

Privatization in Chile

An Economic Appraisal

Dominique Hachette
and
Rolf Lüders



International Center for Economic Growth

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An International Center for Economic Growth Publication

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PREFACE

Since the mid-1970s Chile has undergone a massive privatization program, transferring more than 550 state-owned enterprises from the public to the private sector. *Privatization in Chile* is the first study to provide a detailed and rigorous account of the economic impact of this unprecedented wave of privatization. Here Dominique Hachette and Rolf Lüders examine exactly what privatization has meant for efficiency, employment, government revenues and expenditures, the capital market, and savings and investment in Chile.

Privatization may be an idea whose time has come, but its net effects are often difficult to determine and obscured by preconceived notions and biases. On the one hand, critics of privatization claim that it causes unemployment and leads to disparity in capital ownership. On the other hand, proponents claim that it increases economic efficiency and strengthens capital markets. In this volume Hachette and Lüders take on both sets of assumptions, showing that ultimately the effects of privatization depend on how the process is carried out.

Based on Chile's experience with privatization, unique in its scope, Hachette and Lüders extract policy lessons that are essential for anyone who works on or studies the privatization of state-owned enterprises around the world.

Nicolás Ardito-Barletta
General Director
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D. H. and R. L.

LIST OF ABBREVIATIONS

AFP	administradora de fondos de pensiones (pension fund administration company)
CAP	Compañía de Acero del Pacífico (Steel Company of the Pacific); after 1981, Compañía de Acero del Pacífico S.A. de Inversiones (Investment Steel Company of the Pacific)
CAPM	capital assets pricing model
CCNI	Compañía Chilena de Navegación Interoceánica (Chilean Interoceanic Navigation Company)
CCU	Compañía de Cervecerías Unidas (United Breweries Company)
CGEI	Compañía General de Electricidad Industrial S.A. (Industrial Electric Company)
CHILECTRA	Compañía Chilena de Electricidad S.A. (Chilean Electric Company)
Chile PAC	Red Pública de Transmisión de Datos (Public Network for the Transmission of Data)
CHILGENER	CHILECTRA Generación (CHILECTRA Generation Company)
CHILMETRO	CHILECTRA Metropolitana (Metropolitan CHILECTRA)
CHILQUINTA	CHILECTRA Quinta Región (CHILECTRA-Fifth Region)
CIDCOM	Compañía de Telefonía Móvil (Mobile Telephone Company)

CIEPLAN	Corporación de Investigaciones Económicas para Latinoamérica (Latin American Economic Research Corporation)
CMET	Complejo Manufacturero de Equipos Telefónicos (Telephone Equipment Manufacturing Complex)
CNE	Comisión Nacional de Energía (National Energy Commission)
CNT	Compañía Nacional de Teléfonos (National Telephone Company)
CODELCO	Corporación Nacional del Cobre de Chile (National Copper Corporation of Chile)
CONAF	Corporación Nacional Forestal (National Forest Corporation)
COPEC	Compañía de Petróleos de Chile (Petroleum Company of Chile)
CORA	Corporación de la Reforma Agraria (Agrarian Reform Corporation)
CORFO	Corporación de Fomento a la Producción (State Development Corporation)
CPI	consumer price index
CTC	Compañía de Teléfonos de Chile (Telephone Company of Chile)
CTM	Compañía de Teléfonos de Manquehue (Telephone Company of Manquehue)
DFL	decree with the force of law
DL	decree law
ECA	Empresa de Comercio Agrícola (Agricultural Trading Company)
ECOM	Empresa Nacional de Computación e Informática Ltda. (National Computer and Information Company)
EDELAYSÉN	Empresa Eléctrica de Aysén (Electric Company of Aysén)
EDELMAG	Empresa Eléctrica de Magallanes (Electric Company of Magallanes)
EMEC	Empresa Eléctrica Coquimbo S.A. (Electric Company of Coquimbo)

