

Privatizing state firms

by José A. Martínez de Hoz

THE ROLE of the State in the economy, can be clearly defined by establishing that private enterprise is the main factor of the economic process, which should not be hampered by excessive regulations that annul the benefits of market competition or by the State taking over activities for which private enterprise is available and can handle better.

The State maintains its overall authority to supervise and orient economic activities, especially by means of the basic economic and financial instruments or levers such as the monetary, exchange, tariff, tax, budget and other such policies. In this sense, the State sets the general rules or framework for economic activity and private enterprise fulfils it.

The principle of the State's subsidiary or complementary role in the economy is thus proclaimed. Except for some very exceptional cases which may occur, the State should not undertake as entrepreneur any economic activity for which private capital should be available.

The application of this principle has important practical effects. In the first place, it allows the government to avoid a dispersion of efforts and capital resources, thus obtaining increased efficiency and strengthening of the State in performing its specific functions, which cannot be delegated. As an example we can mention public administration and justice, the enforcement of law, order and public security, foreign relations, economic infrastructure and public health and education the latter when and where private resources are unavailable or insufficient, and so forth.

There is nothing more important for the State than the administration of the State itself and its basic functions. This requires the best allocation of resources, in order that public funds should not be utilized for activities for which private capital is available. Otherwise, as has happened many times when a large proportion of public expenditure is absorbed by the latter, the amount of funds available for the specific functions of the State, those that no one else can do because they cannot be delegated, may prove insufficient.

Even if this were not the case due to an abundance of public resources, there remains the question of efficiency. As a general rule, the State's administration of enterprises or other such activities can never be equal to private management. In the first place there is a lack of personal monetary incentive and also an absence of a system of reward and punishment directly related to results. In addition, certain administrative rules do not allow for the agility found in

private enterprise for decision making and management. Also, in general, civil servants or public administrators are not inclined to assume responsibilities or take risks. He who does nothing outside of a pre-set routine will probably survive longer in his job than someone who has creativity or sense of initiative and is willing to face the responsibility of success or failure. In this sense, the bureaucratic spirit runs counter to progress.

State enterprises in Argentina and the 1976-80 economic programme.

The reduction of the State's functions with the accent on its subsidiary role in the economy as proclaimed in the April 2, 1976 programme, was implemented in the following way:

1. The first and most immediate action was to transfer back to the private sector all the former private industrial and commercial corporations or companies that had been taken over or were under State management due to their situation of bankruptcy and the political concern to avoid unemployment. Their deficits, which were covered by the national treasury amounted to 100 million dollars in 1975.



This was effected by the procedure of holding public tenders for each one of them and they were thus sold to the best bidder. In some cases when there was no private company interested in buying them, that is when there was a lack of bids for their purchase, they were closed and wound up, with due severance compensation for their personnel.

This part of the programme, which had to overcome many legal and practical difficulties and required the approval of a special law to make it effective, was virtually completed by the end of 1980, both in the national and provincial jurisdictions, except for a few of the more complicated cases which have taken a little longer. Under this chapter over 120 enterprises were thus returned to the private sector.

A few of these companies still have not yet been transferred back to the private sector for a variety of reasons, mainly because they were not under the jurisdiction of the Ministry of Economy but of the Ministry of Social Welfare that applied a different criteria to the subject (i.e. Opalinas Hurlingham, Compañía Azucarera Las Palmas) or were under the joint jurisdiction of both these ministries (such as the case of SIAM) and difficulties were found in reaching agreement on issues such as the minimum price for offering the sale of the company by public tender or whether to do so as one unit or separating its branches to facilitate the sale. Sometimes the managers appointed by the government for companies such as these did all in their power to oppose the efforts of privatization: again conflicts of jurisdiction were an impediment for drastic decisions.

2. As to the industrial corporations or service companies

which had been created as state enterprises with or without some degree of private capital participation, several of them that were obsolete or absolutely inefficient were closed (such as the River Merchant Marine and Industrias Mecánicas del Estado (IME), the latter under the jurisdiction of the Air Force).

