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A Review of Chilean Privatization Experience

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by
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Introduction

Chile has had two reprivatization and one privatization processes; however, prior to both the Chilean economy went through a dramatic questioning and attacking of the basic principle of private property during the 1970–1973 period. This highly conflictive political experience led to the nationalization of industrial firms and banks, foreign investment (mainly in CODELCO), land reform, and other state intervention and expropriation measures (for a review of this period, see Larrain and Meller 1991). During 1973, public enterprises' share of GDP reached 39 percent; public firms' gross output share of mining, financial, and public utilities sectors was greater than 85 percent; it reached 70 percent in the transport and communication sectors; and it was 40 percent in manufacturing (Larroulet 1984).

The military dictatorship, 1973–1990, implied a complete reversal of the ideological conception that prevailed from 1970–1973. Private property and the private sector are the basic pillars of the present Chilean economic development model. Even Chilean socialist leaders do not nowadays question private property, the free-pricing market system, or the private sector as the main agents and engines of the economy. Moreover, the concept of private property is neither mentioned nor is it on the agenda of any Chilean political party (including the Communist party; which received 6.9 percent of the vote in 1992). The current political debate is focused on questioning not privatizating any of the ten or so remaining public firms and includes the rationale for not privatizating CODELCO.

This paper reviews the reprivatization and privatization processes implemented in the Chilean economy during the 1970s and the 1980s. Given the fact that Chilean privatization was carried out in 1986–1987, it is possible to examine some preliminary results achieved by privatized firms with respect to their profitability and employment performance. Finally, a few paragraphs are devoted to regulation, as it is a new problem for which there is not much experience. Recently privatized natural monopolies such as electricity generation have even questioned the concept of

regulation, claiming that the state should abstain from regulating even natural monopolies, because such regulation is equivalent to a rebirth of the old role of state intervention.

The Process of Destatization of the Chilean Economy

The deep political, institutional, economic, and social crisis of 1973 was used as the frame of reference for a complete reversal of the development strategy and the role of the state in the Chilean economy. From 1973 on, the state and the public sector were considered the main generators of most of the problems of the Chilean economy; therefore, the smaller the size of the state and the smaller its degree of intervention, the more improved would be social welfare.

The many stabilization and structural reforms implemented during the military regime—like privatization and reprivatization, state and fiscal reforms, liberalization, deregulation, and the opening of the external sector (table 1)—have had as a goal the reduction, and eventually the elimination, of policies and mechanisms available to the state that might allow it to modify optimal economic growth generated by market forces. This type of environment was to give incentives to the private sector to become the engine of growth. The explicit economic philosophy during the 1973–1990 period was that in a laissez faire, free market system, the fundamental role of the state was the maintenance of law and order. This implied, among other things, protection of private property and enforcement of legal contracts.

Other objectives complemented the foregoing: (1) modernization of the state structure, which implied a reduction and simplification of red tape, and elimination of many existing public control measures; moreover, the efficiency of the public sector had to be improved; (2) the maintenance of an equilibrium in the macroeconomic environment, with stable and permanent rules, became the main responsibility of the state; in this way, the private sector would be able to perform a correct microeconomic evaluation of its investment projects; (3) the state should not be involved in the *production* of goods and services (including social goods like housing for the poor, health, and education).

In the implementation of the Chilean laissez faire, free market system, it is useful to distinguish state reforms implemented in the 1970s and in the 1980s.

State Reforms in the 1970s

A schematic overview of the 1970–1973 Chilean economic situation may lead to a better understanding of the deep reforms implemented by the military regime during the 1970s. During the Unidad Popular government (1970–1973), the state assumed a large economic role. In the productive sphere, there was a massive transfer of real assets from the private to the public sector; the mechanisms that were used included nationalization of large copper mines, agrarian reform, nationalization of the banking system, and creation of the so-called social property area (which implied public control of the most important productive firms). Sharp increases in public expenditure through augmentation of public employment and real wages occurred; in addition, there was a large expansion of social expenditures. Control mechanisms, for example, generalized price controls, credit allocation and interest rate controls, foreign exchange and import controls, became the main tools of economic policy. It should be pointed out that these control mechanisms existed prior to 1970, but their use was considerably intensified during the Unidad Popular government.

In 1973 the overall public sector deficit reached 30 percent of GDP. There was a proliferation of black markets and economic changes, and the inflation rate reached 60 percent (a level of inflation unknown before then).[1] This seriously deteriorated economic situation constituted the basis for implementing drastic changes.

As already pointed out, the policy reforms were supposed to lead toward a permanent diminution of the economic role of the state. In the productive sphere, there was a massive transfer of real and financial assets toward the private sector through reprivatization and privatization.[2] Fiscal reform included a significant reduction of public expenditure and a tax reform. These measures generated important fiscal surpluses at the end of the 1970s. Economic liberalization and deregulation, that is, elimination of almost all existing (economic) controls, took place.

