PUBLIC ENTERPRISES IN PERU

Public Sector Growth and Reform

Alfred H. Saulniers

Westview Special Studies on Latin America and the Caribbean

Public Enterprises in Peru

Public Sector Growth and Reform

Alfred H. Saulniers

Westview Press
BOULDER & LONDON

Westview Special Studies on Latin America and the Caribbean

This Westview softcover edition is printed on acid-free paper and bound in softcovers that carry the highest rating of the National Association of State Textbook Administrators, in consultation with the Association of American Publishers and the Book Manufacturers' Institute.

Published in 1988 in the United States of America by Westview Press, Inc.; Frederick A. Praeger, Publisher; 5500 Central Avenue, Boulder, Colorado 80301

Library of Congress Cataloging-in-Publication Data
Saulniers, Alfred H., 1945–
Public enterprises in Peru.
(Westview special studies on Latin America and the Caribbean)
Bibliography: p.
Includes index.
1. Government business enterprises—Peru. I. Title.
II. Series.
HD4123.S28 1988 338.7'4'0985 87-34602
ISBN 0-8133-7565-7

Printed and bound in the United States of America

The paper used in this publication meets the requirements of the American National Standard for Permanence of Paper for Printed Library Materials Z39.48-1984.

6 5 4 3 2 1

Preface

This book helps fill the void in teaching materials about the Latin American public sector. It began as two case studies of public enterprises jointly carried out by the Office for Public Sector Studies of the University of Texas at Austin, which I directed, and the Universidad del Pacífico in Lima. Over the years, the cases expanded into a detailed analysis of the overall growth and dynamics of Peru's rapidly changing government portfolio. The resulting book focuses on the external environment for public enterprise action and develops an interlinkage framework to explain the dynamics of company growth, finances, efficiency, and profits in response to changes in that environment.

The manuscript took shape during a year's leave from the Austin campus, during 1983 and 1984, spent in East Africa in association with the Eastern and Southern African Management Institute in Arusha, Tanzania. The strong, positive reactions from government officials and public enterprise managers of Kenya, Tanzania, and Uganda to the lectures I gave about the Peruvian case testified to the broader applicability of the interlinkage framework in explaining company behavior and led to publication in Tanzania of an early version of excerpts of the sixth chapter (Saulniers, 1985f).

After my return to Austin, Richard Webb, then President of Peru's Central Bank, and Carlos Zuzunaga, President of the Peruvian Center for Applied Research, with assistance from the Friedrich Ebert Stiftung, provided me a unique opportunity, namely a forum to test out my ideas about Peru's public enterprises' relationships to the government before a group of Peruvian public enterprise managers and government officials. The debate during the two-day seminar proved lively, the criticisms well founded, and the experience both enlightening and humbling. The published results of the seminar have fueled the debate about the role of public enterprises in Peru from 1968 to 1980

(Saulniers, 1985g).

A six-week stay at the Universidad del Pacífico, under the auspices of the Fulbright Commission, enabled me to update the material in the manuscript and provided countless opportunities for discussions with colleagues there, at other universities, and throughout the government. My seminars to public enterprise executives at Pacífico and at the Graduate School of Business, ESAN, forced me to revise my ideas about the influence on decision making of time constraints and other pressures faced by managers in actual practice. Additionally, my lecture in the Applied Workshop Series sponsored by the Friedrich Ebert Stiftung gave me the chance to pull together several of the more provocative themes, having a broad Latin American impact, for presentation to a highly qualified Peruvian audience (Saulniers, 1985e). The spirited exchange contributed to further revisions and, hopefully, to a more meticulous book.

This book would not have been possible without the encouragement and support of Bill Glade who, as Director of the Institute of Latin American Studies, was instrumental in shaping the debate about the nature of the public enterprise process in Latin America. He urged publication of preliminary findings from chapter six as part of the Technical Papers Series of the Office for Public Sector Studies (Saulniers, 1985h). His keen interest in the evolution of the Peruvian portfolio and its meaning for understanding the *problematique* of public enterprises spurred me to detail the Peruvian evolution in a more thorough fashion than available elsewhere, while remaining conscious of the implications of the evolving paradigm for public enterprise studies in general.