The philosophy which originated most of the enterprises in this group was the pioneering concept. This means that when an important or strategic economic sector needs to be developed and private enterprise is unavailable for that purpose, the State should step in and fill the gap. Once there is a going and profitable concern the State should then step out and invite private enterprise to take over. This second step, of course, never happened, either because the State enterprises were never able to show a profit or, if by exception they did, then there was a determined resistance by their managers to turn over to private businessmen the results of their efforts.

In cases for which there was no possibility of transferring them totally to the private sector, private capital was invited to acquire shares either in a majority or minority position. Where this private participation already existed, an increase of its percentage was encouraged, with the purpose that over the years this would gradually lead to a total private take-over.

In those areas in which the enterprises were owned and managed by the Armed Forces, with the exception of a few cases, not much progress was achieved in the light of the prevailing philosophy already referred to.

The philosophy which originated this very special category was National Defence and Security, which considered that this was a military responsibility not to be delegated to private enterprise. The opposite concept exists in many industrialized countries such as the United States, where the State or the Armed Forces commission private corporations for the production required for military purposes. Evidence seems to point out that the latter is a more efficient course of action, with better results for National Defence and Security and no harm to it.

Despite this fact, a consensus was gradually emerging that the Armed Forces should reduce their industrial activities to those fields directly related to the manufacture of weapons in its various forms.

A few examples may help to illustrate the difficulties encountered. In the case of petrochemicals and steel, the Ministry of Economy made a big effort to achieve total or partial privatization. In this respect mention should be made of the *Polo Petroquímica Bahía Blanca*, which comprised the ethane plant (Gral Cerri) totally owned by Gas del Estado, the ethylene plant (51% owned by State agencies: 17% YPF, 17% Gas del Estado, 17% *Fabricaciones Militares*) and the satellite plants for products (30% *Fabricaciones Militares*, 70% private).

At a full cabinet meeting, as Minister of Economy I formally proposed that in this case all shares in the hands of State agencies should be immediately sold by public tender to the

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State enterprises and their privatization

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private sector and offered those belonging to Gas del Estado and YPF which were under the Ministry of Economy's jurisdiction. President Videla fully endorsed this proposal and it was approved with the consent of the Minister of Defence. Unfortunately, one week later at the following cabinet meeting, the latter stated that *Fabricaciones Militares*, under his jurisdiction, opposed the measure on the grounds that their presence as stockholders was necessary to ensure the successful termination of the petrochemical complex. This, in my judgement, is a typical example of the confusion as to the importance of stock-ownership to assure the attainment of public objectives. I consider that governments have sufficient powers of control in various forms without the necessity of being shareholders.

In another case, that of *Petroquímica Gral Mosconi* (50% YPF, 50% *Fabricaciones Militares*) although the convenience of turning it over to the private sector was accepted in

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much success.

5. As to TV channels and radio stations (they amounted to 85), as during the 1973-76 government most of the network had been taken over by the state, the decision was taken in principle that there should be only one of each that should remain in the hands of the national, State and each of the provincial states. All the rest should be transferred back to the private sector by means of public tenders. This programme, which was not under the jurisdiction of the Ministry of Economy, was under way but has not yet been completed and, at present, seems to have come to a stand-still.

6. The largest of all the State enterprises were, of course the public service and utility companies, such as the railways and undergrounds, power plants (thermo, hydro and nuclear), telecommunications, water works and sewage, Merchant Marine

the same legal and accounting responsibilities as those of the private sector, allowing them also more agility by eliminating certain regulations. The basic idea was that, although the State remained the owner of 100% of the stock, in all other ways they should operate with no special privileges or encumbrances, which would lead to increased efficiency.

Thus legislation was passed eliminating all the tax exemptions which had until then favoured them (they were exempt from all direct and many indirect taxes). In addition they had to follow the same accounting procedures prescribed by the commercial code, with inventories, balance sheets and annual reports, the former two of which were sadly lacking.

This would permit a more thorough control of their operational costs, which in many cases were virtually unknown. At the same time the level of the prices of their products or rates of their services were gradually increased to market levels, to avoid the subsidies that they otherwise had to receive from the Treasury to cover their operational deficit. There was also an important reduction of their personnel (up to 30%).

