

Privatization in Argentina: When Accountability Suffered

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Argentina's privatization process, one of the first and most comprehensive among transition and developing countries, started in 1989 and lasted through the 1990s. It had distinctive characteristics: it was massive, fast and supported by the public at its early stage. It also resulted in the loss of accountability among the actors involved: the government, enterprises, regulatory agencies and consumers. The Argentinean case provides lessons useful for evaluating the appropriateness of privatization. It shows that design and implementation stages are both critically important. Retaining some kind of control over services, taking the time needed for the process to be successful, regulating the process, legislating to prevent power concentration and enforcing transparency are some of the lessons learned from the Argentinean experience.

Introduction

After a decade of hyperinflation and political instability, Argentina undertook a massive privatization process that started in 1989 and lasted throughout the 1990s. It was one of the first comprehensive privatization processes among transition and developing countries and has influenced thinking on the subject among scholars and practitioners. After a brief introduction to the concept of privatization and the historical context, this paper discusses the more salient characteristics of the experience. Special attention is paid to the social phenomena that caused, or were catalysts for the series of privatizations.

The analysis highlights a consequence that has been marginalized in the literature: the loss of accountability among the actors involved: the government, enterprises, regulatory agencies, and consumers. While it is difficult to separate the consequences of the privatization process from those resulting from the implementation of the neo-liberal model and the opening of the economy in the years prior to the bulk of privatizations, the Argentinean process has features that are worth discussing for lessons about the pitfalls of privatization.

Privatization: A 360° Degree Change

During the first four decades of the twentieth century, South American countries embarked on a process that followed the needs of governments and the political thought of that time: nationalization. In Argentina, the process took place in the 1940s while the rest of the world was at war. It served the strategic goals of the country to control key foreign-owned enterprises. With the early reforms in Chile, Britain, and France in the 1970s and 1980s, the trend was reversed and several countries undertook privatization, in line with the market forces logic of neo-liberalism (Galiani & Petrecolli, 2000).

Privatization is the opening of market forces to the production of goods and services that were formerly provided by the state. Privatization can take different forms. According to Savas' (1993) categorization, these include: contract work, franchise, voucher system, producer subsidies, marketplace, voluntary agreements

and self-service. The privatization in Argentina has used several of these models; however, this paper focuses on the massive privatization of public enterprises under the franchise model. The franchise model is one in which the state gives monopoly privileges to a private vendor for service provision in a specific region. The definition of the model itself brings attention to some of the limitations of privatization.

The franchise model, evaluated in a 10-variable model proposed by Savas (1993), performs well in relating costs to benefits, achieving economies of scale, allowing for the redistribution of wealth and limiting the number of public employees. However, the model does not perform as well in promoting competitiveness. Furthermore, it is susceptible to fraud, necessitates multiple suppliers and is not responsive to consumer preferences. Thus, if this imperfect model is chosen, some positive and negative outcomes may be traced back to design issues.

Alternatively, the process can be looked at from the point of view of evaluating the intentions of the reformers and whether they reached their goals when choosing the franchise model. However, according to Cook and Kirkpatrick (1997), it is difficult to evaluate privatization processes on this basis as policy-makers do not always communicate their objectives. Argentina is no exception, as policymakers had explicit but also implicit reasons for choosing the privatization path.

Most scholars concerned with privatization have analyzed the process from the point of view of economic soundness, paying more attention to results than to processes. Cook and Kirkpatrick (1997), after assessing the difficulty of building a consistent set of indicators with which to evaluate privatization, propose three main macroeconomic indicators – change in the state's share of the economy, reduction in fiscal imbalance and development of capital markets and resource mobilization – and four main microeconomic indicators – technical or production efficiency, cost efficiency, financial profitability and real prices. Birch and Baer (1994) suggest assessing the advantages and disadvantages of the sale of the firms to employees, large domestic or foreign groups; the impact of privatization on income distribution; the types

of regulations instituted for the privatization of natural monopolies; the impact of privatization on government finances; and the complementary measures that are implemented to make privatization more effective.

Any of these approaches can be used to study the privatization process, but other social phenomena that may be ignored in these types of studies should also be assessed. No matter what the limitations of the model are, accountability among the actors involved (governments, enterprises, regulatory agencies and consumers) must be preserved.