Table 1 provides a synthesis of the economic reforms implemented during the 1970s.[3] Table 2 provides the intertemporal sequence of the implementation of these reforms; the lower part of table 2 provides values for inflation, unemployment, and growth, the macroeconomic environment prevailing during the reforms. In this essay I will examine only the reprivatization process.

The first reprivatization process occurred in 1974; 257 firms and around 3,700 farms that had been illegally seized or intervened by the state (or by the workers) were quickly returned to the old owners. This reprivatization process did not involve any

monetary transaction; former owners were asked not to start any legal or judicial action against the state, and they were also required to absorb existing debts.

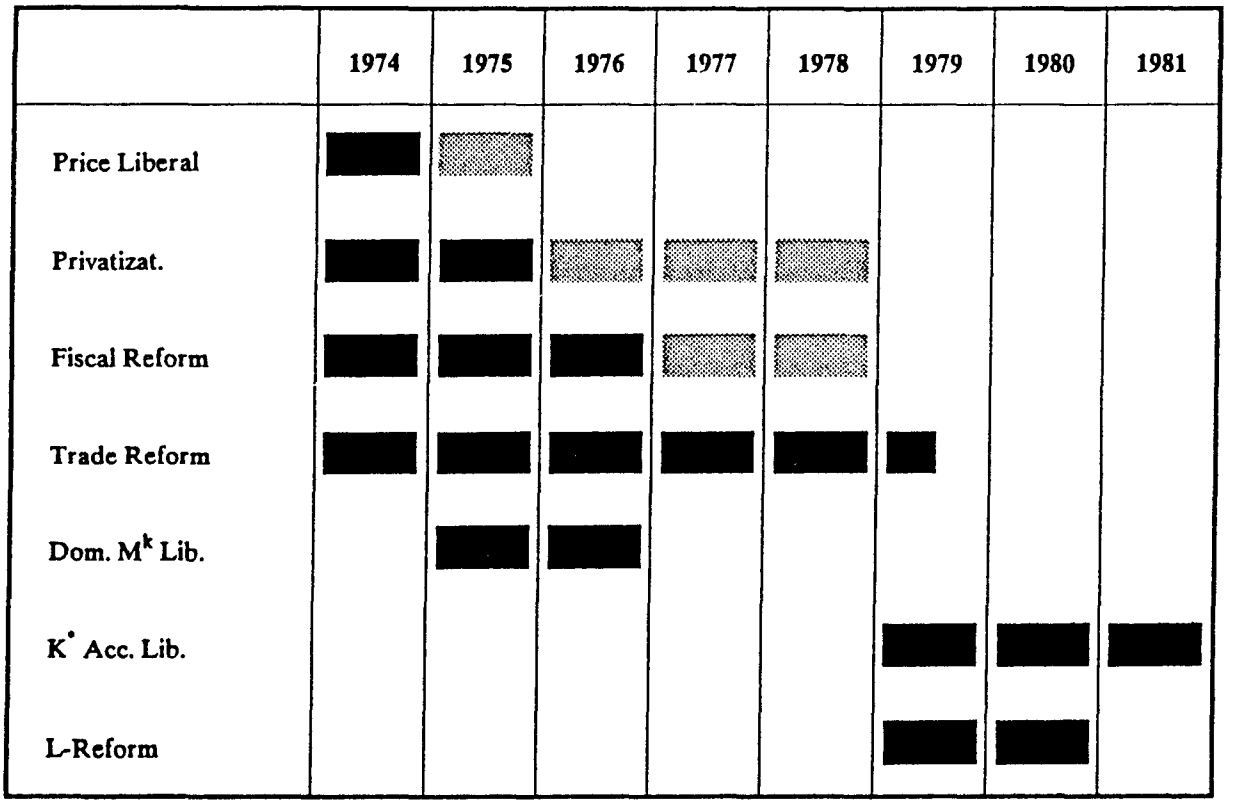
Table 1. Chilean Major Structural Policy Reforms of the 1970s

1972–1973	*Post-1973*
Privatization	
More than 500 commercial firms controlled by the state	By 1980, only 45 firms (including and banks one bank) remained in the public sector
Prices	
Price controls	Market-determined prices except wages and exchange rate
Fiscal Regime	
"Cascade" sales tax	Value-added tax of 20 percent
Large public payroll	Public employment reduced
Large fiscal deficits	Fiscal surpluses in 1979–1981
Trade and Exchange Rates	
Multiple exchange rate system	Homogeneous, unified exchange rate
Prohibitions and quotas on imports	Flat import tariff of 10 percent (excluding automobiles)
High tariffs[a]	
Prior deposits for imports	Absence of other trade barriers
Domestic Financial Markets	
Controlled interest rates	Market-determined interest rates
State ownership of banks	Reprivatization of banks
Control of credit	Liberalization of capital markets
Capital Mobility	
Total control of capital movements	Gradual liberalization of the capital account[b]
Government was the main external borrower	Private sector is the main external borrower
Labor Regime	
Unions played a large role and had considerable bargaining power	No unions and no collective bargaining power
Worker dismissals prohibited	Relaxation of prohibition on dismissals
Mandatory wage increases	Relaxation of mandatory wage adjustments and severe cuts in real wages
High and increasing nonwage labor costs (40 percent of wages)	Reduction of nonwage labor costs (to 3 percent of wages)

[a]The average tariff was 105 percent and the maximum was 750 percent.