EMEL	Empresa Eléctrica de Melipilla, Colchoque, y Maule S.A. (Electric Company of Melipilla, Colchoque, and Maule)
EMELIG	Empresa Eléctrica La Ligua (Electric Company of La Ligua)
EMELMA	Empresa Eléctrica Maule (Electric Company of Maule)
EMPRESMAR	Empresa Marítima del Estado (State Maritime Corporation)
ENAE	Empresa Nacional de Explosivos (National Explosives Company)
ENAMI	Empresa Nacional de Minería (National Mining Company)
ENAP	Empresa Nacional de Petróleo (National Petroleum Company)
ENDESA	Empresa Nacional de Electricidad S.A. (National Electricity Company)
ENTEL	Empresa Nacional de Telecomunicaciones (National Telecommunications Company)
FFCC	Ferrocarriles del Estado (State Railway)
FONDECYT	Fondo Nacional de Ciencia y Tecnología (National Science and Technology Fund)
GDP	gross domestic product
GISP	General Index of Share Prices
GNP	gross national product
IANSA	Industria Azucarera Nacional (National Sugar Industry)
INFORSA	Industrias Forestales S.A. (Forest Industries)
ISAPRE	Institución de Salud Previsional (Social Security Health Institution)
ITT	International Telephone and Telegraph Corporation
JAC	Junta de Aeronáutica Civil (Civil Aeronautics Board)
LADECO	Línea Aérea del Cobre (Copper Airlines)
LAN Chile	Línea Aérea Nacional-Chile (National Airline of Chile)
LIBOR	London Interbank Offering Rate

MRP	stock market risk premium
ODEPLAN	Oficina Nacional de Planificación (National Planning Office)
PEM	Programa de Empleo Mínimo (Minimum Employment Program)
POJH	Programa de Obras para Jefes de Hogar (Program of Employment for Heads of Families)
SAESA	Sociedad Austral de Electricidad S.A. (Austral Electricity Company)
SEBI	Sistema de Estadísticas Básicas de Inversión (Investment Basic Statistics System)
SIC	Sistema Interconectado Central (Central Interconnected System)
SIIC	Standard International Industrial Classification
SING	Sistema Interconectado del Norte Grande (North Interconnected System)
SOE	state-owned enterprise
SOQUIMICH	Sociedad Química y Minera de Chile (Chemical and Mining Society of Chile)
TELECOM-Chile	Telecommunications Chile S.A.
UF	unidad de fomento (production unit)
VTR	Vía TransRadio

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Introduction

After the 1930s, the economic systems of many countries of the world were characterized by growing government intervention and, in particular, by a spectacular increase in public ownership and management of economic activities. Supporters of state intervention usually justified this trend using the concept of market failure, an explanation that became fashionable after the Great Depression and received strong intellectual support from John Maynard Keynes. They argued that several factors made government involvement necessary, including natural monopolies for the production of socially valuable services, the technological characteristics of those services, and capital market imperfections in the presence of large economies of scale. They also argued that public enterprises could be used to stabilize employment and to improve the lot of the poor through subsidized prices and wide distribution of certain social services.

Serious and superficial arguments were mingled, but the available empirical evidence could not justify growing government involvement. In most cases, these arguments were ingeniously used to support power-hungry individuals and political parties in the name of improving social conditions, a peculiarity of the post-Depression period that was most pronounced after World War II in many developing countries.

Over time, however, events have revealed serious weaknesses in public enterprises (and in government intervention in general). Public

firms are often mismanaged, and they frequently contribute to high public deficits and inflation. The market failure argument also loses force in the face of not only technological changes that reduce the importance of natural monopolies but also the strengthening of capital markets and of the private sector in general, which allows the latter to carry out projects even vaster than those of the traditional public sector. Furthermore, gross inefficiency in the distribution of public services resulted in flagrant contradictions with redistributive objectives, while management inefficiencies prevented public enterprises from attaining either internal efficiency or allocative efficiency, although in some cases they achieved technical efficiency, which, for some reason, many considered sufficient and even saw as an object of pride during the 1970s.

A reaction against the widening grip of state enterprises set in both in developed countries such as England and Spain and in developing countries like Bangladesh and Chile. This book tells the story of the Chilean process of privatization. Our main objective is to explain in some detail why privatization occurred, how divestitures were carried out, what difficulties were encountered, and what conditions were imposed to ensure efficiency in both private and public enterprises. We will also describe other aspects of the preparation of state-owned enterprises (SOEs) for privatization and the effects of privatization on government revenues and wealth, savings and investment, the capital market, employment, distribution of property, and management. This account emphasizes the role of the major structural changes carried out by the military government that came to power at the end of 1973, in particular those designed to shift economic functions to the private sector, which would become the main—though not exclusive—actor in the new strategy for development.

This is neither a theoretical nor an ideological book. Our intention is to present as candid and objective a study of the divestiture process as possible, in the hope that the views and experiences narrated here will benefit other countries that are either pursuing or considering SOE privatization. It is not a recipe book or a do-it-yourself divestiture manual. We have aimed for a positive rather than a normative approach, to reduce the scope of value judgments, which have usually colored the general issue of private versus public property. In so doing, we hope to clear up some misconceptions on the subject.