Accountability is critical because it is the foundation of any democratic system. Each layer of government, whether the governing body is directly elected or appointed, has to remain accountable to the public that is the source of its authority. Accountability mechanisms are put into place to prevent malfeasance of those in power. In a privatization process, the private enterprise must play by the rules of the democratic game.

Accountability has both a tangible and an intangible dimension. The above-mentioned mechanisms that take the form of rules, regulations, and sanctions are the tangible dimension. The intangible dimension could be described as the preservation of social trust.

Origins of Argentinean Privatization

In 1989 the Peronist populist candidate Carlos Saul Menem was elected. In 1989 and 1990 Argentina went through two phases of hyperinflation. The country also faced difficulties obtaining financial help from abroad. The people were expecting changes from the government, while the business community was suspicious of the regime (Petrecolla, Porto & Gerchunoff, 1993).

The Peronist party blocked the ruling party's privatization efforts in the early 1980s, but took rapid action in this direction as soon as it was elected. Why did the Menem administration do this? In the beginning, the government declared that the reasons were to increase productive efficiency, to stimulate investment, to reduce the fiscal deficit, to get additional financing and to moderate external restraints to economic growth (Petrecolla *et al.*, 1993). Manzetti (1999) interpreted their goals as: recovery of internal and external public credit worthiness through establishment of relations with multilateral lending institutions (including an agreement with the International Monetary Fund (IMF) and participation in the Brady Plan), improvements of conditions for new placements of debt, reduction of the country's foreign debt and the recovery of short, medium, and long term solvency. There also were four other reasons identified by scholars.

1) *The government had to prove itself to the business sector and the political elites.*

Menem was aware that the domestic conglomerates had sabotaged the economic policies during the last two years of the former administration and wanted to avoid his predecessor's mistakes (Manzetti, 1999). The government needed to express its determination to abandon the

ideological burden with which it had come to power. Its need to gain credibility in the business community explains in part the absolute and sweeping character of the denationalization and the determination in meeting its schedule for transfers to the new private owners (Gerchunoff & Canovas, 1996). The speed of the reform reflected a desire to reduce the size of the state and was a political sign in itself (Galiani & Petrecolla, 1996).

2) *It faced political and economic pressure from the United States and the multilateral lending agencies.*

In 1990, the state no longer had access to any kind of voluntary foreign domestic financing (Gerchunoff & Canovas, 1996). Argentina had to clear its records and come to a solution regarding its external debt and solve its financial situation in the short run. To achieve a substantial reduction in the debt, Argentina had to qualify for the Brady plan. In March 1989, Treasury Secretary Nicholas F. Brady called on U.S. commercial banks to accept an orderly process of debt reduction, and called on the international financial institutions to support this process through changes in their lending policies. To qualify for debt reduction, the plan stipulated that debtor countries should undertake sound economic policies aimed at encouraging domestic savings and foreign investment and promoting the return of flight capital (Sachs, 1989).

3) *Privatization was an ideological trend.*

Beginning in the late 1970s, there was a growing international tendency to question many forms of state regulation, especially public ownership of service enterprises and, above all, goods-producing entities. The theoretical reason behind justifying privatization was the conviction that free competition was an efficient mechanism for resource allocation (Azpiazu & Vispo, 1994). The prevailing view was that the public enterprises' problems would disappear if they were transferred to the private sector (Gerchunoff & Coloma, 1993).

On the other hand, Gonzalez Fraga (1991) claims that those favoring privatization based their arguments on practical, not ideological, considerations. Gerchunoff and Canovas (1996) point out that, in the eyes of the authorities, privatization was the only available instrument to prevent the hyperinflationary experience from repeating itself. This is also a feature of the Argentinean experience that diverges from other Latin American countries, where ideological imperatives were stronger.

4) *It sought political and public support for the process.*

In any process of privatization, the leadership must be able to weaken opposition to reform (Cook & Kirkpatrick, 1997). President Menem had majority support in Congress but also managed to overrule any opposing movement, passing the Public Sector Reform Law (just 46 days after assuming as president) (Manzetti, 1999). Only Menem's unilateral, non-consultative, and executive-centered policy-making style could surmount the many implementation obstacles (Llanos, 2002).