[b]Movements of long-term capital were liberalized in 1981, and those of short-term capital in 1982.

Table 2. Phasing of Chilean Reforms during the 70s



	1974	1975	1976	1977	1978	1979	1980	1981
Inflation (%)	369	343	198	84	37	38	31	9
Unemployment (%)	9	16	19	18	17	17	17	16

There was another reprivatization process from 1974–1978 which included specific monetary transactions. This involved the dismantling of the "social property area" created under the Unidad Popular government. At the end of 1973, more than five hundred firms and banks were under state control; by the end of the 1970s, only forty-

five firms (including one bank) belonged to the public sector; the rest had been "reprivatized."

The 1970s reprivatization process occurred in the middle of a deep recession (in 1975, GDP declined 12.9 percent). At that time, Chile also had a very small domestic capital market. Thus only a few private agents were able to participate in the reprivatization process. This situation led to an acute concentration of property and the formation of a few conglomerates ("economic groups"), which dominated the economy through the ownership or control of the main firms and banks. The state received US$543 million from the sale of banks and firms (see Larrain [1991] for details). It has been estimated that there was a 30 percent subsidy given by the state in the form of the underpricing of reprivatized banks and firms (Foxley 1982).[4] Most of these firms were acquired with an initial down payment equivalent to 10–20 percent of the total costs; CORFO (a public institution) provided the credit for the remaining part. Property concentration of reprivatized firms was a deliberate goal of the economic authorities, and it was achieved through the sale of large share packages, up to 100 percent, of a given firm or bank. It was believed that this procedure would result in higher prices for reprivatized firms (and banks). Many of these reprivatized firms and banks went bankrupt during the 1982–1983 recession. They were then intervened and rescued by the state and underwent a second reprivatization during the mid-1980s.

State Reforms in the 1980s

State reforms in the 1980s consolidated and deepened the reforms of the 1970s; that is, there was further reduction of the role of the state in the economy. The reforms of the 1980s included (1) in the productive (and financial) sphere, a second reprivatization process and a widespread privatization of traditional public enterprises; moreover, there was a social security reform under which the old "equal for all" pension system (administered by the public sector) was replaced by a personal capitalization system administered by the private sector; (2) new tax reform oriented toward a reduction in the size of the public sector; and (3) the establishment of the autonomy of the Central Bank. I shall examine the privatization and reprivatization processes in only a schematic way in this paper; the next sections will deal with specific issues related to these processes.

There were some lessons learned from the first reprivatization. That process was really debt-led, where the newly reprivatized firms started with quite large debt/equity

ratios, which generated a highly unstable financial position (Larrain 1991). The high concentration of property and interlocking decisions of firms and banks also made most of the Chilean private productive and financial structures depend on the appropriate management of the two largest economic conglomerates.

The second reprivatization process (1984–1987) included firms, banks, and financial institutions that were rescued from bankruptcy in 1982–1983. The net stock value of these enterprises has been estimated to be US$1.1 billion (equivalent to 6 percent GDP; Hachette and Lüders 1988) (see table 3). In this second reprivatization process, distinct sale procedures were used: "popular capitalism,"[5] stock exchange, and bidding among prequalified buyers. All of these transactions (except those in the popular capitalism program) required 100 percent cash payments; in this way, the previous debt-led reprivatization problem was avoided. Moreover, this time there was

Table 3. Second Reprivatization Process 1984–1987

Firms & Financial Institutions[a]	*Reprivatization Mechanism* *Private Auction*	*Popular Capitalism*	*Book Value of Assets (Sept. 1987) (US$ millions)*	*Number of Shareholders (Sept. 1987)*
COPEC	X		310	15,922
Banco de Chile		X	285	39,179
Banco de Santiago		X	156	15,919
INFORSA	X		85	3,447
Pesquera Coloso			47	6,340
INDUS	X		45	5,158
Banco de Concepción	X		44	6,110
AFP Provida	X	X	18	7,909
AFP Santa María	X	X	13	6,062

Source: Hachette and Lüders (1988).
[a]See Hachette and Lüders (1988) for the complete list of reprivatized firms and banks; the list shown here includes those having the largest asset book value figures.

a specific objective for the dissemination of property. From a political point of view, this would ensure the irreversibility of the whole reprivatization process.

The privatization of public enterprises began in 1986. Divestiture of public enterprises (all of them created by the state) included public utility firms (electricity, telephones and communications, gasoline distribution) and other firms like the national airline (LAN), the steel company (CAP), and nitrate and coal companies. The total value of the stock assets of the programmed divestment process (excluding CODELCO, the large state copper mines) has been estimated to be US$3.6 billion (Hachette and Lüders, 1988).

