

# Promoting Efficiency or Financing Inequality? Privatizing Latin America

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*Latin America was the first region to take on massive privatization reforms, which spread throughout the continent more rapidly than in any other part of the world. Proponents of privatization point to increased efficiency and profitability among other microeconomic benefits. The results presented in this paper indicate that although privatization has on occasion benefited governments in the region, it has also contributed to growing poverty and inequality, caused by increases in unemployment and volatility in consumer prices. As with other economic reforms implemented in the region, the impact of privatization needs to be assessed not only on efficiency grounds, as represented by microeconomic gains, but on equity, measured against the region's economic and social contexts.*

Sell a man a fish, he eats for a day, teach a man how to fish, you ruin a wonderful business opportunity.  
- Karl Marx

## Introduction

On May 1, 2006, as laborers around the globe united to commemorate International Worker's Day, Bolivian President Evo Morales dispatched hundreds of troops to seize natural gas fields and processing plants, sending ripples throughout Latin America and setting off alarm bells from Washington to the European Union. The re-nationalization of Bolivian hydrocarbons marked the beginning of the end for privatization reforms implemented throughout the country. Similar events, such as month-long street riots in Peru and massive anti-privatization demonstrations in Brazil, Paraguay, Argentina and Ecuador, have led to the persistent reluctance by many of these governments to further expand neoliberal reforms. In the cases of Brazil, Peru and Argentina, social mobilization led to the reversal of such reforms (McKenzie & Mookherjee, 2003).

Discontent regarding privatization has been felt throughout the region, extending beyond small protest groups. Evidence of popular opposition to privatization is summed up by the results of the Latinobarómetro 2003 annual public opinion survey, representing more than 400 million inhabitants in 18 Latin American countries. Only 21% of the participants agreed with the statement: "the privatization of state companies has been beneficial to the country." The data demonstrate a uniform pattern across countries, age, gender and socioeconomic class, with the highest levels of disapproval among the poor and the highly educated. Furthermore, negative perceptions of privatization in the region have been increasing from 1998 to 2003 (Carrera, Checchi & Florio, 2005).

Despite overwhelming popular opposition, economists view privatization with widespread approval

(Megginson & Netter, 2001). The paradox between economic and popular perception exposes the distributional dimension of privatization, demonstrating that privatization is not just a matter of profitability and efficiency (Carrera, Checchi, & Florio, 2005). For example, most economists use microeconomic evaluation criteria—reduction in costs, increased efficiency, market valuation, and labor productivity. Others argue that increasing efficiency and profitability usually translates into restricted access, unemployment and fluctuations in consumer prices (La Porta & Lopez-de-Silanes, 1999).

The distributional impact of privatization is dependent on the type of enterprise being reformed; factors such as market share and elasticity of demand for the product determine how extensive the impact of privatization will be (Bayliss, 2001). For example, the price and quality of services will affect a large number of consumers, so fluctuations will reflect large welfare gains or losses. Furthermore, most of the poor in developing countries do not have access to public infrastructure, such as potable water and electricity, so their ability to gain access to these would constitute significant welfare gains.

This paper focuses on the way privatized utilities affect consumers through changes in prices and accessibility to public infrastructure and vital services. The effects of utility privatization on unemployment, wage levels, and earnings inequalities will be evaluated. The main purpose is to challenge the current financial evaluation criteria used to measure the outcomes of privatization and introduce alternative criteria aimed at highlighting the macroeconomic effects of privatization reforms, such as slow GDP expansion, unemployment, increased income inequality, and reduced public expenditures on health and education. The new wave of nationalization is proposed as an alternative development tool.

## Overview: Privatization in Latin America

During the first half of the twentieth century, Latin American countries carried out a process of nationalization that prioritized the needs of government and represented the predominant ideology of the time. In both Argentina and Bolivia, nationalization of foreign-owned enterprises was carried out enthusiastically as these countries sought to replicate the success of Japan and Britain. However, with early reforms in Chile, France, and Britain during the 1970s and 1980s, the trend was reversed in favor of neoliberal market forces.