Outside of Peru, several colleagues, eminent pubic enterprise or public administration scholars and practitioners in their own right, have read all or parts of early drafts of the manuscript. They include Gene Bigler in Washington, Edwin Jones in Jamaica, James Katorobo in Tanzania, V.V. Ramanadham and Barbara Grosh in Kenya, Enrique Saravia in Brazil, and Henry Dietz, Bill Glade, and Larry Graham in Austin. Former students, Peruvians and Peruvianists, read the manuscript as well, including Brian Branch, Louis DiSipio, Greg Estep, Luis Fernández, Conrad Herold, and Julio Revilla. While the manuscript draws much of its strength from the detailed and pointed comments of these readers, any remaining deficiencies are mine. Finally, successive generations of students in my graduate seminar in public sector studies at the University of Texas provided a testing ground for ideas and, by sharp questioning, forced me to hone the arguments and better the exposition. Greg Estep proved an excellent graphics consultant and translated some of the numbers into forms with higher visual impact than the original tables.

In Peru, my debts are legion. For reasons that become apparent in the text, many of my sources, both inside and outside of government, cannot be individually acknowledged. My institutional ties, however, since 1970, remain a matter of public record and provide a general way of expressing thanks by using institutional precision to cover individual anonymity. To my colleagues at the Banco Central de Reserva, Escuela Superior de Administración para Graduados, Instituto Nacional de Planificación, Ministerio de Economía, Finanzas y Comercio, Universidad Católica, Universidad de Ingeniería, and Universidad del Pacífico, I owe a debt of thanks. They have all, in some way, contributed to the outcome of this book. Public enterprise officials, some of whom may not be included in the above, willingly provided their time to answer questions and to provide hard information. This book is clearly in their debt.

My wife, Suzanne, and daughter, Catherine, have long suffered time demands caused by various drafts and revisions. Suzanne read several versions of the manuscript, offering up many worthwhile suggestions. Catherine provided drawings to lift my spirits. It is to them that I dedicate this book.

Alfred H. Saulniers

Peruvian Exchange Rates: 1968-1984

Year	Soles per dollar (Year-end)
1968	43.36
1969	43.57
1970	43.41
1971	43.38
1972	43.38
1973	43.38
1974	43.38
1975	45.00
1976	69.37
1977	131.56
1978	196.68
1979	250.75
1980	342.61
1981	506.97
1982	989.67
1983	2,271.17
1984	5,695.98

SOURCE: Central Bank Annual Reports.

Contents

Tables

Graphs and Figures

GRAPHS

FIGURES

1

Introduction and Overview

INTRODUCTION

In 1958, when *Fortune* magazine first included a directory of large industrial corporations outside the United States, its top 100 companies included only five government-owned firms and none came from a developing country.[1] By the mid-1980s, the *Fortune* lists of the top 500 companies regularly contained more than sixty government-owned firms, with more than twenty in the top 100, many of them from the developing countries, especially from Latin America.[2] In 1983, two of the top ten Brazilian firms were government owned as were three in the Dominican Republic, four in Mexico and Venezuela, five in Argentina, and seven in Peru.[3] This book examines public enterprise[4] growth and development in one Latin American country, Peru.

Prior to 1970, public enterprises remained a neglected topic of analysis for Latin Americanists. The recent advent of annual *Fortune*-like country-specific and continent-wide industrial listings, has made their role more apparent. These show that Latin America shares a common characteristic with other areas: the importance of public enterprises in infrastructure and basic industry. However, the standard approach of concentrating on large infrastructure and industrial firms neglects an essential consideration: in Latin America, public enterprises do everything. According to records of the Office for Public Sector Studies of the University of Texas at Austin, Mexico, in 1981, had almost 250 public enterprises in manufacturing; 155 firms in finance, insurance, real estate and business services; 62 in wholesale and retail trade, restaurants and hotels; and lesser numbers in transport storage, and communications, agriculture, hunting, forestry, fishing, mining and quarrying, and in traditional electricity, gas and water utilities. The above figures predate the September 1982 bank nationalization (Saulniers, 1985b).

