Luis Fernando Herrera</i> | |
| <i>Arturo Olvera</i> | |
| <i>Ernesto Sepúlveda</i> | |

Chapter Four

| | |
|--|-----|
| Privatization in Colombia: Experiences and Prospects | 201 |
| <i>Luis Alberto Zuleta J.</i> | |
| <i>Lino Jaramillo G.</i> | |
| <i>Carlos Eduardo Ballén</i> | |
| <i>Ana María Gómez</i> | |

Chapter Five

| | |
|----------------------------------|-----|
| Privatization in Argentina | 251 |
| <i>Pablo Gerchunoff</i> | |
| <i>Germán Coloma</i> | |

| | |
|-------------|-----|
| Index | 301 |
|-------------|-----|

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CHAPTER 3

THE PRIVATIZATION PROCESS IN MEXICO: FIVE CASE STUDIES

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Introduction

Purpose and Organization

This chapter presents an empirical analysis of five cases that fully exemplify the privatization experience in Mexico and provide specific lessons and recommendations for future processes in the region. The cases analyzed are sugar mills, Compañía Minera de Cananea (CMC), Tereftalatos Mexicanos (TEMEX), Teléfonos de Mexico (TELMEX), and Compañía Mexicana de Aviación (MEXICANA), which differ from one another with respect to size, the type of good or service provided, the sector to which they belong, the industrial organization to which they are subject, the intersectoral relationships observed, and the complementary policies established.

This chapter is organized as follows: the remainder of this section describes the privatization context in Mexico and the macroeconomic assumptions of the study. The second through sixth sections contain an analysis of each of the five cases of privatization, including background information and a discussion of the privatization process, complementary policies, gains in efficiency, the fiscal and macroeconomic impact, and lessons and recommendations for each case. Finally, the seventh section contains the general conclusions of the study.

* The authors are grateful for the valuable information provided by the Disincorporation Unit of the SHCP (Secretariat of Finance and Public Credit), Mexico Mining Group, FINASA, Alfa Group, ISEFI, Chase Manhattan Bank, and countless individuals who shared with us their experience in the privatization process.

regulations governing the telecommunications industry as part of the privatization of TELMEX; reforms permitting free trade and the importing of sugar, in conjunction with the privatization of the sugar mills; and reclassification of basic and secondary petrochemicals, which expanded the number of products in the latter category that could be privately owned.

Macroeconomic Assumptions

To quantify the fiscal impact and social implications of privatization, we used historic observations and macroeconomic projections (Table 3.1).

Table 3.1 Macroeconomic Assumptions
(Percentages)

| | 1992 | 1993 | 1994 |
|--------------------------------------|-------|-------|-------|
| Real GDP growth | 5.1 | 5.6 | 5.1 |
| Real GNP growth in the U.S. | 1.0 | 2.7 | 3.1 |
| LIBOR interest rate (3 months) | 5.8 | 6.7 | 7.8 |
| Real CETES interest rate (1 month) | 3.0 | 4.0 | 3.7 |
| Inflation | 12.9 | 8.0 | 5.0 |
| Average exchange rate (pesos/dollar) | 3,113 | 3,149 | 3,149 |

Source: Author's calculations.

Ingenios Azucareros

Background

During the privatization period, the Mexican sugar industry was the largest agroindustry in the country. Its share in the GDP had grown considerably since 1979, reaching about 0.9 percent in 1990. The sugar sector was one of the largest sources of employment in the country and in some states the main source of employment. Moreover, Mexico is the eighth largest producer of sugar in the world and the fourth in the Western Hemisphere, after Brazil, Cuba, and the United States.

The sugar industry raised the living standards of the people in the rural areas because the unions (Asociaciones de Cañeros, the Sindicato de Trabajadores de la Industria Azucarera y Similares de la República Mexicana), the owners of the mills, and the public sector had provided schools, hospitals, and other public health and welfare services.

Table 3.2. Sugar Producer Equivalent Subsidy, 1985-88
(Millions of U.S. dollars)

| | 1985 | 1986 | 1987 | 1988 |
|-----------|----------|----------|----------|----------|
| Australia | 16.00 | 86.93 | 89.20 | 67.28 |
| Austria | 102.68 | 62.83 | 41.52 | 12.86 |
| Canada | 5.83 | 19.16 | 4.99 | 4.99 |
| EC | 3,269.02 | 3,885.20 | 3,706.70 | 3,383.50 |
| Finland | 80.82 | 94.48 | 69.79 | 111.62 |
| Japan | 743.05 | 694.44 | 673.61 | 52.77 |
| Sweden | 84.75 | 83.11 | 98.52 | 52.95 |
| U.S. | 1,216.00 | 1,191.00 | 1,384.00 | 1,029.00 |

Source: Organization for Economic Cooperation and Development (OECD), *Agricultural Policies, Markets and Trade: Monitoring and Outlook 1989*, (Paris: OECD, 1989).

Internationally, the relationship between the production factors of this industry is strictly regulated by the setting of guaranteed domestic prices since the grower's only customer is the sugar mill nearest his plantation (monopsony), and the mill is in a similar situation since it must depend on local workers to stay in business. At the same time, governments have protected domestic producers by imposing import controls, heavy duties on foreign sugar, or a combination of the two. One way of determining the degree of government intervention is the "sugar producer equivalent subsidy," which is the difference between the income actually received by producers and the value of their production at world prices (see Table 3.2). The existence of considerable, generalized subsidies makes it unlikely that countries will be motivated by comparative advantages in the production of sugar.

Protectionism and subsidies throughout the world have caused international prices to fall below production costs, which in Mexico has caused the sugar mills' operating margins to contract sharply. Consequently, although in the early 1970s the private sector owned approximately 75 percent of the sugar mills in Mexico, 10 years later most of the mills (75 percent) were owned by the federal government.

The government policies that have shaped the sugar sector in Mexico have included subsidies for the growers of sugar cane (raw material), agricultural insurance premiums, and irrigation project subsidies to guarantee minimum prices for sugar producers and control the amounts sold. In addition, final consumption of sugar has been affected by price controls and subsidized prices.

In the 1983-90 period, the state-owned company Azúcar, S.A. de C.V. (AZUCAR) coordinated the development of the national sugar industry, directing and controlling the operation of the state-owned mills and marketing the industry's products and byproducts. AZUCAR functioned as a monopsony and a monopoly, buying all of the sugar produced by the mills at liquidation prices and