Latin America was the first region to take on large-scale privatization reforms and it extended programs more rapidly than any other part of the world. From 1990 to 2001, private investment in infrastructure alone totaled \$360.5 billion, \$150 billion more than the runner-up East Asia-Pacific region (Harris, 2003). However, it is important to note that most privatization reforms in Latin America were carried out during a time of economic crisis (Cominetti, 1994).

During the 1970s, the United States budget deficit began to reach unprecedented levels due to mass spending on “Great Society” programs and on the Vietnam War. Fiscal indiscipline coupled with OPEC’s oil embargo led to abandonment of the fixed exchange rate regime. Floating exchange rates and the 1973 “Oil Shock” began to squeeze the liquidity out of many developed countries. At the same time, oil exporting countries needed a safe way to invest all of their newly acquired wealth, so they looked to commercial banks in the U.S. and Europe (Pastor, 1987). In light of the recession experienced by the North, commercial banks began to lend to Latin American governments at unprecedented levels, a phenomenon that would later be referred to as “Petrodollar Recycling” (IMF, 2007). By the 1980s, high global interest rates, the increasing value of the dollar relative to other currencies, and a slowdown in export volume created a situation where the initial loans became too expensive to repay. Large-scale capital flight from the region followed, leading to default on foreign debt in many Latin American countries. This massive default threatened the stability of many creditor countries. They collaborated with the IMF, World Bank, and other international financial institutions (IFIs) to restructure each country’s debt using a case-by-case approach. The negotiations allowed commercial banks to provide additional loans and to extend repayment schedules. Under this approach, the release of funds was conditioned on adherence to World Bank and IMF structural adjustment policies (Stiglitz, 2003). Such policies included cutbacks in fiscal spending, tight monetary policy, and a blanket devaluation of currencies to increase exports. The World Bank saw public utilities as an important area in need of market reform; they reasoned that privatizing

this sector would reduce the fiscal debt burden on governments (Stiglitz, 2003).

The privatization of public utilities in economic development policy stems from the “Washington Consensus” set of economic policies that emphasize minimal state intervention in industry while highlighting the market’s superior efficiency. The World Bank and IMF were the biggest proponents of this consensus, arguing that “...economic development is facilitated through the trickle-down of benefits from more efficient private sector management of the economy, which will improve revenues to government who are better able to redistribute wealth through ‘targeted’ subsidies (i.e., a welfare system), and not by operating the industries themselves” (Haselip, 2004, p. 4).

Despite widespread optimism regarding privatization reform, key economic indicators such as GDP growth, per capita income, real unemployment, income distribution, wages and consumption have continued to erode throughout the region. Typically, the criteria used to evaluate privatization reform center around profitability, market valuation, productivity and efficiency. These criteria do not quantify the welfare losses incurred by those impacted most by the reforms: the working class and marginalized poor.

Two case studies are presented to support the arguments made here. Argentina is a large country with a high per-capita GDP, and Bolivia is a smaller country with lower national earnings. Both countries have experienced significant privatization since the late 1980s (Birch & Haar, 2000). The structure of Argentina’s public firms, however, is very different from Bolivia’s. In Argentina, the state holdings consisted of a few large natural monopolies. In Bolivia, however, the state administered a large number of firms across various productive sectors. Although both privatization programs have been immense, Argentina’s experience is richer in the number of privatization cases, while the Bolivian privatization was massive compared to the size of its economy.

These countries’ privatization experiences allow for an in-depth analysis of the direct impact of privatization in sectors where the state was a monopoly before the industry was transferred to private ownership. In both cases, worker welfare was threatened by the inability to transfer their specialized human capital to other sectors of the economy and consumers were limited by the number of providers. The experience of each country highlights the importance of expanding the analysis of privatization to include the impact on consumer and worker welfare, rather than restricting attention to the impact on firms.