The combination of all these measures commenced to bear fruits and by end of the five year period (1976-80), comparing the volume of their production or services with the number of their personnel, the productivity of the major State enterprises had increased by an average of about 60%.

At the beginning of 1976, 14 of them required a subsidy from the National Treasury to cover their operational deficit. By 1978 this number had been reduced to two: the railways and the Post Office.

Important progress was also achieved with respect to the financing of the investment projects of the State enterprises. By 1979-80 for the major companies referred to an average of about 50% was covered by their current income, that is from the sale of their products or services, and the balance by internal credit, with no Treasury subsidies. This percentage is significant if it is remembered that for the private sector in Argentina, the average financing of investment projects is 30% equity and 70% credit.

As to the railways, they were a difficult case indeed. The National Treasury had to support them with a subsidy equivalent to two million dollars a day and their current income only covered 80% of the pay-roll of their personnel.

A reorganization and rationalization programme was put into effect to face this situation. The railway network covered 42,000 Km, built in the days when trucking did not exist and which now absorbs more than 90% of freight. About 20% of these railway tracks were closed, as were 42% of the railway stations, which covered the major areas where competition with trucks was impossible. Passenger train activity was reduced by 50% and railway personnel (which amounted to 156,000) by 40%. Thus over a five-year period, the railways were relieved of over 60,000 workers and employees of all categories, with no social

unrest or complications, due to low unemployment rate and a severance compensation system which was applied, as also a retraining programme which was provided but never required.

Peripheral privatization

With reference to the peripheral privatization programme, it was implemented in a broad area of sectors and its results, although not as easy to visualize as the turning over to private hands of an entire State company had, in practice, deep-reaching positive effects both on public expenditure and efficiency.

As an example, in the case of the railways, it was decided that the workshops should be either closed if they were obsolete or sold to the private sector. Important companies such as grain traders were encouraged to lease the railway tracks and locomotives and provide their own wagons. The operation of some passenger trains was also transferred to private companies under special contracts and this aspect of the programme seemed to have important possibilities both for passenger and freight trains.

Grain exporting companies were also authorized and encouraged to build their own ports on the large rivers, which they did successfully. The same idea was applied to small fishing ports on the South Atlantic, but with no immediate success in this case.

Some important public works and utilities, like the building and operation of a natural gas pipeline which crossed the country from west to east, were effected by private companies under the toll system, thus decreasing public investment requirements.

Perhaps the area where this programme was most successful was the exploration and production of crude oil, where private enterprise participation rose from practically nil in 1975 to about 40% in 1980.

In addition, as a form of economic decentralization and also of unburdening large State enterprises, many public works

examples is that of the National Highways Administration (*Dirección Nacional de Vialidad*), which in the 1976-80 period was able to reduce its personnel from 19,600 to 8,340. This was achieved not only by means of administrative rationalization, but also transferring to the private sector, under various forms of contracts, the maintenance of main roads, the inspection of road construction and the preparation of projects and studies for road building.

Thus, by the end of 1980, 75% of the maintenance of the national road network was under the responsibility of private companies which had been awarded the corresponding contracts under the public tender system.

In addition, 10,500 Km of roads were transferred to the Provincial Highway Authorities.

Closing comments on the 1976-80 period

The whole subject of reorganization and "privatization" of State enterprises required a tremendous effort to reverse the existing structures and the underlying mentality.

Progress was necessarily slow, due to their rigidity and resistance to change, which originated not only from within the corresponding public administration sectors and enterprises and their labour unions, but also from private sectors such as suppliers, contractors or others with similar vested interests, including some inefficient private sector companies that were competitors of the State enterprises in the market.

It is obvious that it was impossible to overturn a situation over 30 years old in five years. Continuity for a longer period was required and, as the major efforts had already been effected in the 1976-80 period, if that continuity had fully existed in the following years, the seeds which had been sown with much effort

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principle by *Fabricaciones Militares*, no practical results were achieved as no agreement was reached as to the minimum sale price and other procedural matters.

