PRIVATIZATION IN THE NINETIES

Edited by Eamonn Butler
PRIVATIZATION IN THE NINETIES

Edited by
Dr Eamonn Butler

With contributions from:

Dr Madsen Pirie
Guy de Selliers
Ralph Blackman
Ibrahim Elwan
Per Westerberg
Üstün Sanver
Adrian Severin
Dr Eduardo Modiano

Adam Smith Institute
London 1992
Bibliographical information

Published in the United Kingdom in 1992 by the Adam Smith Research Trust, 23 Great Smith Street, London SW1P 3BL.

(c) ASI (Research) Ltd 1992

All rights reserved. Apart from fair dealing for the purpose of private study, research, criticism, or review, no part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior permission of the publishers.

The views expressed in this publication are those of the authors and do not necessarily reflect those of the publisher or copyright owner. They have been selected for their independence and intellectual vigour, and are presented as a contribution to public debate.

The contributions contained in this publication are edited transcripts of spoken remarks. Care should be taken with attribution and they should not be regarded as formal or definitive statements of the authors' positions.

ISBN: 1 873712 21 9

Printed in the United Kingdom by Imediacopy Ltd.
'In every profession, the exertion of the greater part of those who exercise it, is always in proportion to the necessity they are under of making that exertion... and, where the competition is free, the rivalship of competitors, who are all endeavouring to justle one another out of employment, obliges every man to endeavour to execute his work with a certain degree of exactness... Rivalship and emulation render excellence, even in mean professions, an object of ambition, and frequently occasion the very greatest exertions.'

Adam Smith

*The Wealth of Nations* p717
Contents

THE AIMS OF PRIVATIZATION
The ten objectives of privatization
  Dr Madsen Pirie  1

Privatization and the European Bank
  Guy de Selliers  8

THE NATURE OF THE PROCESS

Privatization and the wider economy
  Ralph Blackman  14

Privatization of infrastructure
  Ibrahim Elwan  18

THE EXPERIENCE OF PRIVATIZATION

Privatization in Sweden
  Per Westerberg  23

Privatization in Turkey
  Üstün Sanver  29

Privatization in Romania
  Adrian Severin  32

Privatization in Brazil
  Dr Eduardo Modiano  36
1. The ten objectives of privatization

Dr Madsen Pirie  
President, Adam Smith Institute

With the benefit of many years' experience available to us now, it is instructive to attempt a verdict on privatization by asking what governments round the world have sought to do seek to do through privatization, and how successfully it achieves those objectives. A survey of ten principal objectives will help us fill in this picture.

Lowering costs

When governments are motivated to privatize, it is very often because they are pressured by anxious taxpayers to reduce the cost burden of the public sector. So the first objective that one might cite is that of lowering government costs.

State industries cost money to run. They very frequently -- perhaps usually -- lose money and have to be supported with subsidies from taxpayers. In consequence, many governments who turn to privatization do not do so from rational conviction but from desperation. They are seeking some way to cut spending.

Fortunately, there are two ways in which governments do cut spending as a result of privatization. First, the private industries need no more subsidies, and so the annual amount being paid out from the Treasury can cease; and secondly, the proceeds of the sale go into the Treasury. That money can be spent on new capital projects, or even to reduce taxes and so generate growth.

The evidence is clear that privatization works on both counts, with governments saving money in both ways. The loss-makers are taken off the hands of the state, and are no more a public liability. If the privatization has been done properly they will normally make profits; but even if they do not, the loss is no longer the responsibility of the government and the taxpayers.

Because the sums involved can be quite large -- in the UK sales have generated more than £35 billion for the Treasury since the programme started -- every privatizing government worries how it can be sure to get the right price for its state concerns. But
while you have a duty to taxpayers in this respect, you must also be conscious of the limitations of any such attempt.

In most circumstances, nobody knows what a state enterprise is worth. Few of them have ever kept proper audited accounts; most are so loaded with political and social obligations that nobody has the slightest idea what their real trading position is. So if you think you are going to be able to sell an enterprise for the ‘right’ price, resign yourself to probable failure. It is going to be a guess.

But at least you can take advice. And in the UK we are fortunate in having the best professional advice the world has to offer. Our merchant banks, stockbrokers, and management accounting firms buy and sell companies every day, and we know that their guess will be a better one than that of any politician or government official. So we have privatized, so to speak, the process of privatization itself.

And you can always test the water by selling just over half the company in the first instance. Then the market will reveal what people really think the company is worth. If you have guessed the price too low, you can make it back again when you dispose of the residual shares at the market price some time later.

Thus, when we sold British Telecom, we put only 51.2% of the stock on sale. More recently, we have been selling off the remainder in tranches of around 20% — and have been getting more money from those than we did from the original sale, because the value of the company has gone up in the meantime. Now everyone can see its real worth more clearly than they could when it was in the public sector. So remember that you can always recover some of the value on the sale of residual holdings.

**Depoliticizing decisions**

Another aim of privatization is to make industries commercial instead of political: to take them out of the control of government and into independent management.

This means that they have to raise their capital on the market, based on their long-term commercial prospects — rather than on the basis of how hard-pressed finance ministers are able to juggle the many competing political claims upon government resources.

That in turn makes the enterprise much easier to manage. A corporation in the state sector, when it decides to expand, may well pick the most commercially viable site. But it will then have every politician in the land telling it that the new factory should go in his or her constituency instead. There will be delays and horse-trading: and eventually it will be those who can exert most influence on the government leaders who will decide the result. But once the corporation is privatized, this politicization fades away. Decisions can be made more quickly, and on a straightforward commercial basis.

The key recommendation here is that government must be prepared to let go. You would be astonished how many countries try to privatize an industry and yet keep a residual control over it, so they have some influence over its appointments, over its expansion decisions, over its commercial activities. That is not a real private company. If you want to gain all of the benefits of privatization, including commercially sound management, you must be prepared to let go.
Better service quality

A third aim of privatization is to achieve an improved quality of service. A company in the private sector will have to respond to its customers. It will have to become more efficient. It will have to keep its product attractive. Its customers will no longer be the captive taxpayers supplied en bloc by the state; instead they will be people who have choices, who might be attracted to other products, who have alternative ways of spending their money, and must be attracted to spend it on the company. If it faces the threat of competition, it will have to keep ahead of other suppliers or it will risk commercial failure.

In less competitive areas, this improved quality can be achieved by regulators who are specifically charged to ensure that the quality of service is improved. But regulation is very much a second-best: competition is the best regulator.

If there are continuing disputes about the quality of service that is being achieved, you can consider introducing more competition later on. Perhaps the best example from the UK was from our telephone boxes; after privatization, there were still complaints that large numbers of these payphones were out of action and had not been repaired. The regulator told British Telecom to get them working. But he also licensed Mercury, the competitor, to enter the payphone business; and from that moment, all of the British Telecom boxes were working again. It really is true: competition is the best regulator.

Overall, the clear conclusion is that privatization has been a huge success in terms of quality standards. Privatized firms are generally more attentive to customers, and have better quality control. In too many cases, they could hardly fail to be an improvement on what the state sector has delivered previously.

Better management

A fourth objective of privatization is to have industries better managed. It implies no insult to any civil servants to say that their profession, on the whole, does not make ideal managers of private industry. It is constructed on a different basis, and its rewards derive from different achievement standards.

For example, in the civil service, it is typical for seniority to count much more than in private business. And rewards usually reflect the size of your staff -- that is, the greater your office, the more that it spends, then the more important you are and the larger your salary will be. In the private sector, by contrast, ambitious young managers can be promoted because they have been able to cut down departments and save on expenditure. There is a wide cultural divide, and the best managers in the one system do not necessarily make the best managers in the other.

Fortunately, we found in the UK that privatization itself does help close the gap. The same people who behaved one way as civil servants can be transformed when they are exposed to different pressures. Once they are in the private sector, they begin behaving like private sector managers. Once they acquire the freedom to manage, we see their standards of efficiency rising, more responsiveness to customers, decades of state
attitudes slipping from their minds.

There was never any question that management was better in the private sector; but now we know that privatization itself produces this effect. You do not need, in other words, to find all of the ideal managers for your state industry before it enters the private sector. But you do need to get the right person at the top. Get the right person in charge, ahead of privatization, and the rest will sort themselves out. Working in the private sector will rapidly show the value of ambitious and effective managers. The time-servers from the old regime will be quietly shuffled into high-sounding but low-power positions.

Labour relations

The fifth objective of privatization is better labour relations. The public sector in every country in the world is notorious for strikes. This is because it is very much easier for public sector employees to get governments to give in by putting pressure on the general public. The withdrawal of essential services, or the threat of it, makes governments nervous for their popularity and much more ready to concede than a private sector firm would be. The private sector firm risks going broke, so costly strikes are obviously self-defeating. Governments do not, for the most part, go bankrupt. There are fewer strikes after privatization.

Good employee relations are helped by worker co-ownership: by the allocation of part of the value of the company to the workers. Workers receiving dividends and watching the capital appreciation of their own shareholdings are reluctant to strike against themselves. But there is also the fact that a private sector firm tends to consult its workforce more, and to listen to their real objectives. Also, when we move from a state industry to the private sector, new incentive bonus structures can be introduced, so that ambitious and capable employees are able to get ahead and to earn higher rewards than they would be under civil-service pay scales. All this leads to better labour relations.

Accordingly it is wise to set aside 8%-10% of the value of the firm for the workers. In the case of British Gas, we introduced the principle that the longer you had served with the firm, the more shares you were allowed to buy. This broadly corresponded with the workforce’s own view of fairness. But remember that taking 8%-10% of the shares and letting the workers have them at half price or less costs you absolutely nothing at all, because any company in which workers own some of the shares is worth more than a company where they do not. It will have fewer strikes and will be more productive: so the shares which you do sell to the public will then be worth more, and the difference will be more than what it has cost you.

Wider share ownership

Another aim of privatization is wider share ownership, diffusing property ownership more widely in society. This ‘popular capitalism’ is of course aided by popular share issues. In the UK we have taken it further by allowing the general public to buy on credit (so that they do not have to subscribe the whole price of their shares at the outset but pay only one-third now and the rest in later years), by special shareholder benefit schemes, and by massive advertising campaigns. The result has been that we now have
over three times as many shareholders as we did before the privatization movement.

But not every privatization issue is right for every investor. You may happily encourage small savers to bring their money out from the tin box under the bed in order to buy utilities or blue-chip companies. But you would not want people putting their life savings into the oil industry or the aerospace industry, for example. So when we are selling companies in high risk sectors, typically we arrange the sale in a way which appeals only to professional investors. You might have to buy a minimum of 1,000 shares, or they might be sold by the method of tender rather than by fixed price sales.