Public opinion tends to be a problem in any privatization process because it is a movement that

comes from government and the elites, not from civil society. In Argentina, the experience of hyperinflation led to a sense of urgency for structural reforms and changes (Gerchunoff & Canovas, 1996) and a decline in the social value of the objectives of national autonomy (Gerchunoff & Coloma, 1993). These opened a “window of opportunity” for the government to gain support for the massive privatizations (Llanos, 2002). The services provided were expensive and of low quality. To retain public support, the government did not put the enterprises in a sounder technical, productive, economic or financial basis. As a result, the transfer price of the enterprises was very low (Azpiazu & Vispo, 1994).

Distinctive Characteristics:

Comprehensive, Fast and Supported by the Public

The implementation of privatization had several distinctive characteristics:

Comprehensive-Between 1989 and 1992, almost every asset that the Argentinean state owned was privatized. The first two privatized enterprises were services with no direct connection to the public, so the immediate increase in the prices for consumers did not change the public’s perspective on privatization. Subsequently, basic services and other enterprises with a more direct connection to the public were privatized: gas, electricity, highways and oil. By privatizing these highly sensitive services, the state not only transferred the assets but also the capacity to influence the structure of relative prices in the economy (Azpiazu & Vispo, 1994).

Fast-Speed was needed to demonstrate the government’s determination to implement reforms, and to take advantage of the window of opportunity that could close anytime. The public was supportive mainly because of the ongoing deterioration of all public services. A more slowly planned transition that included the previous “cleaning up” and restructuring of the enterprises (advised by all experts to make them better purchases) could have undermined public support for the entire scheme (Petrecolla *et al.* 1993).

Supported by the public-From 1989 to 1991, there was 70% approval for privatization in the Buenos Aires area. It fell to 61% in 1994, although this was still considered high (Somos & SOCMERC cited by Manzetti 1999). As noted above, this support was based on the low performance of the public enterprises prior to privatization.

Outcomes of Privatization

Most government goals were met, but a number of negative consequences arose. The government met its explicit objectives. Argentina’s entry to the Brady Plan meant a rescheduling and ten billion dollars or 35% reduction of its debt. The IMF, the World Bank and Inter-American Development Bank (IADB) provided special loans of over five billion dollars (Manzetti 1999). The exchange of debt for assets was a way of diminishing the debt without inflationary results (Gonzalez Fraga 1991). On these

terms, the achievement of the desired macroeconomic goal (reduction of the debt), without the feared inflation, was a success of the privatization process.

The quality of services improved, in some cases substantially (Galiani & Petrecolla, 1996). Manzetti (1999) believes that privatization was the necessary step to breaking new ground and instilling domestic and international confidence in the government’s overall economic plan. The privatization program undoubtedly had positive effects. The Argentines gave their support through the vote, and Menem was reelected in 1995, after passing a law to allow consecutive reelection, with more votes than in the 1989 election.

Some of the negative consequences resulted from the policy choice itself, including the fact that the macroeconomic figures did not improve after the first period. Other negative consequences were the result of an improper process, including the lack of transparency, ownership concentration and the absence of consumer protection.

The macroeconomic figures did not improve-The repurchase of external debt bonds had a significant initial impact on the cumulative debt. However, this reduction was more than offset by the fresh indebtedness incurred over the period. There was a net increase of some US\$2.7 billion in the external debt between 1989 and 1992. The undervalued selling of assets resulted in an imbalance that was perpetuated by the change in the taxation process and the concessions made in this regard (Galiani & Petrecolla, 1996). The sale was an expensive process, as the government reduced or eliminated both financial and commercial debts of the enterprises to make them more attractive, and, as a result, the Treasury took on additional liabilities (Petrecolla *et al.* 1993).

Lack of transparency in the privatization process-Biddings happened in a highly political environment, where the national counterparts of the international bidders lobbied the decision-makers heavily and used their already enormous power to set contracts on favorable terms (Azpiazu & Vispo, 1994; Gerchunoff & Canovas, 1996). Manzetti (1999) states that competitors agreed on bids in advance. Most of the bidders had been former government contractors, and members of the bidding private companies were the ones who helped the government design the bids.

The weak, and in some cases non-existent, regulatory bodies were not present at the time most purchases were made. Gerchunoff and Canovas (1996) point out that the delay in establishing regulatory mechanisms is unacceptable, since they are the social counterbalance. Moreover, the administrators of the regulatory entities were political appointees, making them unreliable as fair judges of the public interest.