Privatization reforms in both countries were part of an on-going effort led by the World Bank and other IFIs to help governments cope with the debt crisis and support structural adjustment reforms. The magnitude and scope of the reforms created the leverage needed

to open each country's industries to private competition. Policies formulated by the IFIs reflected a region-wide move towards limited state intervention and increased private participation. The design and implementation of the privatization reforms took place during a time when economic restructuring amplified institutional uncertainty and social instability in both Argentina and Bolivia. This was accompanied by high levels of corruption, poverty, inequality and weak institutions. Despite such an unfavorable environment, the design and implementation of reform was carried out with complete support from both governments and the multilateral lending agencies.

The cross-country comparison is insightful because of similarities in the reforms and the diversity of the stakeholders represented across countries, ranging from the public sector to IFIs and from indigenous rights groups to private contractors. Given the policy environment and diverse composition of stakeholders, the cross-country comparison provides a functional framework for understanding the complex political economy that characterized the execution of large-scale neoliberal reforms carried on throughout the region. Argentina's case allows us to analyze privatization reform within the context of a more developed capital market and robust economy whereas Bolivia represents a weaker economy and undeveloped capital markets. More importantly, the mixed results regarding privatization reform in both countries demonstrates that benefits-such as increased efficiency and profitability-do not always outweigh the costs- such as inequality, lost wages and shrinking per capita incomes.

## **Argentina**

Against the backdrop of the Latin American debt crisis, populist candidate Carlos Menem was elected President in 1989 as the nation's economic savior. Unfortunately, during his first two years in power Argentina went through two phases of hyperinflation and saw financial help from abroad dwindle. Although Menem's party was the major obstacle to the previous administration's privatization efforts in the first half of the 1980s, Menem did not hesitate to undertake privatization reforms of his own. Menem justified his move by linking privatization to higher productivity and efficiency, lower fiscal debts, increased foreign investment and a promise to restore Argentina's credit-worthiness through improved relations with the IFIs.

Public Sector Reform Law (No. 23696) was signed by the Argentinean government in August 1989 in the midst of acute hyperinflation driven by the monetization of large fiscal deficits. The law served as the blueprint for the privatization of state owned enterprises (Ennis & Pinto, 2005). The national telephone company was the first to be privatized,

followed by 154 enterprises during the 1990s. The privatization program in Argentina was large in relation to the size of the economy (Ennis & Pinto, 2005).

The astonishing characteristics of the Argentine privatization process were its speed and extent. Argentina's privatization program prioritized the transfer of public utilities, which often demonstrated natural monopolistic behavior, instead of selling industries where potential for competition existed. The largest revenue-generating sources were the oil, gas and electricity sectors (Ennis & Pinto, 2005). It is important to highlight that prior to the privatization reforms, the Argentinean state owned few (albeit large) natural monopolies.

Evidence from utility privatization suggests that an increase in accessibility occurred in most sectors with more household connections to telephone, water and natural gas networks. For example, the telecommunications field experienced a growth in the installation of telephone lines of almost 8% from 1991 to 1997 and the supply of public telephones increased by almost 20% in the same time period. The energy sector obtained enough foreign investment to identify 650,000 users who had previously been illegally connected (Ennis & Pinto, 2005). The profitability of most privatized firms also increased. Large improvements in operating efficiency underpinned the gain in profitability. However, the trade-off was in employment rates, which decreased approximately 40% as a result of privatization. The earnings losses due to displacement, after taking into account unemployment, were approximately 50% of the real earnings of the workers before privatization (Ennis & Pinto, 2005). This estimate demonstrates a large redistribution cost associated with the privatization programs.

Labor productivity increased, not only because of unemployment but also due to increased firm output. The median level of production increased 25% and investment increased 350% as a result of privatization (Ennis & Pinto, 2005). This result is consistent with the view that attracting investment is one of the main motives for privatization in Argentina. Finally, there was no statistically significant increase in prices as a result of the reforms.