Restoring profitability

The seventh aim of privatization is to turn losses into profits. Some governments try to sell an industry and impose so many conditions upon the private operator — that he or she shall employ exactly the same number of workers under exactly the same conditions of employment and so on — that it is not really a private sector operation at all. It is effectively being run by proxy on behalf of the government. This is a mistake: one should never forget the remarkable power of the private sector to turn losses into profits by finding its own way to do the job better.

When we privatized our National Freight Corporation, the profits came on the first day. Every employee of that company knew well what was wrong with it before, so from the day it became a worker-owned privatized firm, the old habits ceased immediately. They earned their reward when NFC was floated on the stock market seven years after they bought it; each one gained 100 times what they had paid for their initial shares. Overwhelmingly, privatization has turned such loss-making state industries into profitable private sector ones.

There are two recommendations relevant here. One is to do any slimming down ahead of the sale; that is, there should be a preparation period in which those who will be the new management are put in charge and in which restructuring can proceed, ahead of the actual privatization. This enables the company to get ready for life in the private sector, with morale high, and greater chance of making a success of things than if they had to spend the first two or three years in bruising internal confrontations.

The second point is to be prepared to write off debt. Naturally, governments who have ‘invested’ millions in state industries over the years want some of it back. But governments don’t invest, they spend. They like to say they are investing, but really they are spending on political priorities. Most of the money ‘invested’ in prestigious but unviable job-creation projects is in fact lost forever: you cannot get it back because it has been spent, and is gone. The moment governments realize that they are generally unlikely to get back their past investment, the easier it is to turn the enterprise into a properly corporatized potential profit-maker.

Replacing capital

The eighth motive for privatization is to recapitalize run-down state industries. As we have seen, there are always other important claims upon government resources. It is always easier for governments to give in to the very visible demands of public
employees, pensioners or welfare claimants, even if this means postponing essential projects in state corporations. Capital spending is not as urgent politically, and state corporations can always be told to make do with their existing capital stock a little longer. That is why the buildings and equipment of the public sector all over the world tend to be run-down and out-of-date.

There are two ways of recapitalizing. One we call asset enrichment — in which, when the government corporatizes, it deliberately endows the operation with assets that it can exploit in order to re-equip. Thus the British Ports Authority, privatized in the early 1980s, was sold with land assets that could generate enough money to recapitalize the docks with the modern equipment necessary to make them viable. It worked superbly and they have been profitable ever since.

More recently, we have imposed upon some privatized companies a requirement to recapitalize, and have built into the price structure the means to do it. For example, our water and electricity industries were reckoned to be very seriously undercapitalized at the time they were sold. We have to replace the mains and sewers for the water services and we have to replace the old and dirty power stations which burn sulphurous coal rather inefficiently. So we placed an obligation upon these companies to recapitalize, and included in their price structure a factor which allows them to raise the necessary money from their customers.

In this way it is possible to recapitalize even badly run-down public sector industries, though it does need to be given enough time to work. You may have to build into the privatization measure a ten-year programme of recapitalization.

**Competition and choice**

Privatization can introduce more competition. The more experience of privatization that you have, the more confident everyone is about the process, the more choice and competition you can introduce. It can be a difficult process, involving the break-up of monopolistic state corporations. In the UK we privatized our gas industry in one piece and perhaps regretted it afterwards; but later we broke up the electricity industry so as to produce at least some competition into power generation right from the start.

Often we introduce the competition first and then privatize afterwards. We did this with our National Bus Company. We allowed private operators to compete; National Bus responded to the challenge by raising its own standards and improving its own services; and then it was very easy to privatize the business afterwards. That is also the course that we have chosen to follow with the railways and with the Royal Mail.

Even if you privatize an industry with much of its monopoly power intact, however, you can always introduce competition at a later stage. When you privatize, you can specify that a thorough review will be made a few years later on, in order to see whether further competition may be justified. Thus at the end of our seven-year review period on British Telecom, the government decided to license an additional six competitors to be added to the two, Mercury and Telecom, already in the field.

**Keener prices**
The tenth aim of privatization is keener prices. The state sector is notoriously bad at containing its costs: passing them on to customers is just too easy when customers are captive.

If privatization is used to introduce competition, that in itself will put a downward pressure on prices. A competitive industry has to root out inefficiencies and keep costs down, or its customers will desert it.

Even if the privatized corporation is left with a degree of monopoly, it is still possible to give some protection to customers through price-capping. In the UK we use a formula based on the cost of living index, called RPI-X. Our regulated utilities are obliged by law to reduce prices every year, under that formula, by a certain percentage below the rate of inflation. It can be reviewed regularly: in British Telecom the price-cap started at 3% below inflation, then it went on to 4.5%, then 6.25%, and now the limit is 7% below inflation.

Conclusion

These are ten key objectives of privatization; and the score in the United Kingdom has been ten out of ten. We did better on some points than on others, and did better in the later years of the programme, as we gradually learned more about how to achieve our objectives. Privatization does achieve all of those objectives listed, but you have to work at it. It is not always easy, but it does work and the process can be learned.

In the UK we have, I think, probably the best concentration of privatization expertise in the world. We hope that other countries will learn from our experience, and the experience of other nations which have privatized, too. There is no need to make yesterday's mistakes over again today. The best teacher is experience, and those who try privatization have learned a great deal about how to do it well, in a variety of different circumstances.

It is a joy to see privatization done well, because it can bring so many benefits to so many people. This is why privatization has undoubtedly earned and thoroughly merited its place in the economic history of our time.
2. Privatization and the European Bank

Guy de Selliers
Group Manager, Merchant Banking, European Bank

Since our creation just over a year ago, the Bank has focused a significant part of its resources on the issue of privatization and has been engaged in a variety of activities in this field. Activities have ranged from advice to government authorities on how to organize and manage a privatization programme to direct support of privatized enterprises through our lending and equity investment. From this work, we have started to gain an understanding of the challenges and problems involved and have developed some basic ground rules on how to tackle the issues at hand. I would not call this a doctrine but, nevertheless, certain basic principles have emerged from our experience: basic principles which we strongly believe in and which we have outlined and discussed with our Board of Governors at our Annual Meeting in Budapest in April of this year.

To begin with, I would like to address three general points pertaining to privatization, namely: the pace is too slow; privatization is only one part of the equation; and the objectives pursued are in many cases still confused. After that, I will make some comments about the different privatization techniques available and finally mention some of the activities of the European Bank in this field.

The pace of privatization

Firstly, the pace. This has on the whole been disappointingly slow. There have been some significant successes in small asset privatization in Poland, in the Czech and Slovak Republics and in Hungary, where more than half of the small assets have been privatized. However, the pace of larger privatization (and by this I mean enterprises with more than 100 employees) has been disappointingly slow. In the best case, Hungary, enterprises representing less than 15% of the larger assets to be sold have been privatized. In the former USSR, where we estimate there to be 30,000-50,000 larger enterprises, only a handful have been privatized. Therefore, if the current pace is maintained, putting aside the CIS where the process has barely started, more than half the state enterprises will remain in the public sector for more than one generation.
Thus, the pace of privatization must accelerate. Governments must increase the momentum and continue to advance transactions, notwithstanding the daunting obstacles and difficult choices they must face. Delay would only mean that conditions would deteriorate further. Decisions which seem difficult to make today will seem next to impossible tomorrow.

Of course, any solution will be controversial and will require a combination of strong political will and ethical rules. This is why it is essential to win popular support for the process and to avoid alienating the public. In particular, it is important to make clear the value of a thriving private enterprise sector in terms of tax receipts and job creation, in comparison to the value of retaining ownership rights over a deteriorating enterprise portfolio.

Other parts of the solution

Privatization is only one part of the equation which needs to be solved to create a market economy. Indeed, notwithstanding the efforts and the resources deployed to accelerate the process of privatization, it has to be recognized that a large proportion of the existing enterprises cannot be sold in their current state and many will have to be closed down. Thus we are faced with the issue of restructuring and its relationship to privatization.

Privatization and restructuring are intimately linked. They share the common goal of giving viable enterprises the means and the skills to survive in a new competitive environment, whilst following different paths. The state can either restructure on its own or transfer the ownership and responsibility for restructuring to the private sector. Therefore, the distinction -- between privatization and restructuring and the question of sequencing -- becomes mainly an argument concerning who will carry out the restructuring. Due to constraints on the state's capacity to carry out restructuring, it is very clear that privatization should be the priority for the majority of the enterprises. Only for those enterprises which cannot be sold in their current condition, should the state assume responsibility for the restructuring.

Recognition of the fact that many of the existing enterprises in central and eastern Europe will not survive in the new competitive environment raises the issue of how to create new employment. Establishing the right framework for the creation of new enterprises is just as important as privatization of existing ones and, therefore, government resources should not be devoted exclusively to caring for the existing portfolio at the risk of neglecting the likely generators of new growth.

For this of course a conducive political and economic environment is necessary, together with the necessary infrastructure, a coherent legal structure and functioning financial institutions. These elements are slowly being put into place throughout the region, but significant deficiencies still exist which must be addressed. We admire the efforts being made in many countries, but it is still not enough.

Foreign direct investment also plays a critical role in privatization and more broadly in the development of the private sector, even though we have to recognize that direct
the development of the private sector, even though we have to recognize that direct investment will only account for a small portion of assets being privatized or of the new enterprises being created. Now, the first responsibility for encouraging foreign direct investment lies with the host countries. And these host countries can do more to put in place laws and regulations which encourage and protect such investments. Just as important is that they can do more to eliminate bureaucratic obstacles which in many cases continue to delay and thwart investment.

But the governments of the industrialised countries also have a responsibility and a role to play in this field. They should consider creative solutions which respond to the legitimate business concerns which are inhibiting investment. We have already mentioned to our shareholders some of the possible devices such as political risk insurance, environmental liability protection and title insurance, as well as increasing the volume of export credit. That being said, we know nevertheless that the most important contribution these governments could make is to provide greater market access for the countries of central and eastern Europe. The continuing presence of crippling trade barriers continues to undermine other efforts being made to transform the economies in the region. It is therefore imperative to encourage greater market access.

Clarity of objectives

The third point of a general nature which I would like to make is that the objectives of privatization should be clear and coherent. The objectives, as I see them, are as follows:

* Privatization programmes must aim at rapid whole-scale transfer of assets or enterprises to new owners who care about the profitability of the enterprise, who care about the future of the enterprise and its workers and who have the means to induce positive action. This for me is the first objective to which all others are to some extent subordinated.