The Argentinean people sensed that the privatizations were not being implemented appropriately, though they continued to support the privatization process. The following chart portrays the opinion rates of Buenos

Aires residents. While support for privatization developed during 1993, as consumers experienced improvements in services, no more than 32% thought that privatization was well carried out.

Table 1

Polls on Privatization

Company	It was good that privatization occurred		Privatization was well carried out	
	March 1993	November 1993	March 1993	November 1993
Entel	51	78	19	32
Electricity	47	72	15	31
Railways	47	68	13	24
Highways	43	59	12	23
Water	43	67	15	29

(Manzetti 1999) Source: SOMISA, polls taken in Buenos Aires and its metropolitan area

Ownership concentration-Purchasers included foreign operators (operators were obliged by the government to participate in ownership), local groups and foreign banks that secured the public debt instruments with which the purchase was made (Gerchunoff & Canovas, 1996). A decisive lobbying effort was made by the domestic firms that benefited from the whole process acquiring several companies' shares; in some cases those companies were their former competitors. Domestic investors of several privatized companies acquired the companies in a vertical integration scheme that included the main inputs for the industries they already controlled. Several examples are provided by Azpiazu and Vispo (1994). The Soldati Group became involved in generation of electricity, distribution and transport of gas, extraction and marketing of oil, railway concessions, highways and distilleries, among others. It is notable that, even as the 1995 recession resulted in high unemployment and rising rates of bankruptcy throughout the economy, Argentina's top 200 companies increased their sales and profits by 11% and 30% respectively (Pastor & Wise, 1999).

Unprotected consumers-The implementation of privatization created economic rents, sheltering private enterprises from competition. This ultimately penalized consumers (Manzetti, 1999). In most cases, the process resulted in private monopolies, losing the feature of distinctive "goodness" of the privatization as described by Savas (1993) when privatization breaks the monopoly rule. Even in cases for which economies of scale favored the restriction of competition, or in the privatization of natural monopolies, the allocative efficiency criteria were blocked. Moreover, some of the privatized enterprises cross-subsidized their divisions (as in the case of Aerolineas Argentinas, benefiting international fares to the detriment of national fares) (Galiani & Petrecolli, 2000).

The growing oligopolization and conglomeration

of the Argentinean economy and the consolidation and preservation of reserved markets with oligopolistic quasi-rents was harmful to unprotected consumers (Azpiazu & Vispo, 1994). Soon after the privatizations, the prices of services from the newly privatized companies (telecommunications, railroads, commercial air transport and road services) had to be renegotiated by the state as a result of public outcry. In these negotiations the government had to make concessions to the companies, reducing and/or eliminating taxes and dollarizing contracts (Gerchunoff & Canovas, 1996).

The necessary investments were made by the new owners, but financed mainly from the windfall profits generated by the fixing of prices higher than those compatible with ordinary levels of profitability. Looking at the patterns of social consumption of public services, this model led to regressive changes in income distribution (Azpiazu & Vispo, 1994).

Discussion

The implementation of a franchise model was the only option for the Menem Administration, since other models of privatization aim at changing the way services are delivered and goods are produced but do not solve the revenue imperative that was the most obvious reason for privatization in Argentina. Therefore, privatization should be evaluated in part with reference to this framework.

Considering Cook and Kirkpatrick's (1997) indicators for evaluation, Argentina was successful as it met the goals related to macro-economy (change in the state's share of the economy, reduction in the fiscal imbalance, development of capital markets and resource mobilization). The micro-economic indicators (technical – or productive - efficiency, cost efficiency, financial profitability, and real prices) were also met, but the gains accrued to the newly privatized companies operating in a monopolistic scheme. Profits were captured by enterprises that in some cases violated their investment pledges.

From Birch and Baer's (1994) perspective, there were advantages as well as disadvantages arising from the privatization process. The most salient, negative and positive, are interesting to note. On the one hand, there was a positive impact on short-term government finances. On the other hand, there was a failure in regulating natural monopolies.

In the case of Argentina, the assets' sale was a macroeconomic stabilizing tool rather than a structural reform aimed at increasing long-run productivity. The tool proved successful in preventing economic breakdown and meeting the government's goals in the short term. It is not the intention of this paper to evaluate the macroeconomic results in a technical detailed manner but to look at other consequences.

Privatization resulted in a loss of accountability among all the actors involved. There was a loss of the government's accountability to the people, of regulatory agencies' accountability to the government, of privatized

firms' accountability to the government and of privatized enterprises' accountability to its consumers.