Privatization was undertaken in part to reschedule foreign debt, which was up to 35% of GDP in Argentina's case. This objective was met though a \$5 billion loan provided by the Inter-American Development Bank (IADB), IMF and the World Bank (Manzetti, 1993). The loan was contingent upon further execution of the reforms. However, the debt rescheduling increased Argentina's cumulative debt by over \$2.7 billion. Additionally, the government assumed the debt of state enterprises that were up for sale in order to make them attractive to investors, thus increasing overall government liabilities.

Although the profitability of the privatized firms increased, the reforms failed to regulate the natural monopolies. In Argentina the privatized public utilities were used to generate revenue rather than improve public services. Thus, the privatization reforms stabilized an economy that was under the threat of hyperinflation and crippled by the debt crisis, but did not serve as a tool to improve the country's long-term growth.

### **Bolivia**

Bolivia, like most Latin American countries at the time, included privatization as part of an overall package of structural reforms designed to liberalize its economy. In an effort to attract private investment and increase efficiency, utilities were targeted as key enterprises to be transferred from public to private provision. This section analyzes Bolivia's innovative take on traditional privatization and details how this "capitalization" mechanism served as the main vehicle to transfer state ownership. The welfare gains and losses associated with Bolivia's capitalization will also be explored.

After its independence, Bolivia remained a feudal state, characterized by stark inequality and an abuse of economic power by the ruling elite. After more than one hundred years the unsustainable situation led to the Revolution of 1952, resulting in a new government that nationalized the tin mines, which had been the building block of the Bolivian economy for generations. The action was undertaken to eliminate the power of the mining and landowning elites that ruled Bolivia since her independence. An electoral law that provided for universal adult suffrage was also approved (Candia & Lora, 2005).

Agrarian reforms accompanying the revolution broke up the large estates in the western part of the country and redistributed the land to peasants under the principle "land belongs to the one who works it". Also, large mines were nationalized under the newly created state-owned Bolivian Mining Corporation (Candia & Lora, 2005). These events made Bolivia one of the first countries in the region with a broad base of stakeholders involved in market reforms. It allowed large segments of society to actively participate in the economy and its reform, giving them a sense of ownership by granting them the opportunity to benefit from the country's growth. Thirty years after the revolution, however, Bolivia was in the midst of hyperinflation and facing enormous fiscal constraints. The state-centered development model acquired after the revolution of 1952 prioritized equity and welfare above efficiency. The mounting fiscal constraints coupled with the world-wide crash of the tin market created a situation where the country could no longer service its debt. The privatization of "inefficient" state-owned enterprises

was at the forefront of structural adjustment policies tailored to lift Bolivia from her crisis.

From 1993 to 1997, Bolivia initiated its capitalization reforms as the main vehicle to transfer state ownership. The reform was an innovative take on traditional privatization efforts in the region and aimed to combine three objectives: the privatization of state enterprises, the establishment of a social security system and broadening the base of stakeholders in the market process (Graham, 1998). IFI resources not only backed capitalization reforms but also enabled additional features of the program including judicial and regulatory reform, strengthening the banking system and modernization of capital markets (IADB, 1995).

Under the capitalization plan, 50% of the state-owned enterprises were sold to private investors, while the remaining 50%, representing existing assets, remained under government control. The capital raised from private investors was invested in the company and provided new liquidity for expansion (Valdez, 1998). The capitalization program differs from other privatization schemes in some important aspects. Instead of selling off the state-owned companies, the government creates "mixed capital corporations" (MCCs) to which a private partner contributes a 50% capital investment. Essentially, the investor buys the right to manage the enterprise and commits to invest what they contribute for their 50% share. Their contribution remains in that MCC, substantially increasing its value (Valdez, 1998).

The MCC is then transformed into a private company, while the government's holdings in the MCC are allocated to pension programs that provide annuity income to Bolivian citizens over the age of 65 (Barja, McKenzie, & Urquiola, 2005). A vital step in this process is the participation of the government and the workers who accept the government's invitation to subscribe shares at book value. A major concern, however, was that since the majority of the population lives below the poverty line, people would sell their shares for much needed income (Graham, 1998).