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3. The National Development Bank and the National Savings and Loans Corporation undertook a programme to divest themselves of the shares they held in industrial corporations not under State management. These shares had come into their possession over the years under different régimes with the purpose of either offering incentives to private investment through a sort of investment funds system or of promoting industrial ventures by providing investment capital. Thus, either by public tenders or through the Stock Exchange they sold back to the private sector all their shares in 200 of the 400 companies in this category. This was necessarily a slow process as it depended on the situation of the capital market and the variation of price levels in the Stock Exchange. It was further complicated by the fact that most of these corporations distributed dividends in the form of stock, which increased the National Banks' shares at the same time that they were trying to divest themselves of them.

4. With regard to the provincial state banks and insurance companies, they were encouraged to accept or gradually increase the private sectors' stock-holdings in them, although this was a slow process which did not achieve

and a State Airline. Except for relatively small cooperative or private groups, the State had a virtual monopoly in these fields.

Exploration and production (although not refinery) of oil had been a State monopoly during most of the period, together with natural gas extraction and distribution.

Both the nature of their activities, the amount of capital involved and their relative inefficiency, made it practically impossible to implement their global transfer to the private sector.

As to the political philosophy involved, there were strong currents of national opinion that maintained that they should remain in the hands of the State. At the same time, private capital was not interested in taking them over, due to the previous experience of nationalization, expropriation or control of utility rates. Most of them were also running a high deficit which made them even more unattractive for a private take-over.

Taking these circumstances into account, a double-pronged programme was drawn up for them:

a) a strong effort on the part of government to make them become efficient and non-deficitarian;

b) a "peripheral privatization" programme, which was a phrase coined to mean that these companies, although the State retained ownership, should transfer as much of their activities as possible to the private sector by means of service and other sorts of contracts which would result in those activities being effected by private companies more efficiently.

As to the first aspect, the most important of the State enterprises were transformed into stock companies or corporations, with the purpose that they should have

Correction

OWING to a printing error, it was erroneously stated in Wednesday's *Open Forum* column, written by former Economy Minister José Alfredo Martínez de Hoz, that "by 1979-80 for the major companies referred to an average of about 50% was covered by their current income, that is from the sale of their products or services, and the balance by internal credit, with no Treasury subsidies." The sentence should have read: "By 1979-80 for the major companies referred to an average of about 50% was covered by their current income, that is from the sale of their products or services, and the balance by internal and international credit, with no Treasury subsidies" (adding the words and in international).

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and services were transferred to the provinces and municipalities, including electric power and natural gas distribution network, secondary electric power generation, irrigation waterworks and sewage systems, river ports and the underground transportation system of the City of Buenos Aires.

Private participation at the Municipal level was encouraged and there have been quite a few towns where cooperatives have been formed with the support of the municipal governments for the distribution of natural gas or to set up a telephone network. Each participant's quota is included in the bills he pays for the service.

Mention can also be made of some State agencies which although they have not the legal form of State enterprises, were also subject to the privatization programme.

One of the most successful

would have already produced still more important fruits by now.

Nevertheless, I consider that over and above the individual cases examined, the most important achievement that remains is to have obtained some sort of change of mentality, some consensus to the necessity of reducing the State's size and the sphere of its activities, as also the importance of the recognition that private enterprise should be the main factor of production and management. The comparison of the electoral platforms of the political parties in the 1973 and the 1983 general elections seems to prove the achievement of this target.

(José A. Martínez de Hoz was Minister of Economy from March, 1976, to March, 1981. This is the first of a two-part article. The second part will deal with possibilities for future privatization in Argentina).

Streamlining the State

by José A. Martínez de Hoz

The transfer of State enterprises to the private sector, under the various forms possible, has three main effects on the economy, which may take place jointly or separately:

1. A reduction of public expenditure. To realize the importance of this effect, it should be noted that the State enterprises represent 35% of total public expenditure in Argentina.

2. A major influence on diminishing the requirements for investment in the Public Sector as they will be replaced by private investment. This is probably the most immediate and important result which can be obtained.

3. An increased efficiency in the economic activities involved. What practical possibilities are open in this respect in the future for Argentina?