Different procedures were used for the divestiture of Chilean public enterprises:[6] institutional capitalism, through which the new privately administered social security firms (AFP) were able to acquire restricted amount of shares; "employees' capitalism," in which workers of divested public firms received special incentives (through price subsidies) for buying shares of the companies in which they worked; "traditional capitalism," which consisted of the sale of packages of shares to qualified buyers through direct auction or through the stock exchange. The sale of divested public firms generated US$1.1 billion. The subsidy implicitly provided by the government in this divestiture process was higher than 50 percent (Marcel 1989). Again, all these privatization transactions required cash payment of 100 percent of the total cost. Furthermore, there was the explicit purpose in mind of disseminating property, to include investors and workers, people in general, without any discrimination between domestic and foreign investors.

Given the fragility of the Chilean financial system and its bad performance during the 1970s, several regulations and changes were introduced during the 1980s:[7] (1) the Superintendency of Banks introduced a rating system of a given bank's loan portfolio according to the degree of risk; then, a specific bank was required to provide reserves according to the default risk of its loan portfolio; (2) a restriction was established on the level of loans a bank could provide to a client related to the owners of the bank; in this respect, all loans provided to distinct enterprises that belong to the same group of shareholders would be considered as one loan and therefore subject to the loan limit established with respect to total bank assets; (3) the Superintendency of Securities and Insurance established new rules for joint-stock corporation with respect to the disclosure of transactions between related companies, sales and purchases of stocks by important shareholders and managers, requirement of consolidated financial

balance sheets, and penalties for publication of false or misleading information; moreover, a risk rating of all securities issues by private (and public) firms was introduced; also, a law established the definition of a conglomerate and of a controlling group of shareholders; (4) mutual funds and insurance companies now have requirements about portfolio diversification that specify limits on investment in securities of one issuer or related issuers; in addition, there are requirements related to information disclosure, net worth, and technical reserves.

Privatization Mechanisms of Public Enterprises

Privatization of public enterprises (during the 1980s) implied a deepening and consolidation of the role of the private sector in the Chilean economy. Public enterprises were a key agent in the previous development strategy. They had been created to provide cheap intermediate goods and cheap public utilities to the import-substitution industries. Given indivisibilities and scale economies, some of these industries were quite large and, during the 1940s and 1950s, only the state was willing to invest in their creation. Therefore, divestiture of these public enterprises was really the final blow to the old development strategy. With the exception of CODELCO and a few other firms, the rest of the Chilean economy at the beginning of the 1990s was in private hands. Moreover, the privatization of CODELCO is now a hot issue. In 1972, all political parties fully agreed on the nationalization of CODELCO; today, the question many people ask is: What are the reasons for not privatizing CODELCO?

Table 4 provides a list of the public enterprises that were privatized during the 1986–1989 period, with the percentages of ownership that were sold. By 1990, around 30 public enterprises were almost 100 percent sold; these included a steel refining company (CAP, 7,000 workers); public electricity generation, transmission, and distribution utilities (ENDESA, 2,900 workers; ENERSIS, 2,500 workers; Chilgener and Chilquinta, 1,750 workers); telephone (CTC, 7,000 workers); telecommunications (ENTEL, 1,400 workers); a nitrate company (SOQUIMICH, 4,700 workers); a coal mine enterprise (Schwager, 2,300 workers); a sugar refinery (IANSA, 2,000 workers); and the national airline (LAN, 900 workers).

As was mentioned previously, different mechanisms were used in the privatization of Chilean public firms; these mechanisms were used even in the privatization of the same firm (see table 4). It was required that a public firm be transformed through a legal procedure into a corporation able to sell shares; its accounting and financial

operations would then become subject to the regulation procedures of the Superintendency of Securities and Insurance. Medium and large public firms were privatized by the sale of packages of shares. The buyers were domestic and foreign investors, pension funds (AFP), employees of the same firms, and the public in general. In the case of small public firms, a simpler procedure was used. All shares were sold in one package to a qualified buyer, who could be either a domestic or a foreign investor, or the firm's employees.