The capitalization efforts in Bolivia secured commitments of about \$2 billion from IFIs and private investors, or about 30% of GDP; capitalization alone accounted for \$1.7 billion (Barja, McKenzie, & Urquiola, 2005). Six of Bolivia's biggest enterprises were capitalized, accounting for 12.6% of GDP (Graham, 1998). The sectors targeted for capitalization were the national airlines (Lloyd Aero Boliviano), the railways, electricity (ENDE), telecommunications (ENTEL), ironworks (EMV), and, most controversially, the state oil and gas corporation (YPFB). Despite 60 years of state control, efficient management that significantly contributed to regional and national budgets, and near-consensus that the oil and gas sector (hydrocarbons) was the industry most likely to stimulate Bolivian

development, YPFB was split into three companies and sold to Enron (U.S.), Repsol (Spain), YPF (Argentina) and Shell (Netherlands) (Graham, 1998). Initially the Bretton Woods Institutions adopted an observer role but once the reforms were completed they extended \$120 million in assistance to the Bolivian government (Barja, Mckenzie, & Urquiola, 2005). This contributed to the spike in foreign investment in the hydrocarbon sector.

However, the new investment failed to decrease poverty and social exclusion. On the contrary, the national population living below the poverty line grew from 62 to 65% between 1999 and 2002, while the percent below the poverty line in rural areas (mostly the indigenous peasant class) rose from 80 to 82% (Casazola, 2002). Meanwhile, the government's income from hydrocarbons dropped from an average of \$339 million per year to only \$40 million (Quirioga, 2004). This resulted in the expansion of government borrowing from 3.3% of GDP in 1997 to 8.7% in 2002, while funding was slashed for education and health care (Unidad de Analisis de Politicas Sociales y Economicas, 2004) and employment in the hydrocarbon sector fell by 6.6% (Kohl & Farthing, 2006).

On the other hand, the country experienced significant gains because of the reforms. With capital contributions obtained from private investors, former state owned enterprises increased their book value from \$706 million to \$2.4 billion (Valdez, 1998). Furthermore, proponents of the reform claim that the changes improved equity and access to public infrastructure. Prior to privatization, the electricity sector in Bolivia was facing significant supply shortages, especially during the winter when demand peaked. After capitalization, the private companies built two plants in the regions of Cochabamba and Santa Cruz. In the telecommunications sector, ENTEL began a new B-band cellular service, creating competition for local telephone providers around the country. As a result, access fees dropped from more than \$1000 to \$76 (Valdez, 1998). Furthermore, the number of available public telephones increased from 2000 to 5000 in the first two years after the capitalization reforms. The airlines and railroads were facing insolvency before the capitalization reforms: the railroads generated losses of \$20 million per year, and the airlines needed to replace at least two airplanes in order to continue operations (Valdez, 1998). After the first year of capitalization, the airlines were able to purchase new planes, increase the number of destinations, and increase the frequency of flights. The newly reformed railroads generated profits of \$9 million during the first year of operation as private companies (Valdez, 1998). The transfer of state owned enterprises to private sector management was handled with a high degree of professionalism and transparency. Tying the reform with a pension program

was an innovative way to garner mass support for the reforms. The average pension under the new system was \$620 per month, compared to \$200 per month under the previous government system. Employee contributions to the system also exceeded expectations.

Despite these gains, Bolivians are poorer today than they were in 1978. The country's per capita income has grown less in the last 25 years (2%) than it grew between 1960 and 1980 (60%) under the state-centered development model (Weisbrot, Naiman, & Kim 2000). Many economists have compared Bolivia to a "poor man sitting on a pot of gold"; however, what they fail to recognize is that the gold has never belonged to the poor majority and that the pot is synonymous with a safe that only the social and political elite can unlock.