Assuming the government has the will to go ahead seriously along the road to privatization of State enterprises, there is much that can be done making the best of the experience and the groundwork laid down in the 1976-80 period.

Let us examine a few examples. In the case of the railways, one of the most promising possibilities is that of private groups taking over the management of certain services. In the course of the implementation of our programme, the Embarcación-Formosa line was taken over successfully by a private company (not the assets or property but the passenger service itself). At that time, there were other private groups that were studying with interest the possibility of doing the same with the Buenos Aires suburban trains and also those running between the Capital and the city of La Plata. This network has been an important source for the railways deficit and it would seem promising if one or various private groups took over this service (not the ownership) and thus relieve the State of the corresponding deficit which, in addition, ultimately is paid either through the inflationary tax or genuine taxes by the rest of Argentine citizens that do not live in the jurisdiction of the city or province of Buenos Aires and thus do not benefit from these services.

An example of other possibilities for the railways is to increase the participation of interested companies with bulk freight (such as grain, wine, cement and construction materials) by providing their own wagons and leasing the use of the track and locomotives from the State Railways.

An important sector of the Argentine economy in which further privatization measures could be feasible is that of grain storage, transport and export. Apart from the railway aspect mentioned above, incentives could be provided for the construction of grain elevators and port facilities by the private sector (farmer's associations, cooperatives, grain merchants and exporters).

In this respect the experience of the 1976-80 period again proves useful. In 1979 a law was passed (N° 22108) authorizing grain exporters to construct and operate under the public service system and for their own trade requirements, terminal grain elevators which under the then existing law only farmer's associations and cooperatives were permitted to do so.

The result of this measure has been impressive. Six private grain

exporting companies constructed terminal elevators in six ports on the River Paraná which, according to the latest statistics, during April 1985 shipped 1,200,000 tons of grain, which represent 31.5% of the country's total shipments of that month, which reached a record level.

Thus, over 30% of elevator shipping capacity has been added with zero public investment.

Following this example, further progress could be achieved in this very important sector which would tend to increase the infrastructure which is at present insufficient for the storage, transport and shipment of volumes of grain which could be 50% larger in a not too distant future.

In addition, a project which has been studied in the past, to form a grain elevator company on the basis of the existing network of State Elevators (at present managed by the National Grain Board) with the participation of the private sectors involved, could result not only in a higher degree of efficiency of the system but also in an enlargement of its existing elevator and port facilities and responsibilities.

Action can also be taken with important results in the case of ENTel. During my term of office at the Ministry of Economy this proved to be a difficult (although not impossible) nut to crack.

Initially, the reaction was negative. On the one hand, naturally, from the company itself and from those who considered that communications were essential to national security and therefore, should be run by the State (it did not seem to matter that they were insufficient and inefficient and, therefore, were no good or even harmful to national security). On the other hand, when the private sector was approached its attitude was also negative, alleging that there was no interest in taking over the telephone system, modernizing and then operating it only to be subject to controlled rates by the government and possibly expropriation or so-called nationalization if the political winds changed. They had already gone through this experience in 1947.

After many months of imagining and studying alternate ways of privatization and many long conversations both inside and outside government circles, a possible solution was found in connection with a public tender by means of which an important number of telephone lines and switching equipment of the new semi-electronic technology would be purchased by ENTel. The tender was finally awarded in the following proportion: 50% to the Japanese firm NEC, 25% to Siemens and 25% to ITT. Another international firm, the Swedish Ericsson, already had some areas of the country operating under its system (in the northeast and northwestern provinces). Thus there were four top-class international companies involved with their corresponding technologies and the idea was to break down ENTel into four subsidiaries with a parent holding company. In each of the subsidiaries ENTel would be a partner with the existing infrastructure as its capital, and each of the four international private companies would be invited to supply the equipment necessary for the modernization and updating of the telephone system, which would become their share in the stock of the

company. Whatever the proportions of the shareholdings, the management and operation of each of the subsidiaries would be in the hands of the private sector.

This solution, which became in principle acceptable both to ENTel and to the international companies, was under way when President Videla's term came to an end. During the following governments, unfortunately nothing more was heard of it, except for an intelligent effort made under the brief period of President Galtieri when Ing. Carlos Dietl was *Interventor* of the ENTel.