Public enterprises are stereotyped as losers and "parasitic parastatals," yet, they lose money far less often than is commonly believed. The stereotype arises, in part, from spectacular and repeated losses by a few firms, including such pathological cases as Argentina's petroleum producer, YPF.[5] British and Italian government firms are held up as a paradigm of inefficiency, yet their performance more reflects their inadequate operating conditions than public or private ownership (Saulniers, 1985d:viii). In fact, most public enterprises on the *Fortune* list show profits and compare favorably with private firms. Detailed financial comparison of Latin America's large firms indicates that type of ownership rarely accounts for statistically significant differences in behavior (Saulniers, 1985b). Indeed, public enterprises regularly earn an operating surplus, notwithstanding government price controls that distort company performance and result in low rates of return to capital.[6]

Public enterprises arose for many reasons. Governments often cited ideology, fear of foreign ownership, and national security in creating them, but they also acted to relieve natural and economic disasters, in retribution for past grievances, to rescue failing private firms, to reinforce personal privilege, and out of sheer accident. For Latin America, the traditional historical view that the public portfolio grew according to some unidirectional, additive, inevitable historical logic has been debunked by recent in-depth studies of the nineteenth and early twentieth century state.[7] These studies show governments owned an important share of the means of production earlier than the second quarter of the twentieth century.

Classifying firms according to known motives for public ownership does not capture the essence of portfolio development by failing to properly acknowledge the importance of accidents and unplanned or unexpected circumstances. Rapid portfolio growth and "accidental" shifts in composition have often occurred through nationalizations of banks, financial holding companies, or the family holdings of deposed dictators.[8] For example, Peru's 1970 takeover of the Banco Popular doubled the government's portfolio as more than thirty private companies, formerly in the bank's portfolio, became public without motive, i.e. with no explicit decision ever taken on whether the public interest was best served by public, rather than private, ownership [See Chapter 2]. Similarly, IRI, the Italian industrial development holding company, one of Europe's largest public enterprises, was founded in 1933 to temporarily acquire banks that were threatened with collapse, but, in the process, its objectives changed by accident as it found miscellaneous unrelated firms in the banks' portfolios.[9] Mexico's September 1982 bank takeovers also increased the portfolio at least a third and current privatization efforts have led to the disposal of shares in some of the accidentally nationalized firms.[10]

Most classifications also do injustice to conjunctural nationalization which takes place when the government is forced to acquire firms, sometimes against its overall interests, by unplanned or unexpected circumstances. The standard rescue of a bankrupt firm to safeguard jobs or to recover debts exemplifies conjunctural nationalization. Likewise, many worker-forced takeovers in Chile during the early 1970s resulted from the conjuncture of short-term forces over which the government often had little or no control.[11]

Both accidental and conjunctural nationalizations are concentrated in agriculture, industry, and services. Other sectors of the economy often show broad sectoral similarities. For instance, basic infrastructure, including electricity, gas, water, and wastewater, is overwhelmingly public, often the result of rational nationalization based on explicit intervention motives including externalities, infant industries, and control of the commanding heights.[12] Overall portfolio size and its haphazard growth through incorporating the portfolios of financial firms have been systematically neglected in part because countries use national accounts standards which exclude public financial institutions from definitions of public enterprises.[13] Accidental and conjunctural nationalization should receive more attention to better understand the nature and scope of government action.

Analysis of large infrastructure or industrial firms too often serves as the basis for overgeneralizing about the nature of government ownership and its role in the economy, yet, such firms are only a small minority of public enterprises.[14] Peru's portfolio serves as an example. In 1982, the two largest firms, less than 2 percent of the portfolio, accounted for 40 percent of sales, and the top 10 percent of firms had 76 percent of sales. In marked contrast, 8 percent of firms had annual sales of less than $100,000 and 23 percent less than $1 million.[15] Indeed, in 1982, several Peruvian companies, not considered above, had no sales, but existed either in a pre-development stage for large, natural resource-related projects or in a post-closure, pre-final liquidation limbo. Ranking firms by sales or assets ignores the numerous small and medium firms that constitute the bulk of the portfolio.

Scholars face a major impediment in extending analysis beyond large companies in infrastructure and industry: the lack of readily available and accurate data on the smaller companies. Legal codes in some countries prohibit government authorities from excessive interference in companies organized under the law of mercantile societies or under non-standard legal patterns and interference is often broadly interpreted to preclude data gathering. As a result, government and the media often report data on large sectoral flagship companies while neglecting others. The MINEROPERU system serves as an example. It and its two main subsidiaries in ferrous and nonferrous mining often figure in reports of government monitoring agencies or in informed analyses of Peru's public enterprises; its twenty additional holdings rarely do (Gallegos et al., 1985:43–44).