* A second objective is to achieve a fair redistribution of the existing wealth. This is the more political objective. To achieve this, privatization programmes must be transparent and provide equality of opportunity for broad classes of potential investors.

* Finally, privatization can raise revenues as a means of solving a country's budgetary problems. This must be viewed as secondary and must be subordinated to the primary purpose of effecting the transfer of ownership quickly and fairly.

Being clear about the objectives pursued when privatizing, not misleading the public about what these objectives are and designing programmes which reflect the agreed priorities, are essential for the success of the privatization effort.
This brings me to the question of which techniques to use. Three simple rules must be applied when designing privatization procedures: simplicity, delegation and multi-track:

* By *simplicity*, I mean the use of simple easily understood rules. Clear and simple ‘rules of the game’ must be set up with regard to both administrative and commercial procedures which will then govern the process. It is imperative to follow the simple business rule of starting with something simple because it is bound to become complicated, especially as we all know what happens the minute the lawyers get involved in the process!

* By *delegation*, I mean the decentralization of decision making and delegation of authority to pre-qualified advisers who supervise transactions on the government’s behalf. It is important to distinguish, however, between decentralization of decision making, and diffusion of decision making responsibility. It is vital that the decision maker in each case be clearly defined with strong powers of independent action. Attempts to involve wide ranges of political constituencies in each decision may slow or even halt the process.

* By *multi-track*, I mean a multi-track approach should be followed, encouraging the most rapid and effective methods to be successful. Different techniques are appropriate to different enterprises and governments should not therefore lay down *a priori* requirements. Instead they should encourage a variety of techniques, following the multi-track rule and thereby let enterprises and investors select the appropriate one, subject of course to clear rules of competition and valuation.

These objectives and rules are, as I said earlier, not to be taken as a doctrine. However, from my own personal experience and from that of my colleagues at the European Bank, I feel strongly that in order to achieve the maximum success rate, these rules are important.

The techniques of privatization

This leaves us now with the techniques to be used -- which ones should be encouraged and which should be avoided. Experience has shown that small assets are best sold by public auction. Medium to large enterprises, however, can be privatized using a variety of privatization techniques, including: public offering of shares; private sale or issuance of shares by negotiation or tender; ‘mass privatization’; sale of assets through liquidation; management and employee buy-outs and leases; and management contracts.

Starting with *broad public offerings of shares*, this technique has understandable political appeal. However, it is risky for the small investor to participate in such high risk nascent equity markets. Not only do they suffer from a lack of legal information, but they also suffer from little legal recourse in the event of misrepresentation and typically lack the experience to make reasonable decisions in the market. Thus, from my exper-
ience, I believe public offerings of shares should not be encouraged, at least in the early stages.

Private sale of shares to corporate buyers, preferably by tender, may, I believe, be the most effective privatization technique, because new owners take the lead in transforming the enterprise into a viable business. Fresh investment can reach the enterprise through a capital increase, thereby diluting the government’s share while providing new capital to the enterprise for necessary investment and debt repayments. The problem here is how many potential buyers there are -- possibly too few compared to the number of assets to be sold.

A third technique, the so-called ‘mass privatization’ or free distribution schemes, should also be considered. We all know that theoretically this can create a broad initial ownership position which balances efficiency, information needs and corporate structure with a fair distribution of property. The mass privatization schemes also usually involve creating investment portfolios such as mutual funds to ‘recapture’ the shares. The shares of the fund themselves are then widely distributed, often deliberately below fair market value but at a price designed to be ‘meaningful’ to the small retail investor for whom the programme is designed. These schemes have to be tried, although the risks are significant in that if strong intermediaries do not arise, the large number of shareholders will render corporate governance ineffective. Also they are complex, and complexity is a problem in countries with emerging but still very weak asset markets, valuation benchmarks and accounting procedures.

Other techniques such as the sale of assets through liquidation may be appropriate, even though there is potentially a heavy social and economic cost to be paid by this method. Management and employee buyouts can also be used, especially where there are no other attractive private sector buyers. The two main difficulties here are fairness and whether or not the incumbent management can improve the performance of the enterprise in question.

Finally, management contracts are an effective way of bringing in foreign expertise, without the risk of investment, but they are expensive and should only be used in highly uncertain environments where foreign interest would not otherwise exist.

The Bank’s activities

Let me outline the European Bank’s own activities in privatization which have enabled me to draw the above conclusions.

The nature of the Bank’s involvement in privatization depends on how far the country concerned lies along the privatization path. In countries just beginning to create a framework, the Bank is acting as adviser to the government on the design and implementation of their privatization programmes, basing its advice on pilot projects and experience gained from specific transactions in other countries. For example, in the City of Moscow, the Bank is assisting in the formulation and implementation of a privatization programme for roughly 16,000 small businesses and 700 medium to large enterprises, controlled by the City. We have successfully privatized three companies,
one through sale to a foreign corporate buyer and two through management employee buy-outs.

Where an institutional framework is in place for privatization, the Bank is supporting the growth of private enterprises through lending and equity investment. The Bank acts as a catalyst in privatization by helping viable enterprises attract investment. As recent examples of Bank involvement in individual privatization transactions show, the Bank can facilitate privatization by taking an ownership stake, with the remainder taken by a committed trade investor and local institutions.

Finally, it must be highlighted that because of the complexity and magnitude of the privatization task, the Bank co-ordinates its activities and policy reform objectives with other international organizations such as the EC, the World Bank group and other multi-lateral and bilateral programmes, so that structural reforms can be carried out with maximum effectiveness.

Conclusion

I have not tried to be exhaustive, just to make a few points about where we stand on some of these topics. It is not that we think we know the truth from our experiences, since we are still learning and still experimenting – as is everyone else. Anybody who pretends to have the magic formula for a fast and effective wholesale privatization of the economies of central and eastern Europe is probably no more than a charlatan. Therefore I believe that it is critical to continue to try different approaches and then exchange our experiences.
3. Privatization and the wider economy

Ralph Blackman
Administrator, Bureau for Private Enterprise, USAID

In the rush to count privatization transactions as a measure of success in the reform process, are we paying sufficient attention to the near and long term viability of industry structure? Are we viewing privatization as an end in itself and not as a key part of a much more complex and longer term process?

The United States is one of the strongest proponents of private ownership, having supported the concept of privatization in the most forceful terms since the early 1980s. We gave it a big push in the mid-1980s with the worldwide conference in Washington, attended by 400 of the developing countries’ top policymakers. We created a Centre for Privatization to provide the wherewithal to make the concept into a reality.

From the beginning, our success was thought to lie in the number of transactions we completed. In fact, though before my time, the leadership of the USAID dictated to country missions that they would bring home two transactions per year. They all very quickly learned, however, that much was to be done before the first transaction could be completed. We had to sell the idea on a country-by-country basis before any company or its assets could be sold. Thus during the 1980s, we invested millions of dollars promoting privatization in what many thought to be a hostile environment. We held conferences, we commissioned papers, we sponsored observation tours by developing country leaders to countries which were having early success in privatization, we put advisers in countries which were committed to privatization and in some, as it turned out, which weren’t. We supported local research organisations that became vocal advocates with their governments. We made our assistance conditional on policy changes that promoted privatization. By and large we succeeded in influencing the debate over the future course of development, highlighting the role of the private sector. Throughout the process, we proclaimed the benefits of privatization to the developing world: reduced financial burdens on governments, increased efficiency for the firms themselves, more rational allocation of national resources, increased employment and many others. The idea was that economic democracy brings about political democracy.
For the most part, all of us in the development business succeeded in altering the course of the debate over the role of governments in providing goods and services to the citizens of the world. I use the term 'for the most part' because we haven't been entirely successful. Some regions -- Africa for instance -- lag behind in accepting the fact that their governments and their citizens will be better off in an economic and political environment that provides freedom of choice. Much has yet to be done in many places around the world, but I would suggest to you that the bulk of the promotional work is behind us.

The pressure of speed

As we succeeded in promoting the concept, so have we succeeded in rapidly privatizing firms worldwide. The results have been impressive and they encourage us that we are on the right track. Many countries are recognizing the successes achieved in places like Mexico and Chile where privatization is accelerating; and requests for assistance in this process are increasing. The World Bank publication, Privatization: the Lessons of Experience, states that in the last decade nearly 7,000 firms have been moved from public hands to private hands. That figure will pale in comparison to what will transpire over the next ten years. The countries of eastern Europe and the former Soviet Union alone will have transactions that none of us could have imagined perhaps just a year ago. Between 1990 and 1991 the proceeds from the sale of enterprises worldwide more than doubled, from $25 billion to more than $53 billion. Mexico alone has received over $8 billion from sales to date and the statistics continue to mount.

The drive to accelerate the pace of privatization transactions is fuelled by several factors. First, political pressures in newly emerging democracies like those of eastern Europe demand that the pace of economic transformation match that of political transformation. In other words, political stability is dependent upon economic stability. Witness Poland and other countries, where success or failure of the economic reforms dictate how voters will choose who might lead them. Demonstrated success in the privatization process is necessary to persuade voters that the reforms are worthwhile and that the better future promised them is, if not immediate, within view. This gives rise to what I call the 'window of opportunity syndrome' -- that is, the reforming governments feel a tremendous pressure to move as rapidly as possible to privatize firms lest a dissatisfied populace close the window too early.

Fiscal pressures also dictate the pace of the privatization process. Governments strapped for cash have no alternative but to stem the fiscal haemorrhage caused by ill-advised subsidies to non-productive assets. We, the donors, press for speed as we use the numbers of privatized firms as a benchmark to request additional funds from our taxpayers to support the process.

The price of failure

While the focus on transactions is certainly justified by these and other factors, there are other concerns that I feel beg for our attention. For instance, what if we fail? Overly rapid privatization can lead to failure. I think of the example of Chile during the 1970s
as instructive to all of us. Many enterprises were privatized rapidly. The privatized firms took on a huge debt burden with funds borrowed from the government to acquire those assets. The companies, however, were too weak in many cases to withstand the recession of the early 1980s and as a result, they failed. When they failed, they reverted to government ownership, requiring in the late 1980s and the early 1990s that the government once again go through the privatization process. Having occurred once, can the phenomenon repeat itself in a different place with different problems?