### **Alternative Views**

This section expands upon the deteriorating macroeconomic conditions faced by Bolivia and Argentina, which occurred despite the seemingly successful reforms. The purpose is not to establish a strong correlation between the capitalization reforms in Bolivia or the privatization reforms in Argentina and the macro-economic indicators presented. Instead, it is argued that the current methods used to measure the success of capitalization and privatization reforms are inadequate. For instance, how do we know that the privatization of energy in Bolivia directly influenced access? Could it not be attributed to other factors, such as the increase in illegal connections that occurred as the poor free rode off the expanded service to middle income groups? Privatization advocates such as IFIs, governments and the international investment community argued that privatization reforms would considerably improve the macroeconomic condition of a country. This section of the paper evaluates the privatization and capitalization reforms carried out in Argentina and Bolivia on macroeconomic criteria such as economic growth, changes in per capita income, real unemployment, income distribution, wages, and consumption. Because both Argentina and Bolivia were trying to lift themselves out of a debt crisis at the time of reforms, the macroeconomic perspective is important.

During the time period when the bulk of privatization was taking place, data show that the average annual growth rates of GDP in Latin America, as a whole, declined from 5.4% to 2.0% (ECLAC, 1995). The World Bank reports that the average annual growth rate of GDP declined from 2.5 to 0.8 % in Argentina, and from 4.5 to 1.1% in Bolivia (ECLAC, 1995). According to the 1994 United Nations report, the average annual growth rate of real GDP per capita dropped from 0.7 to -1.6% in Argentina and from 2.0 to -2.7% in Bolivia (ECLAC, 1995).

Privatization advocates argue that an expansion of employment in the private sector compensates for the decreased levels of public-sector employment caused by the reform. However, according to the 1995 Labor Statistics yearbook, overall unemployment increased in Argentina from 2.6% in 1980 to 6% in 1992 and in Bolivia from 18% in 1985 to 19% in 1990 (ILO, 1995). Another area that privatization aims to improve is the distribution of benefits from increased efficiency and profitability across income groups, but from 1980 through 1990 the World Bank reported that the shares of national income for the lowest 20% households and highest 20% households were 6.3 to 50.2% in Argentina and 2.1 to 66.0% in Bolivia (Vivian, 1994).

In addition to measures of macroeconomic performance, it is beneficial to evaluate the overall living standards, as defined by poverty, wages, and consumption during the time privatization reforms were being carried out. From 1960 to 1970, when most policies were centered on state control, the percentage of Latin American families below the poverty line dropped from 51 to 40%. In contrast, during the period of structural adjustment and privatization, the proportion of people in poverty in the Latin American region increased from 41 to 62%, and the total number of poor in Latin America increased from 136 million to 266 million (Bello, Cunningham, & Rau, 1994).

Increases in poverty, declining wage levels, and fluctuating consumer prices diminished the capacity of individuals to satisfy basic needs such as health, nutrition, education, and housing (Tanski, 1994). The situation has been especially detrimental to the poor. Since the implementation of market reform policies in Latin America, the availability of basic social services for the poor and lower to middle income groups has dropped, leading to a decline in consumption levels (Altimir, 1994). These changes can be attributed to the reduction in social spending, one of the conditions imposed on countries receiving loans for structural adjustment. In the 1980s, the real per capita social spending declined in Bolivia (from \$67.5 to \$61.0) and Argentina (from \$82.6 to \$80.4); this decline especially affected the quality of health care and education (Cominetti, 1994).

Privatization in Latin America was intended to reduce the debt burden on governments, improve current account deficits, and attract foreign investment; however, the data show that these objectives were not achieved. The World Bank (1995) reports that Latin American debt expanded during the privatization period, from \$398 billion in 1984 to \$548 billion in 1994. External debt as a percentage of exports also increased between 1981 and 1991, from 233 to 281% (World Bank, 1995). Although \$70 billion in foreign direct investment (FDI) poured into the region (an increase of \$8 billion), this was a double-edged sword since it represented a large-scale shift towards foreign

ownership of domestic assets (World Bank, 1995). Results included the expansion of foreign control over national economies, the creation of inequitable competition, and a detrimental impact on local entrepreneurship and capital formation (Odle, 1993). The increase in foreign investment and ownership during the privatization period, coupled with a chronic decrease in domestic investment and savings rates, translated into the erosion of local industry and domestic capital in Latin America.