The Significance of the Chilean Experience

The case of Chile is particularly interesting, given the large share of public enterprises in gross domestic product (GDP) when the process of

privatization began and the depth of the process itself; with the divestiture of about 550 enterprises between 1973 and 1988, SOE participation in GDP fell from 39 percent to 16 percent (Tables 1.1 and 1.2).

Until the Great Depression of the 1930s, state enterprises played a limited role in Chile. After the depression, however, and until the military takeover in late 1973, most Chilean administrations intervened heavily and increasingly in the economy. Part of that intervention took the form of the creation and management of state enterprises. In this respect, the State Development Corporation (CORFO, a state-owned development bank) became an important instrument. During its initial years, it created several large corporations related to the steel industry (the Steel Company of the Pacific, CAP), the sugar beet industry (the National Sugar Industry,

TABLE 1.1

State-Owned and State-Managed Enterprises in Selected Years, 1970-1989
(number of enterprises)

	1970	1973	1983	1989
Enterprises related to CORFO	46	571	24	24
Subsidiaries	46	228	23 ^a	24 ^b
State-managed enterprises	0	325 ^c	0 ^d	0
Banks	0	18	1	0
Other state-owned enterprises	20	22	21	18
Other financial institutions	2	2	2	2
CODELCO	0 ^e	1	1	1
Total	68	596	48 ^f	45

NOTE: See Appendix A for a list of enterprises included in the different categories of this table. CORFO is the State Development Corporation. CODELCO is the National Copper Corporation of Chile.

a. In 1979, two enterprises in which the state participated were created: *Compañía Chilena de Litio* and *Télex-Chile*.

b. Between 1983 and 1989 the following fourteen new SOEs were formed as a result of the breakup of existing companies: *Empresa Eléctrica de Aysén*, *Empresa Eléctrica Colbún-Machicura*, *Empresa Eléctrica del Norte Grande*, *Empresa Marítima del Sur*, *Empresa de Servicios Sanitarios de Tarapacá*, *Empresa de Servicios Sanitarios de Atacama*, *Empresa de Servicios Sanitarios de Coquimbo*, *Empresa de Servicios Sanitarios del Libertador*, *Empresa de Servicios Sanitarios del Maule*, *Empresa de Servicios Sanitarios del Bío-Bío*, *Empresa de Servicios Sanitarios de la Araucanía*, *Empresa de Servicios Sanitarios de Los Lagos*, *Empresa de Servicios Sanitarios de Aysén*, and *Empresa de Servicios Sanitarios de Magallanes*.

c. Excludes state-managed enterprises (*compañías intervenidas*) in which CORFO had a minority interest, which are included in the group of subsidiaries.

d. After September 1973, 350 state-managed enterprises were returned to their owners, most of them during 1974.

e. Although CODELCO did not exist, the state owned 50 percent of the big copper companies. It acquired this percentage when it invested in foreign-owned companies during 1970 as a result of the Chileanization process.

f. This does not include more than fifty "odd sector" enterprises indirectly managed by the state, which fell into government hands during 1983 as a result of government intervention in some financial institutions and which were privatized before 1989 (see Chapter 4).

SOURCE: CORFO.

TABLE 1.2
Share of State Enterprises in Sectoral GDP, 1965–1988 (percentage)

Sector	1965	1973	1981	1988
Mining	13.0	85.0	83.0	n.a.
Industry	3.0	40.0	12.0	n.a.
Utilities	25.0	100.0	75.0	n.a.
Transportation	24.3	70.0	21.0	n.a.
Communications	11.1	70.0	96.3	n.a.
Finance	0.0	85.0	28.3	n.a.
All state enterprises and public administration	14.2	39.0	24.1	15.9

n.a. = not available.

SOURCES: C. Larroulet, "Reflexiones en Torno al Estado Empresario en Chile," *Estudios Públicos* (Winter); Embassy of the United States in Chile, (Santiago, 1985); authors' estimates.

IANSA), the energy sector (the National Electricity Company, ENDESA), and others. Later, CORFO took over several privately owned corporations that could not service the large CORFO credits they had received.

During the 1930–1973 period, other large state enterprises were also created, including the Agricultural Trading Company (ECA), the National Mining Company (ENAMI), the National Petroleum Company (ENAP), the State Maritime Corporation (EMPRESMAR), and the National Airline of Chile (LAN Chile). In 1970, sixteen of these "giant" SOEs were functioning. In addition, the government engaged in a large-scale land reform program toward the end of the 1960s, expropriating and managing many farms. At the same time, it "Chileanized" (purchased a 50 percent share of) existing large copper companies.