I don’t predict that rapid privatization will have that result everywhere, but I think it is time for us to pause long enough to consider the broader impact of how we are pursuing these transactions. The privatization transaction is not an end in itself but part and parcel of a broader goal of creating competitive firms within competitive industries, and able to compete in a global marketplace. As political transformation requires the underpinning of institutions for it to succeed, so too does economic transformation. It is of little value to transform a public monopoly into a private monopoly or to privatize firms into an environment where failure is probable. Statistics show that most privatization success stories come from high or middle income countries where the institutional infrastructure tends to be more developed, where the macro-economic framework tends to be better, and where the capacity to regulate tends to be higher.

Building the broader market

Another way of saying this is that privatization tends to succeed where competitive markets exist. As we all know, competitive markets do not exist in most places where we are investing donor resources. And investing we are! Hundreds of millions of dollars of donor funds are being invested in the policy reform efforts of more than 100 countries around the world. As we make these policy investments and as we pursue privatization transactions, I wonder if we are being sufficiently forward-looking about how we invest these limited resources. The goal of the transformation process is to create competitive firms within competitive industries, and it is in this area that we need to be particularly cautious in emphasizing the speed and the number of transactions. A successful strategy may well require sacrificing some of the speed and some of the proceeds in favour of long-term stability. While investment bankers may be attracted to a property that has substantial market power, we should question whether or not that particular transaction benefits the wider economy.

A more thoughtful approach to privatization and one which, in my opinion, deserves close attention is one currently being taken by the Polish Ministry of Ownership Transformation. It is using a number of expert advisers to deal with target privatization sectors. For example, the US government is providing advice on the divestiture of 34 firms in the Polish glass industry. Initially, the advisers are evaluating the entire industry, its structure, its size, its value, its potential competitiveness. Only after this initial work is complete will the government begin a series of appropriate privatizations within the sector. In my opinion, this sectoral view comes close to providing a much more comprehensive approach to the impact of privatization and the future of a target industry within a country.
Some have criticized the process as too slow – I would say that experience will speed the process. Some feel there is too much central planning reminiscent of former days – but then it is important for privatizing governments to pay very close attention to the strengths and the weaknesses of the components of its industrial structure and not merely to privatize in a vacuum. It is essential that governments adjust the policy environment to assure that privatized industries are operating in a competitive market-oriented environment.

Reassessing our objectives

I would note that in any particular country there are many donors, and most if not all promote policy reform. This leads me to ask, of the hundreds of millions of dollars being invested in economic reform, how much is being invested directly in conjunction with the privatization of specific sectors. I know that the transaction-driven policy reform process is being used in many sectors, particularly power and telecommunications, but is enough of it occurring? Are we careful to look at the full range of issues that impact on an effective privatization? When we privatize a company or an industry, are we at the same time co-ordinating the development of the requisite financial market for that sector? Are we working to assure that needed capital is available? Is there another industry, perhaps one that provides raw or semi-finished goods, whose successful privatization is a pre-requisite to the success of other industries?

I do not know the answers to these questions but I think that raising these questions, and I hope answering them, is important to the long-range success of the economic and political expansion that we seek to support. With the severely constrained donor resource flows available, we owe it to both ourselves and to the people we seek to assist to maximize the rate of return on the investments being made.

I would challenge you to help me find the answers to some of these questions, because I firmly believe that how we go about privatizing the companies of this world has implications for both the near and long term viability of the economic and the political development of huge numbers of people.
4. Privatization of infrastructure

Ibrahim Elwan
Manager, Private Sector Financial Operations, World Bank

Privatization emerged as an objective in the developing countries only out of necessity, after they recognized that the restoration of macro-economic balance would dictate the rationalization of public sector expenditure. Wherever you see today agreements with the multilaterals or international organizations supported by all donors, you will see as a central theme an emphasis on the reduction of government expenditure, a rationalization of the capital market and a more prudent fiscal and monetary policy to be pursued over a short time horizon. The demands of these economies continue and the only option is to seek the private sector with its knowhow and its financial resources.

Background economic conditions

Before turning to the privatization of infrastructure, I would just like to take a few moments to outline where we are today. In the developing countries, similar to the industrialized countries, the post-independence era put on governments the need to restore a sense of equity, a sense of investment, a concentration on industrialization and the promotion of exports, a better utilization of extractive industries, and so on. All of these have necessitated heavy investments and consequently governments started to assume the principal role of developing their economies – supported, I may say, by the multilaterals and bilaterals.

Examples are available throughout the world of how these responsibilities have grown. In Mexico in the 1950s there were eleven state economic enterprises; prior to the privatization move there were 4,000 economic enterprises owned by the government. Egypt had seven public enterprises in the 1950s and today it has 8,000 such enterprises, the bulk of which is causing the government great losses and absorbing over 60% of annual public expenditure.

We will not go too deeply into the reasons why governments are compelled to bail these enterprises out but it is important to mention the lack of financial discipline, the
pursuit of independence that prompts governments to build industries that are unviable, the concentration on import substitution and the use of public enterprises as a means of masking economic policy failures by generating new jobs. Finally, there is the inability of state economic enterprises to generate the revenues, or the unwillingness of governments to let them retain their profits should they secure them, to finance their growth and introduce new technologies.

We are now aware of these problems throughout the world. Today every economic policy calls for privatization. The successes achieved by the industries that have been privatized in Britain, and in New Zealand and other places, have given a strength to policy-makers in the developing world to pursue the same policies. We all are supportive of it; but let us remember that Britain’s success in privatization had elements which in most countries are missing. Britain has always had a cadre of capable technicians, policy planners, commercially oriented managers, a fully functioning and a fully operative capital market. So does New Zealand. To a large extent, successes in the developing countries which try to emulate the practices in the industrialized countries have been concentrated in telecoms, because of its foreign exchange earning potential and the possibility of introducing new technologies that leave economic rent to re-invest and generate a healthy rate of return. There have been other successes in the extractive industries, in the export industries; and these are where we should start.

The capital markets in the developing world are constrained, they are thin, they are unable to accommodate the vast investments that are needed in order for the private sector to take hold and to begin to assume its role as an agent of growth. Entrepreneurs in the developing countries are very scarce and too unsure to assume the risks that are involved. The de-regulation of the economies that are pursuing privatization has not been complete. Sustained help from the outside to the countries pursuing privatization has been long on advice but very short in terms of actual resource transfer for privatization.

**Infrastructure finance**

Let us now concentrate more on infrastructure. Power, water, telecoms and transport account for over 60% of any developing country’s expenditures. All require massive capital investments, which cannot be mobilized from the countries themselves. But equally the risks involved in having these massive capital transfers into the developing world cannot be underestimated. There is a need for deregulation of the capital market; there is a need for a regulatory framework to be in place and fully functioning; there is a need for the capital market within the country itself to be able to mobilize local investments and local savings; there is a need for the exchange rate risks to be moderated in a consistent manner; there is a need for pricing mechanisms and pricing structures that recognize the need to cover costs fully and for the private sector to secure rates of return that are competitive; and there is a fundamental need on the part of the policymakers to understand that the private sector will only invest in a country if its rate of return is competitive with alternative uses elsewhere. There is no such thing as dollars earmarked for Ghana or deutschmarks earmarked for Egypt or pesos earmarked for Mexico. We basically have one international capital market and policymakers must recognize the fact that these investments will not come unless the
entire framework is in place, that the private sector’s interest has to be protected, and that its ability to function must be unhindered by intervention from government.

We come now to the role which the multilaterals could play. Today out of the $20 billion being lent by the World Bank and the $10 billion by the Asian Development Bank and the $3 billion by the European Bank, very little is filtering to the private sector. We have yet to come up internationally with vehicles and instruments by which we can truly support the private sector. We are asking developing countries to open their economies, but at the same time we are asking the private sector to assume greater risk. Unless a partnership develops between the private sector and the multilaterals and the bilaterals, the potential for success through privatization in the developing world, particularly in the non-export industries, will be constrained.

I do not believe that in the next five to ten years the developing world will be able to mobilize the resources needed to sustain its growth, to meet the increasing demand for public services and for infrastructure, or to provide the base for growth, if there is no fundamental change by all donors in the way by which we are channelling the resources. Virtually all of the resources being channelled, 90%, are directed to developing countries under government guarantees. In other words, we are actually asking governments to assume the full risk of borrowing from these institutions – but why should policymakers be adding to the national debt and then handing it over to the private sector? So there is a need today for us to create new instruments which will leverage the resources available with the multilaterals to provide long-term financing for the private sector to undertake the heavy investments needed in the infrastructure sector.

I think there is a greater need for guarantees to the private sector against risks which the private sector cannot bear. Risks such as the transfer risks, foreign exchange risks, expropriation risks, failure by government to live up to its obligations in terms of pricing, in terms of labour policies, in terms of enabling laws, taxation, or customs duties: all of these elements which the private sector cannot control but which are essential for the proper operation of a private sector in a developing country. These are the areas where the multilaterals and the bilaterals should be joining forces to seek ways to leverage their resources by bringing in risk capital from the commercial community and the international financial markets.

I do not believe that the infrastructural needs of today could be met solely by the private sector. We estimate that $200 billion is required over the next five years for investment in power alone. But if we are to look at the resources flowing into the developing world for infrastructure, they account only for 40% of all the lending of the multilaterals. If we are to increase this flow of resources, then we must devise means to support it. Unless the international community finds a means by which we can design instruments to protect the private sector, we are not going to be able to deploy its considerable resources upon the policy initiatives that we are implementing in the developing world.
entire framework is in place, that the private sector's interest has to be protected, and that its ability to function must be unhindered by intervention from government.

We come now to the role which the multilaterals could play. Today out of the $20 billion being lent by the World Bank and the $10 billion by the Asian Development Bank and the $3 billion by the European Bank, very little is filtering to the private sector. We have yet to come up internationally with vehicles and instruments by which we can truly support the private sector. We are asking developing countries to open their economies, but at the same time we are asking the private sector to assume greater risk. Unless a partnership develops between the private sector and the multilaterals and the bilaterals, the potential for success through privatization in the developing world, particularly in the non-export industries, will be constrained.

I do not believe that in the next five to ten years the developing world will be able to mobilize the resources needed to sustain its growth, to meet the increasing demand for public services and for infrastructure, or to provide the base for growth, if there is no fundamental change by all donors in the way by which we are channelling the resources. Virtually all of the resources being channelled, 90%, are directed to developing countries under government guarantees. In other words, we are actually asking governments to assume the full risk of borrowing from these institutions -- but why should policymakers be adding to the national debt and then handing it over to the private sector? So there is a need today for us to create new instruments which will leverage the resources available with the multilaterals to provide long-term financing for the private sector to undertake the heavy investments needed in the infrastructure sector.