### **Nationalization as an Alternative Development Policy**

The above analysis has suggested that privatization and capitalization in Argentina and Bolivia failed to foment sustainable economic development that provides equitable benefits to the poor and reduces inequality. This failure has been attributed to the reform's lack of practical applicability to Latin America, a complex region immersed in uncertainty. In this section it is argued that, within the context of Latin America, nationalization can be a favorable alternative to privatization. The assumption is that nationalization replaces conflict and competition with cooperation by changing the social relations of production. In the Latin American context, competition is not always beneficial to the economy because the most productive capital is concentrated in a few hands. The inequitable distribution of resources allows small factions to exercise economic power by restricting entry and exploiting their highly asymmetrical relationship with the rest of the economy. Proponents of nationalization argue that the state should run and administer essential public services such as transportation and utilities in the interests of consumers, and should protect the population from the consequences of market failures. Nationalization also aims to protect the working conditions and income levels of citizens. In fact, this was the motivation behind most nationalization efforts in capitalist economies such as Britain and Japan (Coleman, 1991).

Nationalization has also helped developing economies to stem the repatriation of profits by foreign companies and achieve economic independence. As a consequence of market reforms with privatization as the focal point, foreign capital has formed an enclave within the local economy, furthering inequality and creating a dual system whereby small affluent groups with ties to foreign capital prosper while the rest of the population is adversely affected. Nationalization attempts to create a more equitable distribution of wealth by appropriating profits that would otherwise go to owners of private firms. Private investors repatriate a large fraction of their profits, whereas the government looks to employ its capital domestically. Specifically, the policy aims to equalize the distribution of personal

incomes through the reduction in the prices of goods consumed by lower income consumers. Nationalization relies on the principle of providing basic necessities for all. Furthermore, nationalization has the potential to ameliorate differences in the cost of living in urban versus rural areas or across regions of the country (Coleman, 1991). Private industry differentiates prices on this basis, charging higher prices to those who can least afford it. By nationalizing natural gas, communications, and transportation industries it is possible to cross-subsidize commodities and services to keep prices low (Stiglitz, 2003).

Nationalization can serve to create economic stability where market mechanisms are dysfunctional, especially in cases of natural monopolies. These arise in industries that are often essential to social welfare, but due to the monopolistic characteristics private owners can exploit the market structure for their own gain (Coleman, 1991). Nationalization can also be advantageous because the state can operate on a longer time frame than private capital since it is not constrained by investors' desires to reap short-term returns. This enables the state to embark on long-term initiatives with higher social returns.

Furthermore, many developing countries are extremely vulnerable to global economic downturns due to their over-reliance on foreign capital. Nationalization helps ensure macro-economic stability through direct control of investment in key industries. As such, nationalization appeals to many governments because it can be a powerful development tool that counters problems in the business cycle and promotes long-term planning of the economy. Governments can use nationalized enterprises as instruments of policy more easily than privatized industries.

Finally, nationalization broadens the stakeholder base and encourages public participation in economic reforms. Many developing countries have seen an oligarchic system replace the feudal systems of the past. Historically, there has never been a sense of ownership in economic reforms by the popular majority since they have not benefited from the resulting economic gains. Structural reforms such as privatization and capitalization force people to adopt a secondary role in economic reform, reinforcing the notion that human capital and domestic resources are unable to bring about development. In contrast, nationalization establishes a relationship with the citizenry by recognizing that they are indispensable to the planning and development of the national economy, thereby cultivating local expertise and a building a sense of solidarity in relation to the reforms.

As an example, on May 1<sup>st</sup>, 2006 Bolivia nationalized their petroleum industry and re-negotiated all outstanding contracts. The negotiations resulted in significant increases in the monetary value of the contracts and have provided an effective way to lock in

the benefits of such concessions. As part of this new deal, the government will receive a larger share when prices increase and will enjoy the flexibility to hedge their risk when prices fall.