As it has already been mentioned, in rural communities and small townships, the participation of the *usuario* or consumer has been already successfully experimented both for the installation of telephone networks and for the distribution of natural gas. This procedure can be enlarged and extended. A cooperative or a corporation can be formed to install, own and operate the system, for which purpose capital contributions in exchange for shares can be obtained not only from the *usuarios* but also from suppliers of equipment and the municipalities themselves.

There are other ways which can also be used to broaden the alternative procedures for privatization from which to choose. One is by means of floating shares on the stock exchange or by other means of tapping capital markets. Obviously this requires that the latter should be large and strong enough to absorb them. But it might even prove to be a way to foster the growth of equity markets if sufficient incentives are provided. The participation of small and medium-size shareholders could become a way to get people really interested in the performance of these companies and promote a sort of *capitalismo del pueblo* with respect to them.

Another way is to distribute shares of the State enterprises undergoing a process of privatization among their employees and workers: here we would have an example of a "workers' capitalism" which might prove very helpful to create efficiency and responsibility in the way they are run, as also continuity of the privatization policy.

A very interesting effort along these lines is the privatization programme put into effect by Britain's Conservative government.

Under this plan, the State has sold proportions varying from 100% to 50.2% in companies such as British Aerospace, British Telecom, British Petroleum, Britoil, Enterprise Oil, British Gas Onshore Oil Assets, Cable & Wireless, Associated British Ports, Sealink, Amersham International, Jaguar, National Freight Co. British Rail Hotels, International Aeradio, British Sugar Corporation British Technology groups and some others.

Other more difficult sales are being prepared, such as British Airways, British Shipbuilders warship building yards, the Royal Ordnance Factories, as many as possible of the nation's airports, as also substantial parts of British Steel, Rolls-Royce, British Leyland and the National Bus Company (as to the latter, it is worth while remembering that the deficit-stricken and costly urban transport company of the City of

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Buenos Aires (Corporación de Transportes de Buenos Aires) was very successfully privatized in Argentina during the term of Dr Roberto Alemann's Ministry in 1961 and nowadays privately owned efficient *colectivos* perform that duty on the streets of Buenos Aires).

British Telecom (the equivalent of ENTel) was the largest operation among them, the net proceeds amounting to 3,916 million pounds sterling. This sale (which represented 50.2% of the shares) attracted two million individual investors, mainly due to the policy of selling the shares "cheap" in order to make it attractive to small shareholders. A special bonus was offered to those who kept their shareholdings for at least three years and four fifths of the initial shareholders did so. The plan is to sell the balance of the shares in the State's hands in the near future (perhaps 1986), thus achieving total transfer to the private sector.

Probably the most successful case of privatization in Britain has been that of the National Freight Consortium. In February, 1982 a little over 10,000 of its employees (out of a total of 23,000) bought 83% of the company's shares. In order to make this possible, as the employees could only put up 6.2 million pounds sterling, financing for 84 million pounds was obtained from British clearing banks who only kept 17% of the equity. Additional leasing-borrowing took the firm's debt up to 100 million

pounds and the resulting long term debt-equity ratio resulted in about 80% (excluding leasing).

The results were impressive: productivity rose by 35%, total operating profits and property profits increased by 49% and 36% respectively and the value of the shares rose substantially (from one pound to 8.60 pounds). It is considered that to attract future investment for growth the company may have to go public, which would perhaps require the introduction of rules to protect the existence of a certain minimum percentage of employee shareholdings.

I have gone into some detail describing the recent British examples of privatization, in order to show that there are different ways by means of which even in seemingly difficult cases this objective can be practically achieved, either totally or partially, but certainly with important benefits to the community and to the State.

Obviously, each country has its own characteristics, and what may be possible in one may not be so in another. But is my firm belief that with some imagination, a strong conviction and decision to act, a lot of political courage and steadfast continuity, there is a broad field in which the privatization process in Argentina can be successfully resumed.

(This is the second part of a two-part article by J.A. Martínez de Hoz, who was economy minister between April 1976 and April 1981.)