I think there is a greater need for guarantees to the private sector against risks which the private sector cannot bear. Risks such as the transfer risks, foreign exchange risks, expropriation risks, failure by government to live up to its obligations in terms of pricing, in terms of labour policies, in terms of enabling laws, taxation, or customs duties: all of these elements which the private sector cannot control but which are essential for the proper operation of a private sector in a developing country. These are the areas where the multilaterals and the bilaterals should be joining forces to seek ways to leverage their resources by bringing in risk capital from the commercial community and the international financial markets.

I do not believe that the infrastructural needs of today could be met solely by the private sector. We estimate that $200 billion is required over the next five years for investment in power alone. But if we are to look at the resources flowing into the developing world for infrastructure, they account only for 40% of all the lending of the multilaterals. If we are to increase this flow of resources, then we must devise means to support it. Unless the international community finds a means by which we can design instruments to protect the private sector, we are not going to be able to deploy its considerable resources upon the policy initiatives that we are implementing in the developing world.
Choosing candidates

I come now to the next issue. Let us look today at countries that have gone through a process of transformation, that have been operating under a coherent reform plan, that have invested in the pursuit of economic independence and that are today trying to privatize. They still have some industries today that, if you put them on the street free of charge, the private sector still would not buy. There are economies of scale that would not be secure and there are losses that cannot be absorbed by the private sector.

But the question that is important today in the area of privatization is: do we all, as a developing world, go to the market simultaneously to sell all of our industries, or do we rationalize amongst industries and begin to be selective, and move in a phased way from corporatization gradually towards privatization as the market gains confidence? Today we are moving at such a speed to sell public holdings that the markets are unable to carry it. Failures are right now becoming more common than successes not because of the unwillingness of the governments to sell but because of the inability of the market -- local and international -- to make the size of investments that are needed to turn these industries around.

I believe a two-tier approach is needed. We follow the policy of deregulation, we follow the policy of liberalization, we follow the policy of developing the framework for the private sector to operate, we create the enabling environment for it fully; but we must also begin to assist developing countries in recognizing what industries, if put on the market, would be successfully privatized in the shortest possible period, rather than letting them believe that it is possible to privatize all their industries in one go.

In Poland we saw plans for mass privatization followed by sequential privatization followed by cluster privatization -- the names have been grand but the realities have not been overwhelming. In the developing world, people are now saying that holding companies are the solution to the ailing industries. I believe that in many cases holding companies are nothing but another excuse to hide the sick behind the healthy, nothing but a means by taking loss-making enterprises and putting them together with the profit-making enterprises that can be privatized in order for the whole to look not as bad as it used to look. In some countries, holding companies have allowed policymakers to postpone privatization. We are guilty throughout the world of making resources available for the creation of new entities more elaborate than the ones we have started, which are in fact working against privatization.

But the World Bank have started with a new approach of providing guarantees to the private sector. These guarantees are aimed at taking some of the risks which we are more able to identify and bear, leaving commercial risks, completion risks, and operation risks to be borne by the private sector. We have started in two or three pilot projects, but I believe the future calls for a greater concentration by the multilaterals on such guarantee systems and on sharing the risks between the public sector and the private sector than has been the case in the past. These will not succeed unless there is also a fundamental change in the bilateral systems and in the export credit facilities that are being provided to the developing world today. Rarely do we see today a willingness by the export credit agencies to lend at limited recourse to the private sector; but we need export credits with sovereign guarantees. The ECGB was the first
to recognize the need for limited recourse financing for major projects, though to date only extractive industries and export oriented industries have gained from this scheme. The industries which badly need the transfer of technology, and the private sector which badly needs flows of resources of long duration and long tenancy, have not benefited. Unless these issues are addressed, I believe we will not meet the targets set for ourselves when we started on privatization.
5. Privatization in Sweden

Per Westerberg
Minister of Industry and Commerce, Sweden

As the British journalist and historian Paul Johnson has pointed out, the twentieth century can be described as the century of the state, the century when the state interference in civil society and market was enlarged in a way never seen before. But also it was the century when the state's ability to hurt and destroy grew faster than its ability to make good. I believe this is a correct description.

The implementation of the so-called welfare state, with its extensively large public sector, high taxes and many regulations, is one clear expression of how the state's power has been extended. Political regulations and state intervention was seen as the means to promote social welfare. In recent years, almost every Western country has suffered from the results of these policies. Instead of promoting welfare, the state has been threatening economic growth and the basis for welfare and jobs. In political decision-making, the necessary incentives for creating a new welfare have been sometimes forgotten.

Changed thinking

But during the last two decades, I would say the renaissance of the ideas of Adam Smith have changed this political and ideological climate. Today no-one will deny the fact that welfare can never be created through political decision-making alone. Individual freedom, private property and free enterprise are values that must be protected in order to get a free and prosperous society.

The concept of privatization must be viewed as an expression of this enlightenment of the late twentieth century. Privatization, taking the state out of the market, leaving the private sector, is re-establishing an order in which individual freedom and welfare will be increased and the state's role will be to set up and monitor the basic legislation that defines the market framework.
The economic background

The Swedish government views the programme for privatization of state-owned companies as an important part of the economic strategy to get Sweden back on the track of economic growth. The Swedish economy today finds itself in a very deep recession. Industrial production and investment have declined; for three years the economy has not recorded any growth and as a consequence there is now a steep rise in the number of unemployed and an increased budget deficit. Since the beginning of the 1970s, Swedish wage-earners have had almost no increase in purchasing power if one takes into account inflation and taxes. Because of that, in recent years the ratio of Swedish indirect investment abroad and foreign investment into Sweden has been running at 10:1. Foreign enterprises and investors have not found the Swedish business climate good enough for investment and for locating production inside Sweden, and neither do Swedish business companies, I regret to say.

Of course we are all affected by the international economic recession but to a major extent the present problems in the Swedish economy are home-made. I would say that the foundation was laid in the late 1960s. For almost two decades the public sector expanded much more rapidly in Sweden than in other countries in the Western hemisphere. Socialist-oriented politicians used this public sector growth artificially to reduce the level of unemployment in Sweden compared with many other countries. As a result of this, the Swedish tax burden climbed to a record level. This of course stunted the incentives to work, reduced savings and discouraged enterprises. It also expanded the realm of uncontrollable costs and resulted in the high inflation of the 1980s in Sweden. Public services in Sweden were organised from the beginning as huge monopolies and like all monopolies, private or public, they tended to get fat over the years. I would say that even the transfer payment system tended to be a bit overgenerous, which had had a negative effect on productivity as well as public expenditure.

Today we have to cope with these internal structural problems but also with the international recession and the challenges caused by the European single market and the economic transformation in central and eastern Europe. I would say these four challenges are at the same time opportunities for us if they are handled in a correct manner. If not, they can be disastrous for our economy.

Therefore we now pursue a policy for change and renewal in the Swedish economy. We cannot and will not be able to run away from this task. The present Swedish government has said that every single decision made by the government has to be able to be justified by its positive impact on economic growth and the general business climate. The government's freedom to choose policy is of course very restricted because we have a very open economy. We have to walk a long way with budget cuts, privatization, deregulation, more competition and tax reduction in order to promote growth, decrease the level of unemployment and secure lower inflation and lower interest rates. I would say this is the only way because every other way will lead to higher unemployment, higher budget deficits and an even worse economic situation in the future.

Sweden's privatization policy

Our economic policy could be described in four key phrases. These are: full
membership in the European Community and access to the European integrated market; strategic tax cuts in order to promote savings, investment and enterprise; a tight fiscal policy with budget cuts for lower inflation and lower interest rates; and deregulation and privatization of state-owned companies and utilities in order to increase competition and economic efficiency in our country.

As Minister of Industry and Commerce, it is my responsibility to carry out the privatization programme. It is one of the Ministry’s main policy areas. Besides this we also deal with the creation of more favourable and more competitive conditions for small and medium-sized companies, increasing competition throughout the economy and stimulating industrial research and development.

All our efforts in these various areas will improve the business and industrial climate in the country. For example, we have made some strategic tax cuts in order to stimulate the growth of small and medium-sized companies. These companies were perhaps the heaviest taxed companies in the Western world before the present government came into power. But now, capital tax will be abolished within two years, and our ambition is to create the basis for a more efficient and private venture capital market. New laws on deregulation and competition legislation will be based upon the European Community legislation, with special provisions achieve competition and privatization within the public sector at the same time.

We can see many good reasons to privatize state-owned companies and utilities in Sweden. Firstly, we believe that the privatization will make the companies stronger and much more competitive. New private owners can, for example, provide the necessary support for strategic and forward-looking operations which the state never will be able to do. Job opportunities and economic vitality will be improved when the companies are liberated from political control. And the UK experience is that the privatized companies generate increased tax revenues without raising the tax rates.

Secondly, through privatization we streamline the role of the state in society and in relation to business and industry. Only the state can establish, maintain and monitor the basic legislation that defines the market framework: the problem arises, however, when the state also operates as an actor in the market through ownership of companies. This entails a major risk of an overlap in the various roles for a government. We see that privatization would clarify the state’s role in society.

Privatization gives us an opportunity to spread the private ownership throughout the whole society. We believe a healthy market economy requires a widespread ownership. In our larger sales we will give priority to company employees and the Swedish public, but of course at the same time, Swedish and foreign investors are welcome to participate in the privatizations.

Fourthly, revenue from the privatization sales will release capital that can be used for infrastructural investments in roads, railroads, airports and telecommunications, science and higher education -- or just to reduce the national debt. In other words, through privatization the state switches from one form of asset to another in a way which strengthens the nation’s overall competitive power.
Practical steps

In an enabling measure, Parliament has already granted the government the right to privatize 35 state-owned enterprise groups. Thanks to this general decision, we do not have to introduce a separate parliamentary bill for each sale. This will, I think, increase the efficiency in carrying out the programme and even the taxpayers will of course benefit from this decision.

We will only privatize commercial companies acting in a market with competition. No natural monopolies will be sold in Sweden. Public utilities will first be constituted as corporate entities, then their public role will be separated out and their areas of operation will be deregulated and opened to competition. After the completion of these measures, they can be privatized. An example of this process is the power generating company of Vattenfall, one of the biggest power generating companies in Europe. On 1st January 1992, Vattenfall was constituted as a corporate entity. The following spring, Parliament passed a bill on deregulation of the electricity market which will increase the competition between producers and distributors of electricity. When this process is completed and we have got a more competitive market and even better connections to the markets for electricity outside Sweden, the privatization of Vartermfall can start. The Swedish telephone system will be treated in exactly the same manner and we already foresee that we will have three fully competing telephone companies in Sweden during the coming years.