The government's accountability to the people was harmed because of the unclear way in which the bidding occurred. As the country moved from a situation of bankruptcy to one of political and economic stability, people progressively began to expect more of their politicians in terms of accountability and performance on issues other than inflation (Manzetti, 1999). The policy-making style (decrees, strong lobbying and concentration of power) helped enact reform but led to corruption and policy insensitivity, contributing to increased social discontent (Pastor & Wise, 1999).

Related to this, the regulatory agencies' loss of accountability to the government (if they ever had any at all) is also harmful to the relationship between government and citizens because the regulatory agencies are the ones that are supposed to represent the interests of the consumers. Chisari *et al.* (1997, as cited by Manzetti, 1999) estimate about US\$ 915 million worth of losses due to ineffective regulation of public utilities that, on average, resulted in 16% additional tax per household for those services. Gerchunoff and Coloma (1993), Azpiazu and Vispo (1994), Galiani and Petrecolla (1996) and Pastor and Wise (1999) note deficiencies in regulation as the most significant problem.

With deficient regulatory agencies, privatized firms showed no accountability to the government. After the concessions and contracts were enacted, some firms did not comply and took advantage of the government's weak position. Not only did the government have difficulties in making firms comply with contractual stipulations, it also feared bad publicity that could harm further privatization prospects and Argentina's image to investors and multilateral agencies.

The loss of the firms' accountability to consumers occurred soon after starting to operate. For example, in a highways case in 1991, firms operated in open violation of the contract, ignoring a waiting period and the US\$1.50 rate established. They charged US\$2.50 and made no improvements in infrastructure or service. This led to public outrage that pushed the government to renegotiate the concession contracts. In the end, the highway companies agreed to reduce the toll rate to the original US\$1.50 but received in return the elimination of the concession fee (US\$780 million), cuts in business taxes (US\$285 million) and provision of subsidies (US\$690 million) (Gerchunoff & Coloma, 1993). Consumers had a voice using public protest, but, in the end, the deficiencies of contracts and conditions were paid by all Argentines, if not in the form of fees and tariffs, in the form of public funds.

Conclusions

Privatization in Argentina was part of a large plan to change the economic model of the country, and as a macroeconomic tool it served its purposes. Despite

these unique dimensions of the case, there are lessons for other countries undertaking this kind of reform.

In the case of Argentina, the process was implemented in a way that harmed society's confidence in and control over basic services, establishing a system of absolute control by a few powerful domestic groups. The deterioration of trust and the concentration of power are undesirable outcomes that other countries have solved by applying a more deliberate approach and not only looking at urgent fiscal needs. Some of these lessons have already been learned by neighboring countries and those in other regions of the world (such as the former Soviet Union and Eastern European countries).

Governments must retain control by establishing contracts that ensure enterprises will be responsive to constituents without changing contractual stipulations. The cost of changing contracts is enormous and has consequences in investment grade and market confidence in the country. Sometimes, the decision not to retain control is taken deliberately to prevent politics from intruding in business decisions. If that is the case, special provisions should be built in contracts to prevent abuse. This is especially relevant in cases where consumers cannot opt to punish the enterprise "with their pockets" because the enterprise is the only provider accessible to the client.

Rushing in the process is highly risky, since the process can be more easily manipulated by the government or by the bidders. Attracting the highest number of bidders, screening them and establishing effective regulatory frames are critical. Allowing for proper time also entails building reliable and effective regulatory bodies. This is crucial for retaining control as well as for guaranteeing accountability among all actors throughout the process, and once the privatization has been fully implemented. There is extensive research on how regulatory bodies should be structured and managed, and authors have been studying the Argentinean case to learn from its failures and successes.

To implement privatization, the design stage should include supportive legislation. Extensive vertical and horizontal integration should be avoided, and the problems of some services that are inherently difficult to provide by private companies should be addressed.

Transparency is the key to preventing many of the problems. In the case of Argentina, no effort was made in this direction and the consequences cannot be accurately measured. Transparency is essential not only to monitor foreign actors but also domestic players. Transparent adjudication processes are in the best interest of the public, the taxpayers and future customers.

Above all else, the Argentinean case shows the dangers of using privatization as a means of revenue generation instead of as a tool for the improvement of public services. The case deserves further study as it offers multiple lessons concerning the appropriateness, design and implementation of privatization.

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