Table 4. Privatization of Chilean Public Firms 1986–1990

Public Firm	*Activity*	*Privatization Percentage*			*Privatization Mechanisms*				*Book Value of assets (Sept. 1987) (US$ millions)*
		1986	*1987*	*1990*	*AFP*	*Stock Exchange*	*Employ-ees*	*Private Auction*	
CAP	Steel refin.	52	100	100		X	X		679
COFOMAP	Forestry	n.a.	n.a.	100				X	
Chile Films	Movies	0	0	100				X	
Chilmetro	Electr. distr.	63	100	100	X	X	X		206
Chilgener	Electr. gener.	35	100	100	X	X	X		264
Chilquinta	Electr. distr.	63	100	100	X	X	X		52
CTC	Telephone	11	63	99	X	X	X	X	306
ECOM	Computer	100	100	100			X		
Edelmag	Electr. distr.	12	12	100		X	X		
Edelnor	Electr. distr.	0	0	16		X	X		
Elecda	Electr. distr.	n.a.	n.a.	98		X	X	X	
Eliqsa	Electr. distr.	n.a.	n.a.	98					
Emelari	Electr. distr.	n.a.	n.a.	96		X	X	X	
Emec	Electr. distr.	100	100	100		X		X	
Emel	Electr. distr.	100	100	100			X		
Enacar	Coal	0	0	16	X	X	X		71
Enaex	Explosives	0	100	100				X	
ENDESA	Electr. gener.	0	30	96	X	X	X		1,314
ENTEL	Telecommun.	30	33	99	X	X	X		93
IANSA	Sugar refin.	46	49	100		X	X		90
ISE Gen.	Insurance	0	0	97		X	X		
ISE Vida	Insurance	0	0	99		X	X		
Labor. Chile	Pharmaceutical	23	49	100	X	X	X		
LAN Chile	Airline	0	0	68		X	X	X	49
Pehuenche	Electr. gen.	0	0	100			X		
Pilmaiquén	Electr. gen.	100	100	100				X	44
Pullinque	Electr. gen.	0	100	100				X	
Sacret	Financial credit	0	0	100					
SOQUIMICH	Nitrate	55	100	100	X	X	X		102
Schwager	Coal	0	42	100	X	X	X		
Telex	Telex	100	100	100				X	8

Source: Marcel (1989); Sáez (1992); Hachette and Lüders (1988).

Let us review in more detail the distinct privatization mechanisms.[8] In the employees' capitalism system, shares of the privatized firm were sold directly to the employees working in that firm; in only a few cases, like ENDESA (the largest electricity-generating firm; see table 4), other employees of the public sector were also able to acquire shares. In general, employees were allowed to buy 5–10 percent of total shares. To induce these employees to buy the shares, they were sold at a subsidized price with a guarantee that the firm could buy them back at the employee's retirement at a price at least equal (in real terms) to the price the employee had paid. Moreover, the workers could use the money accumulated in the firm's pension fund to buy the shares. In short, employees of the divested firms received the offer to buy their own company's shares "at a price lower than the market, without putting down any money and without running any risk" (Hachette and Lüders 1992). As has been pointed out, the rationale for this mechanism was to obtain political support for the process of privatization. As a by-product, this process also achieved the goal of dissemination property shares.

The institutional capitalism privatization system allowed the private pension funds (AFP) to acquire a regulated amount of shares in privatized firms. The participation of the AFP in the privatization process ensured property dissemination. There has, however, been a dual concern with respect to the AFP role, which explains the strict regulations imposed. On the one hand, no risks to the functioning of the newly privatized pension fund management system (AFP) could be allowed; the political cost of its failure was too large. A Superintendency of AFP was created. It supervises and regulates the fund's portfolio and imposes limits on its composition, that is, the amount or percentage of each type of investment (bank deposits, bonds, shares) of each AFP. Moreover, there is a special Risk Evaluation Committee (seven members, four from the private sector and three from the public sector) that evaluates the risks related to the portfolio of each AFP. Only 5 percent of the portfolio of each AFP can comprimise shares of the privatized firms. There are also limits on the percentage of shares that can be acquired in a specific firm. On the other hand, the resources accumulated in the AFPs are large compared to the size of the Chilean domestic capital market; by 1990, the AFP had accumulated 15 percent of GDP. Therefore, the participation of the AFP in the stock exchange had to be gradual to avoid abrupt fluctuations in share prices. In spite of all these limitations and regulations, the AFP acquired in 1990 around 25 percent of the shares of the privatized firms.

Foreign investors participated in the Chilean divestiture process mainly through stock market auctions. In this case, up to 10 percent of equity could be bought through a broker or directly on the stock market floor. It should be pointed out that no single foreign buyer acquired a controlling portion of equity through this stock exchange mechanism (Sáez 1992). The mechanism foreign investors used to acquire majority ownership of privatized enterprise was an open auction. For example, in the case of the large telephone company (CTC), there was an open international auction for 51 percent of the shares.

The privatized enterprises in which foreign investors have acquired shares are:[9] CTC, Chilgener, Enaex, IANSA, LAN, Pilmaiquén, and Telex (see table 4 for identification of the firm activity). Foreign investors paid for shares mostly through debt-for-equity swaps. With the exception of CTC, no restrictions or requirements were established for foreign investor participation. In the case of CTC, the international auction required that the buyer invest US$200 million in a program designed to increase the availability of telephone lines.

Criticism of Chilean Privatization

Distinct aspects of the Chilean privatization process have been criticized. In fact, this process was implemented under a dictatorship without any public discussion about its rationale and its implementation mechanisms; moreover, the speed of the process was so great that many public enterprises were privatized in under two years (see table 4).

Marcel (1989) has compared the U.K. and Chilean privatization experiences and shows that, in relative terms, the annual flow of revenues generated by the Chilean public firms' divestiture process has been more than twice as large and much more rapid than in the United Kingdom (table 5). These figures also indicate the key role played by privatization in balancing Chile's budget.