The 35 companies listed in the enabling measure are very different from each other. We have, for example, a food and medical producer, we have steel, a mining company, the big power generating company and odd activities like the state training school for dogs! Because of this variety, every privatization must be a very unique one. The specific needs of each company will be of central concern if every privatization is to be a success. For every sale, the present business conditions in the relevant market must be taken into consideration. The privatization must strengthen each company. And of course every sale must be a good deal for the buyers and the present owners, the taxpayers. But every sale must at the same time be regarded as a part of a larger scheme. The good reputation of privatization is essential for a successful continuation of the full programme.

Early experience and future ambitions

The first privatization sale of any size, our state steel company, took place in Spring 1992. The approach used here was to offer the public and the institutions, both Swedish and foreign, the chance to acquire state bonds with detachable options to buy shares during a period of 18 months. We have chosen this method because it fits the present steel business cycle. That is favourable for both the company and the taxpayers but the method must be considered as unique to this company in this situation and in this recession. The next sale will be different one way or another because a different company has different needs and will face different business conditions.

It is now obvious that this first privatization offer is a big success in Sweden. There have been more interested individuals and institutions than there were units of bonds and options to sell -- and even more than the banks thought it was possible to sell. More than 100,000 individual buyers registered for more than 200,000 units.
Unfortunately only 67,000 units were offered to the Swedish public in this sale.

But the privatization programme is a long-term one. It stretches over several electoral periods and our ambition is to introduce two big sales annually, one in the spring and one in the autumn, with smaller direct sales in between.

Of course, the programme will be conducted on the basis of conditions in the venture capital market. For this reason alone, it is important that we are successful in our effort to stimulate both overall individual savings and foreign investment in Sweden. Therefore of course we welcome foreign capital in the privatized companies.

On my appointment as a Minister, one of the very first measures I introduced was to remove the obstacles to foreign businesses in Sweden. We need more foreign investment and the Swedish economy must therefore of course be open for foreign enterprises and investments. Privatization of state-owned companies is useful for this.

Organizational features

In Sweden we have a system in which every sale of every company is prepared by a special project group. Each group consists of representatives from the Ministry of Industry & Commerce and the company itself. Different external advisers are used, depending on the specific needs of the company, for the preparing and restructuring. By using external advisers, we manage to carry through the preparations, the valuations and sales with only a very very small staff of Ministry officials. Our ambition is to have close co-operation with the companies’ boards, management and employees during the whole process. Such an approach will underline the overall aim of privatization: to make the companies more vital and more able to grow and be more competitive.

Before the government makes the final decision on a sale, we consult our special advisers in the Privatization Commission. It is roughly the same system they have in France. This Commission, appointed by the government, consists of nine highly experienced senior persons, mainly from the business community. Its function is to give advice on the price and structure of every sale. It will help guarantee that every privatization sale is accomplished professionally in a manner which is profitable for the company, the buyers and the taxpayers.

I am very satisfied to see in the report from the OECD in the latest Economic Outlook, that it regards our government’s privatization programme as a central contributor to economic development in Sweden. I would say that this verifies our view on the programme as a major part of the strategy to re-establish growth and enterprise in the country.

In a cross-nation study referred to by The Economist, the World Bank concludes that privatization is successful, with hardly any exceptions. This only confirms every country’s practical experience from privatization. Some of our political opponents used to say that our privatization programme was designed by blind dogmatists. I think they forget that privatizations are being carried out all over the world, no matter the political colour of the government. Among the supporters of privatization, one way or another, we today find the Socialists in France and the Socialists in Spain. They are just
Like governments and politicians in other countries, like the Centre-Right government in Sweden -- in favour of privatization because privatization is good for the companies, the employees, the taxpayers and for the whole economy. And this is the very reason why we are now carrying out one of the biggest privatization programmes, as a proportion of our GNP, to be found anywhere in the Western world.
6. Privatization in Turkey

Üstün Sanver
Chairman, Public Participation Administration, Turkey

Let me talk briefly about the role of the state in the Turkish economy, and then review the developments that took place in the last decade which now have brought Turkey to a position where the government can pull out of the economy wholly -- with the exception of a few areas like some strategic industries, probably parts of defence, health (which can also be done jointly with the private sector), social security and national security, and probably still primary education.

A mixed economy

Turkey was never a centrally planned economy without a private sector. When the Republic was first formed in 1923 there were not enough entrepreneurs, nor enough accumulation of capital, so the state had to do certain services and establish certain industries. But this changed with the 1950s. Even though the state’s role never really went below 50% of the economy, entrepreneurs emerged and a lot of major companies in the areas of textiles, contractors, manufacturing, and service areas also emerged. Right now we do have a mixed economy and we do have the framework to operate as a fully competitive economy with all the institutions of a market economy.

In the last decade, starting in the 1980s, there were some major steps taken towards the liberalization of the economy, mainly by reducing tariffs on imports, then taking measures to develop the capital market, the establishment of the Istanbul Stock Exchange, the formation of the Capital Market Board, establishing the Central Bank’s role as an independent institution, introducing independent auditing and financial reporting standards, taking certain monetary measures to develop the foreign exchange markets and the local economy, including the encouragement of a very competitive banking sector and some more recent steps taken towards the full convertibility of the Turkish lira.

Of course all these steps, along with some major investments in the areas of infrastructure like telecommunications and transportation, have made Turkey a very conducive environment to attract foreign capital.
Turkey in the world economy

Before getting into some specific details about the Public Participation Administration’s privatization plans for the next five years, I would like to stress a couple of important points that I believe are important in understanding Turkey’s position.

Of course Turkey is in a very strategic position located between the East and West, the Middle East and Europe, and currently between the recently independent states of the former Soviet Union and the Balkans. The nations around the Black Sea and the governments of the Turkish Republics of the former Soviet Union have signed a cooperation agreement under the Black Sea Cooperation Zone concept.

The role we believe we can play in that specific region is that the former Republics of the Comecon countries, positioned on the Western part of the former Soviet Union, once had long trade relations with the Central Asian Republics, which are major producers and suppliers of raw materials; but the links that used to exist under the former Soviet system do not really exist any more. So we believe that the Black Sea Cooperation Zone can be an important facilitator to re-introduce the trade channels between these two groups of countries. Of course Turkey has very well established ties with the Central Asian Republics, both cultural and linguistic ties, and more recently some very important business relations. Turkey’s long history of trade with the former Soviet Union also, I think, provides a useful opportunity for Turkey in this context.

Three-phase privatization programme

Currently we do have a very experienced private sector, a large local market with about 60 million people and a very young workforce, so we are at a stage when we can really start a massive privatization programme in our country. The previous privatization activities in Turkey that started in 1986 until the end of 1991 generated about $870 million of revenue for the state through public offerings, buy-outs and trade sales. Since the beginning of this year, with the new government, this activity has been speeded up.

We now have a three-phase programme. With the first phase we are trying to sell the state’s share where the state is a partner to private enterprise. We have done some successful privatization activities there, and that is ongoing.

On the other hand we are also trying to sell groups of companies in various industry groups which are more than 90% owned by the state, in some cases 100% owned by the state. Eleven cement factories are for sale, representing about 15% of the cement market. The government has transferred to the Public Participation Administration the ownership of four major state-owned companies which are active in agricultural industry: the state dairy products company; the state meat, poultry and fish distribution and processing company; the feedstock companies; and the forestry products companies. We are going to be through with the analysis and evaluation process with these companies soon and will then be able to recommend a strategy to the government on how to proceed on privatizing these companies.

In the meantime we are also working on some larger state-owned companies. They are
not on the privatization programme schedule for this year but we are working on the legal framework to privatize them, especially as far as the anti-cartel regulations are concerned; and those companies are in the areas of petrochemicals, energy, telecommunications and transportation. We believe that following the sale of the cement factories and decisive action on how to privatize the agro-industry companies we shall be able to move into the state-owned steel companies, petroleum distribution (where the state has still a 52% share), and telecommunications, where we think that the telephones can also be privatized within the next 24 months and where we are selling the state’s stake in two telecommunication companies which are already run by foreign shareholders which are partners in those operations.

The decade of the investor

We aim to generate $10 billion over the next five years through privatization. We will also try to reduce the state’s role to the areas that I initially specified. Of course we do have certain obstacles in front of us. We have a very young population. Most of the state-owned companies are overstuffed and it sometimes is difficult to act very decisively considering the social and political potential ramifications that might emerge.

But it is a very competitive time to attract foreign capital; most of the formerly centrally planned economies are trying to privatize thousands of institutions, as are some other countries which probably were not centrally planned but are under heavy pressure from the previous decade’s debt. They are all competing to attract foreign capital.

So in an environment like that, it is going to be the decade of the investor. That is why I agree with some of the initial points that were made by Dr Pirie. Of course one should not sell an enterprise for nothing if it is not worth nothing -- but on the other hand we really dare not hesitate and think too much on how to proceed. The sooner those companies are in private hands, the better will it be for those companies.

Of course, in Turkey, there is a very strong foreign capital presence and the legal system for foreign investment is very conducive to attract foreign investment, so we feel relatively comfortable with our privatization efforts simply because we have done our homework. We have done all the necessary steps, at least most of the necessary steps, in the previous decade and have prepared ourselves. We have been talking about privatization for the last seven or eight years so I think the coming years are going to be a good decade for Turkey; and we shall attract a lot of knowhow and new technology, along with new capital, to our privatization efforts.
7. Privatization in Romania

Adrian Severin
President, National Agency for Privatization, Romania

The dilemmas in privatization

The big dilemma of privatization is: is privatization a political process or a commercial process? Our answer in Romania is that this is a political process. Privatization is important not because we can obtain good prices and a good income for our budget from selling the state companies, but because it produces a wholesale global re-structuring of our economy -- and more than this, a re-structuring of attitudes, a re-structuring of behaviour.

Another dilemma is: should we start immediately with privatization or should we wait until the population is sufficiently educated and prepared? Our answer is that we have to start as fast as possible. Of course we have to focus attention on education, on public information, but I believe that the best way to learn is to start doing. I think that people are smarter than we believe and they can well appreciate how a market economy is in their interest.