One year after the completion of the nationalization process, Bolivia's economic indicators have continued to show improvement in growth, fiscal balances, balance of payments and foreign reserves. These improvements can be largely attributed to the government's policy choices, such as increased royalties and control over hydrocarbons, which have provided the necessary capital to embark on various government programs that target the poor and marginalized (Weisbrot & Sandoval, 2007). Total revenues for the entire public sector increased to 40.2% of GDP in 2006, compared to 27.5% of GDP in 2004. Most of this increase is due to the government's policies in the hydrocarbons sector, starting with the 2005 hydrocarbons law that increased royalties and then a major hike in royalties resulting from the complete re-nationalization of the sector. Nationalization policies and escalating natural gas prices have increased the hydrocarbon's share of GDP from 5% in 2004 to 13.3% in 2006. Revenue from hydrocarbons, through May 2007, has increased by an additional 26% in real terms compared to 2006. Finally, Bolivia's 2006 current account surplus of 11.9% led to the accumulation of foreign reserves totaling 32% of GDP (Weisbrot & Sandoval, 2007).

## **Conclusion**

The "Washington Consensus" style reforms such as privatization, deregulation, and structural liberalization represent a sharp contrast to the historical economic practices in Latin America. Throughout their most important stages of development, Latin American countries governed through a system where the state played a central role in the management of public enterprises. On many occasions, the political and bureaucratic elite exploited the state's power for individual gain. Even so, state control contributed to the alleviation of poverty through the generation of employment, expansion of education, provision of basic services, and protection of local entrepreneurship and capital (Manzetti, 1993). State enterprises provide Latin American countries with strategic advantages, both economic and political. Although they represent a relatively small amount of GDP, public enterprises can serve as a social safety net and a symbol of sovereignty.

The privatization and capitalization initiatives reviewed in the case studies of Argentina and Bolivia were enacted in an environment of unstable economic conditions with high levels of inflation, external debt, poverty and unemployment. These conditions led most Latin American countries to adopt stabilization and adjustment programs. Influenced by the Bretton Woods

Institutions, Latin American governments altered their historical state-centered policies to reflect the principles of free market reforms. This paper argues that social indicators such as poverty rates and inequality have not significantly improved after privatization and that, in many instances, conditions have worsened. The promises of privatization—such as economic growth, debt reduction, decreased poverty levels and increased social welfare—have not been realized in most Latin American countries. The assumption was that once state owned enterprises became privatized they would stop acting like a monopoly, but most firms failed to reduce prices after privatization (Bayliss, 2001). Furthermore, privatization reforms grossly underestimated the role of the state in maintaining an informal welfare system through the tolerance of illegal access to public infrastructure by the poor and by providing a significant source of employment.

Even in light of its limited success, and popular opposition, privatization has not lost political support. As stated in the previous section, income distribution throughout Latin America is heavily stratified, with large percentages of wealth and assets concentrated in the hands of a few. The richest gain the most from privatization because they have enough capital to participate in the process. For example, the greatest local beneficiaries of privatization in Argentina have been domestic conglomerates that bought many of the large public firms. Furthermore, ownership of privatized enterprises by political leaders and bureaucratic elites has increased significantly (Kaplan, 1985).

Privatization reforms ignore the fact that private firms will act as profit-maximizing entities and will invest where they expect to make a commercial return (Bayliss, 2001). How can the profit-maximizing behavior of private firms be reconciled with the government's social obligations to expand service to poorer sectors or provide affordable access to public services? As with other economic reforms implemented in the region; the impact of privatization needs to be assessed not only on efficiency grounds, as represented by microeconomic gains, but also on equity grounds, measured against the region's economic, social, and historical context. When it is in direct conflict with the goal of poverty reduction, privatization as a development tool needs to be reconsidered at a fundamental level. In the context of soaring commodity prices and slow capital accumulation rates, governments in Latin America should shed the misconceptions associated with nationalization and analyze it as a viable alternative.

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