The divestiture of some of the largest privatized firms, like CAP and ENDESA, has been unclear. Let us look at each case separately (for further details, see Marcel [1989] and Hachette and Lüders [1992]). CORFO (a public institution) owned 89 percent of the equity in CAP in March 1986. At that time, CORFO decided to sell about 65 percent of the total shares to CAP; the "preferential" price that CAP paid per share (during the March–June period) was US$ 0.25, while the average stock market price was US$ 0.31 in May 1986 and US$ 0.39 in June 1986. CORFO then proceeded to write off all those shares. In this way, by June 1986, CORFO had reduced its

percentage ownership of CAP to 51 percent, while the previous private investors increased their ownership from 17 percent to 49 percent in three months, paying $72 million for a package of shares that fifteen months later (September 1987) was valued at $194 million (see table 4).

In the case of the privatization of ENDESA, its high debt/capital ratio did not make its shares very attractive. To solve this problem, ENDESA issued $500 million in shares, which were all bought by CORFO; CORFO paid $28.92 per share while the average monthly market price share of ENDESA during 1986 was $13.81, with a range of $6.40 to $20.00 (see Hachette and Lüders 1992 for ENDESA monthly price shares during the 1985–1989 period; there is no value higher than $22.60, and the median value is $16.20). Through this procedure, ENDESA's debt-capital ratio was reduced from 2.61 (prior to the CORFO operation) to 0.77 (after the CORFO operation). In short, the privatization of ENDESA was carried out by transferring an important part of its debt to the public sector (CORFO).

Table 5. Proceeds from Divestitures of U.K. and Chilean Public Enterprises (%)

	Proceeds from divestiture	
Country and Period	*As % of GDP*[a]	*As % of Gov. Revenues*[a]
United Kingdom (1980–1984)	0.21	0.5
United Kingdom (1985–1987)	0.85	2.0
Chile (1986–1988)	1.87	5.5

Source: Marcel (1989).
[a]Average annual flows for the period.

The effective sale price of some privatized firms has also been criticized (for a more detailed discussion, see Marcel 1989). Using different valuation procedures, like book value, stock exchange valuation, and present value estimation, Marcel (1989) estimates that the capital loss of the Chilean public sector from divestiture of the twelve largest public firms (1986–1987) fluctuated between 50 percent and 64 percent (table 6) of total asset value of those firms; this is greater than 4 percent of GDP in 1987.

Also criticized has been the decision to allow foreign investors to participate in the divestiture process. Foreign investors were allowed to use Chilean external debt

certificates (debt equity swaps), available at a 30 percent to 40 percent discount on the secondary market during 1986–1987, which the Central Bank then redeemed at par value. In this way, foreign investors received a double subsidy—on the domestic price of the assets themselves and on the devalued exchange rate.

Does foreign investment require such large incentives before it comes to Chile? In fact, there has been relatively active participation by foreign investors. In the reprivatization process they acquired 40 percent and 51 percent, respectively, of the two largest private social security funds (Provida and Santa María; see table 3). The usual argument for the benefits of foreign direct investment is that it introduces new technology, new machinery, and new know-how, and opens new export markets. One may well ask which of these is being provided by the foreign investors' majority participation in Chile's largest AFPs.

Table 6. Capital Loss of Chilean Public Sector from Divestiture of Twelve Public Firms, 1986–1987

Method	*% with Respect to Public Firm's Assets*
Asset[a]	50.0
Stock exchange valuation[b]	63.7
Present value[c]	56.9

Source: Marcel (1989).
[a]The asset method corresponds to the measurement of the effective sale price with respect to the accounting book value procedure.
[b]The sale price of the shares of privatized firms is compared to the stock exchange valuation (September 1987).
[c]An average real rate of return of 6 percent is used from 1990 on.

Another problem is that divestiture of public firms has been so rapid that there has not been time to establish a regulatory framework within which the natural monopolies will operate. Neither is it clear what role the large institutional investors, such as the private social security funds, will have.

In spite of some of the criticisms mentioned, however, the new democratic government has clearly stated that there will not be a reversal of the privatization process, and that there will not be any official revision of the privatization procedures that were implemented and completed by the military regime. Moreover, the wide

dissemination of ownership (direct and indirect, through the AFPs) of both the privatized and the reprivatized companies creates a constituency that will be opposed to any reversal.

Some Preliminary Results from Privatized Firms

Even though only a few years have passed since the Chilean privatization process, some features can be pointed out in relation to profitability and employment.

From the point of view of profitability, let us consider the average rate of return observed in 1989–1990 for a set of selected large privatized firms (see table 4 for book values). Table 7 shows the following: there are three firms (Chilmetro-Enersis, ENTEL, IANSA) that show rates of return higher than 20 percent in both years; four firms (CTC, Chilquinta, Lab. Chile, SOQUIMICH) have average rates of return higher than 10 percent; three firms (CAP, Chilgener, ENDESA) show rates of return in the 6 percent to 8 percent range; two firms (LAN, Schwager) showe negative rates of return in 1990.