This book goes beyond the standard approach to public enterprises by undertaking a detailed analysis of Peru's entire portfolio. It avoids the "big company problem" by including data on all firms, regardless of size. It goes beyond the stereotype of parasitic parastatals to show which Peruvian firms earned profits, which showed losses, and why. It improves on the traditional approach to classifying motives by demonstrating that many public enterprises resulted from accidental or conjunctural factors. It avoids the national accounts definitional problem by comparing both financial and nonfinancial firms. It meets all these objectives by combining an institutional approach to the analysis of events with an economist's perspective on accounting and economic data.

The effects of massive government intervention in a country's productive sector have never been adequately documented. Most country-based studies suffer from two major problems. First, they usually rely on outsider information and inadequately report internal action. Unfortunately, outsider information is often incomplete and deliberately or inadvertently distorted by government authorities. Deducing the basis for and consequences of government action is only slightly more rewarding than the blind man's proverbial search for a black cat in a lightless room. Second, they rarely examine more than a handful of companies, justifying this notable omission of the smaller and medium sized companies on the basis of cost efficiency. Unfortunately, the big company problem leads to extrapolating the behavior of the average firm in the portfolio from a sample limited to the largest companies. Such induction is as invalid as is describing the consumer behavior of the average American pre-World War I family based on an analysis of spending patterns of the Vanderbilts, Goulds, Harrimans, and the other families that frequented Saratoga Springs and Newport. In examining the economic and financial evolution of Peru's public enterprises, this book overcomes the outsider problem by relying heavily on direct, insider information and it overcomes the big company problem by drawing conclusions from more complete portfolio information.

OVERVIEW

With Independence, Peru inherited public enterprises; since then, Peruvian leaders have never agreed on their uses and hence Peruvian governments always changed public enterprise policies. These features of an evolving government presence in the productive sector within an unstable, changing policy environment characterize public enterprises in many countries and Peru is no exception.

Since independence, two long-term trends, on which are superimposed various shorter-term cyclical fluctuations, have determined Peru's portfolio size and composition. Ideologically dominated long trends and cycles only recently surfaced in the theoretical literature on public enterprises (Boneo, 1981b). Peru's are particularly well marked. The first was a long-term downward trend in portfolio size, which lasted from the mid-1820s to the War of the Pacific. From a numerical high reached in 1824, a long continual decline set in until the 1870s when the Chilean occupiers eliminated most remaining firms. The second long trend lasted from the War of the Pacific until the mid-1970s, during which time the portfolio grew in a discontinuous fashion for more than 80 years. Peru's trends aid in discrediting the traditional view that Latin American public enterprises arose following trade disruptions caused by the great depression and the second world war.

By 1968, according to Latin American standards, Peru had a small, but growing portfolio. Under the military government from 1968 to 1980 and the civilian ones in the 1980s major changes occurred in portfolio size and composition, changes that compressed the evolution of other Latin American countries during the previous three to seven decades. Because the time period was so short, because key government internal documents are still available, and because many the key decision makers are still readily accessible, study of Peru's public enterprise portfolio provides valuable insights not only into the public enterprise growth process in Peru, but insights that are generalizable to other world areas and to other time periods.

Underlying this book is an institutional framework applied to dissect the interplay of governmental institutions and to reveal the excessive frictions that can build up from interorganizational interaction. Other authors have examined how general political and social factors constitute linkages between public enterprises and "polity, society and economy."[16] The main premise of interlinkage systems analysis is that public enterprises do not exist in isolation. Instead, they are unique elements strongly tied to the rest of the government within a wider national and international system. I narrow the focus to the intergovernmental subsystem to demonstrate that just as imperfections within the system can adversely effect public enterprise performance, so too, any improvements in the system can generate positive effects.

Analysts often try to make sense of the haphazard and chaotic process of creating public enterprises by systematically classifying motives for their creation into taxonomies. Classifications are common, indeed almost every public enterprise-related article or book proposes a different one, and they are usually based on some combination of underlying political, ideological, or economic grounds. There is, however, little underlying rigor or consistent application to this approach. I have analyzed conceptual and practical problems with the taxonomic approach elsewhere (1983, 1985c), but some issues bear on the Peruvian experience. Chapter 2 examines the weaknesses of post-hoc categorizations about Peruvian government motives in creating a public enterprise under conditions where: decisional issues are complex and ambiguous; creation motives are many and varied; each