Tables 1.1 and 1.2 show the number and scope of state enterprises toward the end of the 1960s. In 1965, the SOEs produced 14 percent of GDP, although in some sectors—utilities and transportation—they produced up to 25 percent of sectoral GDP. The total number of state enterprises (excluding the expropriated farms and the Chileanized mines) in 1970 stood at sixty-eight, still a rather limited number.

Until the late 1960s, despite growing opposition, the expansion of the state enterprise sector had not become an issue, although the land reform was a point of contention. The election of Salvador Allende, a Marxist-socialist, in 1970 changed that climate. Nevertheless, the nationalization of the remaining shares of the big foreign copper companies still received unanimous legislative support. The reaction against the large state enterprise sector began when the government accelerated the land reform program, intervened in the management of industrial

enterprises—legalized by a never-used decree law issued in the 1930s during the 100-day “socialist” government¹—and purchased a controlling interest in most of the wholesale distribution and financial firms of the country.

Between 1965 and 1973, the number of companies controlled by the state grew from 68 to 596, excluding the expropriated farms. Of these enterprises, 325 were state-managed industrial firms (*compañías intervenidas*) and 18 were banks;² they included the most important industries in the country and almost all the financial institutions (Table 1.1). The expropriated farms included more than 60 percent of irrigated land. The relative share of the state enterprise sector exploded to 39 percent of GDP in 1973, encompassing 100 percent of utilities and more than 85 percent of mining and financial services (Table 1.2).

Chile’s privatization experience has been unique in both scope and diversity. In a First Round of divestitures (1974–1979), nontraditional public enterprises were divested. Many of these firms, however, returned to public control in the midst of a major financial crisis and depression (1982–1983), only to be privatized again in 1984 and 1985. In a Second Round (1984–1989), the large traditional public enterprises were privatized. Other unusual aspects of the Chilean experience include, first, its new rules for public firms, which not only stimulated efficiency, but also served as preparation for divestiture, and second, the ingenious variety of privatization modes.

Main Conclusions

Although our conclusions will be explicitly detailed and supported in every chapter of the book, it may be useful to highlight here what we consider to be the main results of our analysis of the Chilean divestiture process. On the whole, the process of privatization was successful in distributing property ownership; it stimulated the private sector to improve efficiency; it opened new investment opportunities and created new responsibilities for the private sector; and it helped reduce practical and psychological dependency on the powerful and pervasive public sector. The process was also successful in converting critical and antagonistic groups, convincing them of the benefits of privatization. In doing so, it reduced the risk of reversibility despite significant changes in the political setting when the military government transferred power, after elections, to a democratic government. The latter recognized the validity of the privatization process and is even following in the steps of its predecessor, though at a more modest pace.

Errors were committed in the process of privatization. Some were predictable; others were unavoidable; and still others, put forward by some critics, were nonexistent. The most repeated error—though not unique to Chile—appears to be the lack of transparency in divestitures. Although we do not believe this affected the fiscal impact of privatization in any relevant way, it raised eyebrows, to say the least, and provided ammunition to groups that felt they were not given fair access to SOE stock being divested and ideological groups opposed to any notion of privatization. This lack of transparency appears to have been, in retrospect, the main shortcoming. The authorities, however, learned from their experience and, even with respect to this issue, made improvements that had some bearing in the later divestitures.

The success of privatization in Chile resulted from the political and economic environment and from the diversity of divestiture modes. A president who held power for seventeen years and was firmly convinced of the economic and political significance of privatization ensured the relative constancy of the process. Although the presence of a military government may appear to have been favorable for maintaining constancy, it should not be forgotten that critical views were voiced within the military establishment: autarkism and interventionism were two favorite war-horses. The views of the president, General Augusto Pinochet—that democracy could be strengthened only with widespread property ownership, a strong private sector, and a public sector in a subsidiary role—ultimately prevailed.

The economic situation in the early stages of privatization and through the 1970s was favorable to the process. The large fiscal deficit and high inflation inherited from the socialist government, caused partly by public enterprise losses, were convincing factors. Then, structural changes carried out by the new authorities strengthened competition, stimulated the capital market, freed prices and interest rates, improved resource allocation, and raised investment levels, creating a propitious environment for divestitures. The financial crash and deep depression of 1982–1983, with its concomitant reversal in privatization, was largely overcome by the beneficial impact of the institutional changes implemented in the 1970s, which came to maturity in the 1980s when the largest divestitures occurred.

Finally, the diversity of modes of privatization ensured that objectives as varied as maximizing government revenues and spreading property ownership—two important goals favored by both supporters and opponents of privatization—were met. A price had to be paid to spread property; however, it does not seem high, given the extent of property distribution obtained so far and the growing political support the process of privatization has earned.