Table 7. Rate of Return of Selected Privatized Firms (%)

Enterprise	1970	1978	1983	1986	1987	1988	1989	1990
CAP	10.9	–2.4	0.7	2.3[a]	4.6	8.8	10.6	4.7
CTC	0.7	4.2	11.9		10.9	12.3[a]	17.2	12.4
Chilmetro-Enersis				9.5[a]	9.8	14.1	21.7	29.7
Chilquinta				8.2[a]	8.6	12.1	18.4	18.4
Chilgener				5.8	3.0[a]	7.5	8.0	8.9
ENDESA	0.3	0.2	6.4		4.9	12.3[a]	7.3	6.1
ENTEL	–0.7	9.6	13.0	35.4	39.0	45.5[a]	45.6	38.8
IANSA	–9.3	–19.2	–24.0	5.5	7.0	37.4[a]	57.2	37.3
Lab. Chile	4.1	1.0	7.4	12.7	14.9	28.9[a]	23.5	3.4
LAN	–0.6	7.7		12.8	8.2	9.3	11.3[a]	–19.0
Schwager				10.4	5.2	3.9[a]	3.1	–0.5
SOQUIMICH	–65.3	–6.0	10.1	30.8[a]	34.6	42.8	21.1	5.2

Source: Sáez (1992).
Note: Rate of return calculated from net income (after tax profits) over shareholder's equity.
[a]Year of privatization when private investors' ownership was higher than 50 percent.

In short, (1) privatized firms two years after privatization show higher rates of return than they had when they were public firms; (2) many privatized firms show relatively

high rates of return, that is, higher than 10 percent; (3) there are a few privatized firms that are showing financial problems, that is, privatization of some firms may not have solved the economic difficulties they had when they were public.

Union leaders in Latin America have, in general, opposed privatization of public firms, fearing that after public divestiture many employees would lose their jobs. It is commonly believed that privatized firms will employ fewer workers than the equivalent public ones, because political pressures generate overstaffing in the public sector.

Table 8 provides the evolution of employment for selected privatized firms before and after privatization. When comparing levels two and four years before and after privatization (in 1986), one observes the following:

1. There are more privatized firms showing an increase in employment than a decrease. CTC, ENTEL, IANSA, LAN, Lab. Chile, Chilgener, and Enersis have higher employment levels after privatization than before. On the other hand, ENDESA, Chilquinta, and Schwager show lower employment levels after privatization. It is not clear how SOQUIMICH should be classified according to the changes observed in its employment level.

Table 8. Employment in Selected Privatized Firms (Number of Employees)

Enterprise	1970	1979	1983	1986	1987	1988	1989	1990
Enersis-Chilmetro				2,495[a]	2,587	2,828	2,962	3,052
Chilquinta				983[a]	956	770	746	731
SOQUIMICH	10,814	7,109	4,096	4,704[a]	5,024	5,527	5,453	4,111
Chilgener				760	852[a]	837	845	876
CTC	5,887	7,206	6,338	6,938	7,374	7,518[a]	7,36	7,530
ENDESA	6,512	4,270	2,705	2,905	2,828	2,925[a]	2,980	2,833[b]
Entel	1,161	1,236	1,338	1,402	1,456	1,460[a]	1,546	1,547
IANSA	2,827	1,597	1,079	2,027	2,103	2,023[a]	2,144	2,163
Lab. Chile	567		527	592	618	681[a]	749	728
LAN	3,608	2,059	1,372	88	983	1,093	1,430[a]	1,551
Schwager				2,264	2,277	2,296[a]	2,304	2,171

Source: Sáez (1992).

[a]Year of privatization when private investors ownership was higher than 50percent.

[b]In January 1991, this enterprise was reorganized and as a result 434 employees were permanently laid off.

2. Nine out of eleven privatized firms show higher employment levels one year after privatization (table 8); however, in this case, it could be argued that the public firm was being prepared (by reducing its employment level) to make privatization more attractive. Therefore, the previous comparison is more relevant.

3. Most of the privatized firms have an increase in employment of less than 7.0 percent. In the three privatized firms in which there was a contraction of employment, this decrease was higher than 12.0 percent.

4. Comparing the employment level of the privatization year with 1990 for the eleven firms, we observe the following (table 8): seven privatized firms showing an increase of employment, have created 988 new jobs, which represent 6 percent of their initial employment level (16,459 jobs). Four privatized firms have had an employment contraction equivalent to 1,496; that is, the percentage of jobs lost is 13.7 percent of the initial employment level (10,908 jobs). The net result of the employment impact of the eleven privatized firms is a reduction of employment of 508 jobs, which represents 1.9 percent of the total initial (year of privatization) employment level.

Final Remarks

Chilean privatization processes provide some general lessons. In my judgment, these are the following.