Another dilemma: should we start by liberalizing prices, wages, rates of interest, rates of exchange; or should we start by privatizing? This was a big dilemma and it is still a dilemma in Romania. Of course theoretically we can have several approaches. But I think that liberalization should start sooner because otherwise we cannot have a proper information about the performance of companies; and it is better to start liberalisation of prices, of wages and so on while privatization is accomplished, since we have all realized that privatization is not such a fast process, unfortunately.

Should we start on privatization or should we wait until the demonopolization is accomplished? Some of us consider that private monopolies are even worse than state monopolies, especially when these private monopolies are the successor or the former state monopolies. I think that this is true, but anyhow we cannot wait for demonopolization, and I think that privatization is in fact a vehicle for demonopolizing.

Another dilemma: privatization first, or valuation of enterprises first and afterwards privatization? I think that it is useless to waste time and money valuing enterprises at the desk. Of course a valuation is necessary, an orientative one -- but nevertheless the
market is what finally will show us the real value of the enterprise to be privatized. That is why I would not advise wasting too much time and money evaluating.

Another issue: privatization or macro-economic stabilisation? How can we privatize, ask some experts, in a country where we are witnessing a high rate of unemployment, a high rate of inflation? Indeed this is a big problem, and it is difficult to sell companies when inflation is very high; but nevertheless I think we have to adapt ourselves to this situation.

Privatization versus restructuring is another big dilemma. To restructure first and afterwards to privatize; or to privatize and afterwards to restructure? I think that a very flexible case-by-case approach in this area is most suitable. I cannot believe that we can formulate a general rule. I think sometimes restructuring is necessary because it is rather difficult to sell something which is nobody is prepared or willing to buy, and to this end we have to restructure. But whenever it is possible to privatize before restructuring, I think we should leave the task of restructuring on the shoulder of the private owners because they know better what and how to restructure than the state ever would.

The lessons of experience

Of course the answers I have tried to give these dilemmas were the answers which have been chosen in Romania. Trying to make a synthesis of these answers, I would say that a multi-track approach is necessary, to combine the different methods and different policies in order to give an answer to all these problems and to all these contradictory dilemmas. A simultaneous start in solving these matters is also a possibility; but it requires choices much like the physician makes when we are suffering with several diseases and the best medicine for one is wrong for the other one. Finally, we have always to look to the next best solution and not to ideal solutions.

I think that in trying to give an answer to these questions and to solve these dilemmas, we have to believe more in people than in the state. I am sure that people are able to solve the matter better if they are free to be involved in the process of privatization and restructuring. That is why I think that it is not right to assume that privatization in eastern European countries is a failure: rather, the expectations have failed, not the privatization. We have to improve the management of expectation and not to slow down the process of privatization.

The momentum of privatization

The second topic will be about the speed and momentum of the privatization -- is it a secondary problem or an essential problem? I think that speed is essential for privatization and I would give you just two reasons in this respect. We have to privatize, we have to change quickly so as not to leave the people the possibility to come to the conclusion that before -- during the Communist regime -- was better than now. They are not so patient; they have waited decades and decades for an improvement and now when they see that at first it is getting worse rather than better, they are losing their enthusiasm. And that is why they are not supporting any more our political efforts.
Secondly, I think that we have to make this change and to achieve privatization as quickly as possible before the counter-reformist forces reorganize themselves and start to fight against the implementation of the reforms. Indeed the speed of the reforms and of privatization cannot be directly and fully controlled by the government, but I think that in this respect mass privatization is a must because it is the only way to speed up the privatization in a reasonable manner.

Legal and institutional systems

The third problem I would raise is the relation between the systemic reform and structural reform. We have already accomplished in almost all of the eastern European states, and especially in Romania, a systemic reform. We have changed the legal framework, the institutional framework and so on. But the new system comes into collision with old structures; and from this point of view I think that privatization is the best vehicle for changing the structures -- the economic structures, the social structures, the mentality structures, the managerial structures.

We have established different systems of privatization. A case-by-case system gives us the feeling that things are moving on. It can provide us very quickly with some success stories and success stories are very good to keep up the level of support both inside and outside our country. But a case-by-case approach, I think, is not everything and it is not the most important approach. A systemic approach, a mechanism which could work more or less in an automatic way, in a natural way until the privatization is a global process, is, I think, a better approach. Of course we have to combine these two to provide some successful cases and we are starting in Romania a so-called pilot privatization programme in order to provide people with these success stories, but on the other hand we have necessarily to build up a system of institutions able to assure the success of privatization as a global and systemic process.

Ingredients for success

What does the government need in order to be successful? Four things are quite important. First, a good concept; second, skilled civil servants; third, enough financial resources; fourth, political will. I am not going to comment on these. What I can say about Romania is, let’s agree that we have a good concept, let’s accept that we have political will and popular support. Definitely we lack skilled civil servants, and more than this, we lack financial resources. Privatization, if it is successful, is due not only to the concept but to the financial resources involved. This is a very important problem.

What do people need in order to be successful in privatization? I think information inputs and financial inputs. We will not be able to achieve privatization if we are not able to build up a system of institutions which can provide the people with these kind of inputs.

Foreign investment conditions

Finally, why invest now in our country? Why aid our country in order to achieve
privatization? This is a crucial question because, since the financial resources are missing, since the private national capital is also missing, since it is necessary not only to privatize but to rehabilitate state companies, to assure fresh capital enters the country, it is obvious that foreign investment and foreign aid is crucial.

I think this is the right time to invest in Romania and in all central and eastern Europe. The market is being born, and I think that it is much better to build together from the very beginning this new market in accordance with your standards, since your standards are the standards of developed economic democracies.

No longer do you have the protection of the Berlin Wall in order to defend western Europe against the wild east. So, consequently there is only one alternative. Either the western civilization based on the recognition of the private ownership, free market prices, civil rights and political pluralism, will conquer the wild east — or the wild east civilization inherited from the former communist regimes and based on poverty, frustration, stagnation, disequilibrium and false gods will conquer the west.

If we are to build a new stability, both of us should co-operate. After years of Communism, we have a better sense of the danger, a better taste of the risk, a better perception of the possibilities; and we do not believe any more in communist ideologies. After eradicating communism in eastern Europe, I think it is necessary to eradicate it in western Europe; and to replace it everywhere with a real economic and political democracy. The only way for mankind to achieve happiness is freedom and welfare, since freedom without welfare is in vain and welfare without freedom is in peril. This is the big danger: what is in vain could be abandoned and what is in peril could be lost.
Brazil has led economic growth in Latin America since the war, based on the model of import substitution and state-led growth. This policy fared quite well in Brazil, which has grown since the war by almost 8% per year, and I think it is one of the few less developed countries with a very complete and a very modern industrial sector.

But as a result of this policy, we ended up with a closed economy; industry in Brazil was highly protected and the state was present in almost all sectors of the economy. This policy of growth at any cost was possible when we could borrow in the foreign markets, though as a result of that we accumulated a large foreign debt. As international rates skyrocketed and Mexico faced the 1982 foreign exchange crisis, foreign savings disappeared from Brazil, making it clear that this import-substitution and state-led growth model could not be sustained. Unfortunately it took us ten years to change the model, to recognize that we could not proceed growing at that pace. That is why we called the 1980s in Brazil the ‘lost decade’ in which we saw growth decline from 8% per year to 2.1% per year, almost the same rate as population growth in Brazil.

In March 1990 when President Collor took over the situation, the country was on the verge of hyper-inflation and economic chaos. He announced a set of structural reforms to modernize the Brazilian economy. The idea was that growth now should be in the private sector and should be followed by a more even distribution of income than we had during the 1970s or after the war. I must say that few presidents in Brazil, and I should think few statesmen in the world, would have had the courage to sacrifice the short term in the name of medium and long term growth; and he was never afraid to fight vested interests. I think that many of the political problems that we are facing in the government in Brazil now are the reaction of these vested interests. But I must say that two years later, even the Opposition has to admit that most of the economic reforms that he proposed during his campaign have either been instituted by the Executive, by the President himself, or have been sent to Congress for implementation.

The programme combines both a stabilisation programme and a modernization programme for the Brazilian economy. The difficulty that we have as compared to
other countries is that we are conducting those two programmes at the same time. This is different from other countries, where they have been able to stabilise the economy first and then start modernizing the economy, opening the economy and privatizing. In Brazil we did not have the proper conditions to stabilize the economy so we decided to conduct both programmes at the same time, with the thought that one should boost the other. As inflation falls, we have more interest in privatization and we speed up the reforms; and as the reforms speed up, given the medium and long term scenario, they help to stabilize in the short run. But this is definitely one of the difficulties that we have.

Stabilization policy

Inflation in Brazil has gone down from almost 100% per down to 20% per month. It is too high for all international standards and it is too high also for our targets and our ambitions, but certainly there is no risk of hyper-inflation in Brazil any more. There is a general consciousness now in Brazil that a further and permanent decline in inflation rates depends upon the speed of modernizing reforms, in the sense that government has done most of its part and we expect Congress to approve the remaining proposals.

Between those modernizing reforms, we have suggested and sent to Congress an important fiscal reform that involves a lot of constitutional amendments but which should reduce corporate taxes, enlarge the tax base, simplify and reduce the number of taxes and also improve the distribution of revenues and expenditures between the federal, state and local governments. The general feeling is that only with this fiscal reform and the speeding up of the structural reforms, will we consolidate any decline in inflation rates or achieve any recovery of economic growth.

Structural reforms

Brazil has opened its economy to foreign trade and foreign investment by eliminating all non-tariff barriers to trade, and by establishing a gradual tariff reduction for the next two years that should reduce the average tariff from 40% to 15% by mid-1993. (The reason why we have done that so gradually is to give time to our industry to prepare itself for international competition.)

This opening up of the Brazilian economy has been occurring at the same time that we are producing a trade surplus of $1 billion and our foreign exchange reserves have increased to more than $15 billion. So the fear that a lot of people had that opening the economy should get us into a foreign exchange crisis never happened, much the contrary.

Also, we opened the access of foreign investors to Brazilian stock markets and vice versa.

The second structural reform is the new industrial policy that aims to promote competition, both domestic and international, and technological innovation. We want competition, efficiency and productivity to substitute for the oligopolies, privileges and
market restrictions that dominated the Brazilian economy during the 1960s and 1970s. For this purpose we have a new industrial policy in Brazil. We are democratizing the access to all medium and long term financing, and offering more favourable conditions to projects that improve the competitiveness of the Brazilian economy and involve some technological advance.

The third structural reform – and that is where privatization comes in – is redefining the role of the Brazilian state in the economy. We want the Brazilian state out of the productive sector and more concerned with the basic needs of the population. Brazilian society, after 21 years of military rule, demands that from the Brazilian government.