The Chilean reprivatization process of the 1970s showed that privatized firms could go bankrupt (1) if privatization was a highly debt-led process, or, (2) if there existed a high degree of interlocking between productive and financial enterprises. In many Latin American countries, private firms do not go bankrupt; rather, they are rescued by the state. In Chile, reprivatized firms went bankrupt and were rescued by the state; in this way, heavy private losses were socialized.

Using rates of return as indicators of efficiency, it could be said that privatized firms have been, in general, *much more* efficient than they were as public firms. We have to expect that in some cases, however, privatized firms will not be able to overcome previous inefficiency problems; therefore, let us not emphasize the bad experiences and forget the successful ones.

The fall of employment in privatized firms does not seem to be a general problem; that is, it is not a general rule that privatized firms' employment drops. The reduction of employment could be a serious problem in certain firms; in which case, there

should be a policy focus (for example, retraining of displaced workers) in those specific firms.

For political and income redistribution purposes, it is important to incorporate workers and low-income groups into the privatization process. The Chilean experience provides some mechanisms that were used even under the military dictatorship. The Chilean experience also shows, however, that privatization has been mainly a highly regressive asset-redistribution process.

Regulation of natural *privatized* monopolies (i.e., the public utilities) will become a highly conflictive issue because the Chilean state: (1) has neither the expertise nor the know-how to regulate, (2) there is no clear regulatory framework, and (3) there are no trained regulators. This situation will generate problems with the evolution of public utility prices and with the level of future investment in public utilities.

There are distinct aspects related to the role of foreign investment in recent Chilean economic history. First, during the economic recovery of the 1980s, public investment played the leading role followed by foreign investment; only later on, did private domestic investment start to increase, after domestic investors realized that foreign investors were picking up the most profitable projects. Second, from a Latin American perspective, foreign firms have several positive features: they bring capital, modern technology, and modern know-how, and open up new external markets. Moreover, some of them bring a better entrepreneur-worker relationship to the firm. Through the demonstration effect, this fact has a positive impact on the domestic economy. Something similar could be said with respect to the relatively higher ecological concern of U.S. and European firms.

Some lessons from the past, however, show that there exists a conflict between a foreign multinational firm's profit-maximization objective at the global level and the host country's objective (for example, Chile's objective with respect to foreign investment in large copper mining), which is related to national income maximization. Output expansion by the foreign firm over domestic GDP could be the best way to avoid such conflict.

A different problem is related to the free entry and exit of short-run speculative capital. Given the relatively small size of the Chilean financial market, these short-run capital flows could have serious macrodestabilizing effects and could thus affect domestic perception with respect to long-run foreign investment.

Finally, in Chile, the old development model is gone. The present Chilean economic model—free-market, open economy, exported-oriented, private sector–led—will continue. This is not a 360-degree move. Chile has already learned and appreciated the advantages of the market mechanism and its integration into the world economy. There exist many new private domestic entrepreneurs who are helping to increase exports, investment, and growth. There were only a few before. There are still key problems that have to be solved however; the new role of the state (i.e., the public sector–private sector relationship), and the improvement of poverty and income distribution.

Notes

The author acknowledges the useful comments received from William Maloney and Miguel Ramírez; usual caveats are valid.

1. For a more elaborate review and analysis of the economic problems during the Unidad Popular government, see Larrain and Meller (1991).
2. The use of the terms "privatization" and "reprivatization" here follows conventional usage in Chile: firms divested after previously being acquired by the state through direct intervention or purchase, or firms that were previously seized by the state without compensation are said to be "reprivatized"; public firms, originally created by the state, which are divested correspond to the "privatization" concept. For a more detailed review of this subject, see Foxley (1982), Hachette and Lüders (1988), Marcel (1989), Larrain (1991).
3. For a more detailed analysis of these reforms, see Foxley (1982), Ffrench-Davis (1982), Harberger (1982), Zahler (1983), Ramos (1984), Walton (1985), Edwards and Cox (1987).
4. For a different view on this issue, see Hachette and Lüders (1988).
5. Under popular capitalism the government sold the shares of reprivatized firms at prices below their market value, providing 95 percent of the credit at zero real interest. Buyers could deduct from their income tax up to 20 percent of the total value of the transaction the following year. Buyers facing a marginal tax rate greater than or equal to 30 percent got a tax credit greater than their down payment. In short, the government paid some of the buyers to acquire the shares. Given the benefits, there was a limit on the amount of shares one individual could buy. The two largest private banks (Banco de Chile and Banco Santiago) and the two largest AFPs (Santa Maria and Provida) (each had belonged to the two largest conglomerates) were reprivatized using the popular capitalism system. Fifty-five thousand shareholders participated in this system by the end of 1987 (see table 3).
6. For more details, see Marcel (1989), Hachette and Lüders (1992), Sáez (1992).
7. For more details, see Ramírez (1989) & Sáez (1992).
8. For a more detailed discussion, see Marcel (1989) and Hachette and Lüders (1992).
9. In most sales of shares through the stock market, it is not possible to identify domestic and foreign investors.

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