The first reduction of the government intervention is that we have deregulated the Brazilian economy. We have now abolished all price controls. In Brazil, since we had a highly concentrated industry sector, we had price controls for years and years. We have now free markets as we never had in the past.

The second reform within the reduction of the role of the state is the privatization programme. We have three targets in our privatization programme. The first is to reduce public debt: in fact all revenues from the sales of state enterprises have to be used for the reduction of public debt. Also we want to use privatization as part of our new industrial policies, so we are stimulating competition in the economy, splitting companies, restructuring as much as we can in order to improve competition through privatization. Third, we have a very small capital market, but within it we want to promote wider share ownership, democratizing capital (which is also very concentrated because of our growth model of the past).

Privatization mechanisms

Differently from other countries, we have a general privatization measure in Brazil which was approved by Congress, so we don’t have to go to Congress on a case-by-case basis. This law establishes very rigid norms for each process of privatization. We have to have two private consultants hired by public tenders to evaluate the companies, so we have two independent evaluations, and each process has to be overseen by independent auditors also hired by public tender. If we follow this in each process, then Congress has given us, the Privatization Committee, authority to decide both on the minimum price of the company and also on what model should be used for each privatization.

The Privatization Committee reports directly to the President, having been placed above all our state companies and above all the ministries in order to avoid conflict. It has 12 members of which seven are from the private sector, so you might say we have privatized the Privatization Committee!

The Privatization Committee has a lot of power according to the law. It conciliates the targets of the programme: reduction of public debt, investment, increasing competition and democratizing capital. At the same time, it suggests suitable privatization candidates to the President; the President approves the suggestions of the Committee and also recommends the conditions of sale.
The second agent in this programme is the BNDES, the National Bank of Economic and Social Development, which is the manager of the programme; it executes the decisions of both the Privatization Committee and the President. It supervises and does all the managing work, consulting, supervising, and hiring consultants and auditors for each of the privatization operations.

Progress to date

We have completed ten auctions. We have privatized ten companies, and have recommended the closing of two other companies. We started with Brazil's biggest steel company on 24 October 1991, almost 18 months after the President Collor had taken over. We had riots in the streets, we had to delay the auction for one month, we had actions in court to deal with.

Since our first privatization target was one of the most profitable and one of the most productive steel companies in the world, however, it set the tone of our privatization programme -- in which we are not privatizing just the money-losing companies for fiscal reasons, but showing that we wanted to really change the role of the Brazilian state in the economy.

These ten privatizations and two closures realized about $2.8 billion. Besides being able to reduce the debt by about $3 billion, we have transferred those companies with another $1 billion of debt, so the total debt reduction that we have achieved is $4 billion. Also we have transferred to the private sector about 25,000 employees. And the premium that we obtained varies from zero in the case of a small fertilizer company to 160% in the case of the manufacturer which produces cars for subways. The average premium was about 23%.

Of course the revenue obtained looks modest if compared to other countries. Brazil has obtained only $2.8 billion of revenue in privatization as compared to Mexico (almost $20 billion) and Argentina. I would like to explain why.

First of all, if we take the case of Mexico, it has more than 60% of the privatization revenue coming from the banking sector which was nationalized in 1982. The banking sector in Brazil has never been nationalized, and has always been in the private sector. Also telecommunications are another important source of revenue, both in Mexico and Argentina; we cannot privatize the telecommunications sectors in Brazil for the time being because of a constitutional impediment. The same constitution that created restrictions to the fiscal management of the economy also impedes privatization of both telecommunications and the oil sector. So if we take the case of Argentina, we see that most of the revenue comes from telecommunications and oil, which we cannot privatize. If we take industry, then Brazil of course is doing well; the only thing that we can privatize for the time being is our industry.

The other point I would like to make is that Brazil is using the revenue from privatization for debt reduction, but if we look at what has been done in Mexico and Argentina, most of it has been used for current expenditure: in Argentina about 30%, in
Mexico almost 100% for debt reduction.

We have selected the steel, chemical and fertilizer sectors as the main sectors for privatization and we expect to complete this privatization by mid-1993. Of course we have included companies from other sectors as well. But the reason why we have selected the steel, fertilizer and petrochemical sectors is because of the importance of the state in those sectors.

We accept several currencies to be used in privatization. We accept them directly in exchange for shares of Brazilian industry. Since we had to reduce public debt, we decided to accept Brazilian debt, both domestic and foreign, directly in exchange for shares in the auctions. However, out of the total payment in terms of debt, the foreign debt has been very insignificant, around 1% of the revenue. This is largely because, according to the law, the participation of foreign capital is limited to 40% of the voting capital; and also because foreign debt trades at 25% of face value, while the domestic debt is accepted in exchange for the shares at par.

Obviously these factors limit the participation of foreign capital, although foreigners can still participate by using domestic debt; even though it may not be attractive to use foreign paper, they can go into secondary markets and buy domestic debt.

We are trying to eliminate these restrictions to foreign capital. The first one to tackle is the 25% discount for foreign debt. We expect now, as Brazil is concluding its renegotiation of the foreign debt with the banks, that this will be re-examined and that the conclusion will change the 25% into acceptance at near face value. Then there is the limitation of the 40% of the voting capital: a constitutional amendment has gone to Congress to eliminate all discrimination between domestic and foreign enterprises, so if this is accepted by Congress, the restriction on the 40% is eliminated automatically. We had other restrictions, for example that capital had to stay in Brazil for twelve years; we reduced this to six years and we are presently thinking about reducing it to two years or one year. There were restrictions on both the sale of the stock and also on the remittance of profits and dividends which have also been eliminated in the last six months.

**Future plans**

We expect, as I mentioned, to conclude the privatization of the steel, petrochemical and fertilizer sectors by mid-1993, along with the sale of small companies in different sectors of the economy. It is important to say that we have included now the railroads, and we are now hiring consultants to evaluate the company and suggest how they should be privatized.

How do we intend to widen our horizons and move ahead? First of all we want to get into public services and infrastructure, so now we have approved in Congress two bills for the transfer of public sector services to the private sector and modernisation of the port system. (The labour legislation in the port system in Brazil dates from the 1930s and Brazilian ports sometimes have costs that are about four times international costs. We have to change this and we have to change it through Congress; the government
has not the power to do that by decree so we have submitted this bill to Congress.)
Also we have sent to Congress the constitutional amendments for opening up
telecommunications and oil to the private sector and we are including new companies
in the programme. We have recommended to the President to include two electricity
distribution companies that belong to the federal government and also the only bank
that belongs to the government.

I think that Brazil should earn the credit of the international financial community for
conducting such broad and ambitious reforms in the country. We do not have a lot of
the advantages that other countries have; we do not have a majority in Congress and
we are fighting for constitutional amendments that we need two-thirds of Congress to
approve. We do not have the dominance of any single political party; we have not gone
through the traumas of hyper-inflation that make people more eager for changes.

So, if we compare the Brazilian privatization programme and structural reforms to
other countries, I would have to say that we have a long way to go and our road will be
probably more gradual, more difficult. But I am very confident that as the results of
privatization start to show -- we have now 67% of public support and in the beginning
we had less than 50% -- we expect that as the results can be translated into benefits for
the population in general, and that Brazil will recover economic growth and be able to
establish a position of leadership among the less developed countries.
Other ASI Publications

The Manual on Privatization
Edited by Dr Eamonn Butler and Dr Madsen Pirie

The comprehensive guide to all aspects of privatization, drawn from the papers in Mechanics of Privatization, Privatization in Practice, and Privatization Now! -- with new material by Eamonn Butler and Madsen Pirie and a guide to UK privatization advisors by Peter Young. Experts go through the different techniques and processes of privatization that have been used all over the world in all sectors - industry, utilities, infrastructure, local services, and more.

UK Price £75 (£79 elsewhere)

The Mechanics of Privatization
Edited by Dr Eamonn Butler

Leading experts from around the world explain the 'nuts and bolts' of privatization -- its benefits, how to deal with interest groups, choosing the best strategy for each service, and managing the sale. Case studies are presented by the chief executives of the newly privatized industries themselves. From the First London Conference on Privatization.

UK Price £45 (£48 elsewhere)

Privatization in Practice
By Rt Hon Lord Lawson, Sir Bryan Carsberg, David Clementi, Dr Robin Bomer, Gerry Grimstone, and others

The themes addressed by these distinguished privatization experts at the Second London Conference on Privatization include Privatization by share issues with a case-study of the British Airways privatization, Protecting the Consumer featuring the de-regulation of British Telecom, Alternative Strategies for developing countries, and Utilities and Infrastructure which explains the private financing of the Channel tunnel project.

UK Price: £45 (£48 elsewhere)
Privatization Now!

With contributions from John Redwood MP, Chris Patten, Sir Paul Beresford MP, Laurie Brennan, Peter Muth, John Eccles, Roger Leeds, and others.

From the Third London Conference on Privatization, these papers look at the political objectives of privatization, spreading popular capitalism, privatization without stockmarkets, reviving industrial losers, contracting-out local services, and private finance of infrastructure. The role of the development agencies in privatization is reviewed.

UK Price £55 (£58 elsewhere)

Privatization and Economic Revival

Rt Hon Lord Howe, Dr Ernest Stern, Henrietta Holsman-Fore, Dr HR Zayyad, Dato Seri Sami Vellu, Krysztof Stupniki, and others

Strategies for privatization in developing and post-communist counties, including the use of the fund and voucher concepts and contract management of state industries as steps towards privatization. Case studies of commercialization in Africa, Malaysia, South America, and Europe. Creating capital markets, drawing up the legal and accounting framework, and introducing competition into state monopolies are all explained.

UK Price: £65 (£68 elsewhere)

Privatization: Theory, Practice, and Choice

By Dr Madsen Pirie

Systematically reviewing ‘the most significant economic fact of our age’, the leading privatization policy analyst explains the twenty two different methods of privatization and commercialization, with practical examples of each. Key elements of a privatization strategy, such as designing it to overcome opposition from vested interest groups, are explained and illustrated.

UK Price: £28.50 (£30 elsewhere)

Privatization: East and West

With contributions form Rt Hon Peter Lilley MP, Dr Madsen Pirie, Brian Pomeroy, Vicky Pryce, Guy de Selliers and others.

East European Ministers and Western Bankers, investors and advisors review the experience of economic reform and assess what lessons can be drawn. From the Fifth London Conference of Privatization.

UK Price: £65 (£68 elsewhere)