BALANCE SHEET OR BALLOT BOX?:

INCENTIVES TO PRIVATIZE IN EMERGING DEMOCRACIES

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Abstract

When do political leaders in newly industrializing countries initiate needed economic reforms? This essay examines nine presidential or prime ministerial terms in Argentina, Mexico, Brazil, and India, 1982-1992. Among these cases, neither the reasonable hope of thereby improving the performance of state-owned enterprises, nor the crush of fiscal deficits or foreign debt, necessarily led to meaningful privatization. However, the prospect of domestic and/or international political benefits for the chief executive from privatization by firm, sector, or organizational task easily predicted decisions to transfer production to private owners. A "rational choice" model of policymaking accounts for outcomes quite well.

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When do policymakers decide to privatize?[1] The sale of state production to private buyers in the 1980s and early 1990s was the newest patent medicine in the kit bag of would-be doctors of national economies as diverse as slow growth advanced industrial countries of the capitalist West (such as Great Britain), heavily indebted developing countries emerging from a decade of depression only to face hyperinflation (Argentina, Peru, and Brazil), newly liberated non-hard currency countries of Eastern Europe (Poland, Czechslovakia), and protected, state-dominated, mixed economies in very poor countries (India). Economic advisors to governments usually assumed or hoped that demonstration of an objective "need" to reduce the state sector would result in a privatization policy being implemented.[2] But politicians often had other concerns.

This essay argues the obvious yet frequently neglected point that a <u>supportive political environment</u> for privatization is at least as important, and probably even more crucial, to democratic politicians confronting the difficult decision to shrink the government's directly productive role as are compelling <u>economic reasons to privatize</u>. As contrasted with politicians in advanced industrial countries, democratic leaders in new, fragile, and/or emerging democracies in relatively poor countries may find privatization a harder sell to their populations, whose expectations of access to long-delayed political voice are likely to be coupled tightly to anticipations of improvements in short-term economic circumstances. Several possible immediate consequences of privatization--including job losses for previously protected employees, foreign ownership, and higher prices for the good or service previously supplied by the state-owned enterprise--may be unpopular with voters. However, and again as compared with politicians from wealthy capitalist democracies, leaders in developing countries typically also are under relatively greater political pressure from abroad to pursue privatization and other measures of economic liberalization. For both of these reasons--the political fragility of many developing democracies and their vulnerability to international pressures and blandishments--the presence or absence of an objective economic "need" to privatize seldom is a good predictor of actual public policy choices in emerging democracies.

I examine actual progress on privatization, while assessing the comparative strength of both economic and political incentives to elected chief executives, in the three Latin American countries with the largest, most industrialized economies: Brazil, Mexico, and Argentina. To illustrate that the argument is general, rather than culture or region-specific, the comparison also includes India, for a total of nine administrations in four country cases during the years from the early 1980s through the end of 1992. The chapter's concluding paragraphs return to the link between politicians' incentives to privatize and the larger issues of the interaction of democratization and economic reform.

Case Selection and Incentives to Privatize

The main criterion for choosing Argentina, Mexico, Brazil, and India as the four country cases was the absolute size of the industrial sector, which was of comparable scope in each. In 1988, roughly midway through the period studied, Brazil's industrial gross domestic product (GDP) was $139 billion, India's was $71 billion, Mexico's was $62 billion, and Argentina's was $35 billion.[3] The ratio of overall gross national product (GDP) likewise was a maximum of about four to one within the group, with 1988 figures ranging from Brazil's $324 billion to Argentina's $79 billion. The economic role of the state in each also had important similarities. The best <u>quantitative</u> indicator of the size of the state sector is the public sector's share in gross fixed capital formation, roughly speaking the state's direct contribution to productive investment. In 1980, this measure ranged from a low of just under 20 percent in Argentina, to 29 percent in Mexico, to a high of 34 percent in both Brazil (in 1979) and India.[4] The <u>qualitative</u> aspects of overall state economic regulation varied widely among the four, but appeared to yield approximately the same ordinal ranking: from least to most state involvement in Argentina, then Mexico followed closely by Brazil, and, finally, India. The greater role of Brazilian and Indian, as contrasted to Argentine and Mexican, public enterprises in manufacturing was closely related to the larger share of heavy <u>versus</u> light industry (irrespective of ownership) in the first two countries. (See Encarnation, 1989; Ramamurti, 1987; Trebat, 1983.) The 1987 ratios of producer to consumer goods were 81 percent for Argentina, and 72 percent for Mexico--but fully 132 percent for Brazil, and 152 percent for India. The state regulated agricultural production and pricing, and owned some distribution networks in all four countries, with least to most direct ownership and/or limits to free private competition in Argentina, Brazil, Mexico, and, with by far the largest state involvement, India.

Curiously, differences in national political rhetoric often made outsiders conclude that the directly productive role of the state differed more than it actually did. All four had mixed economies with a large role in the industrial sector for both state and private capital, including foreign capital, although the space for foreign-owned production in India was significantly smaller than in any of the three Latin American countries. In Brazil and Argentina in the 1970s and early 1980s, policymakers professed their commitments to free markets--yet they managed and even expanded weighty state-owned enterprise (SOE) sectors. Conversely, to hear Mexican and Indian politicians describe themselves, the listener might imagine Mexico as a peasant and workers' state, and India a socialist mecca, dedicated to the redistribution of income and inherited wealth. These visions of Mexico and India only occasionally were true, at best.

The nine administrations are those of: President Raul Alfonsín (1983-1989) of Argentina; President Carlos Menem (inaugurated 1989) of Argentina; President de la Madrid (1982-1988) of Mexico; President Salinas (inaugurated 1988) of Mexico; President Sarney (1985-1990) of Brazil; President Fernando Collor (1990-92) of Brazil; Prime Minister Rajiv Gandhi (1984-1989) of India; the combined terms of Prime Ministers V.P. Singh (1990) and Chandra Shekhar (1990-1991); and Prime Minister Narasimha Rao (inaugurated 1991) of India. The study ends at the close of 1992, although Menem, Salinas, and Rao were still in office.

Why does one administration decide to pursue thoroughgoing privatization while another balks? Many people participate in these decisions in any government. All the usual caveats about the limits of assuming multi-person national governments are unitary rational actors apply to this paper's discussion. (Allison, 1971.) This essay assumes that the chief executive wields ultimate authority over economic policy decisions that come to be defined as "important" and that privatization in all four countries was sufficiently contentious to be politically important. The discussion of probable benefits from privatization, that is, always assumes the viewpoint of the president or prime minister (as advised by senior technocrats). Possible benefits include both the self-regarding (as in maintaining oneself in power, regardless of substantive public policy achievements) and the altruistic (as in governing well).

Policymakers thus face four kinds of incentives when considering privatization: (1) "Intrinsic Economic," (2) "Pragmatic Economic," (3) "Domestic Political," and (4) "International Political." The next several paragraphs detail a reasonably replicable set of indicators of each of these four composite incentives for each of the administrations examined. However, the great virtue of the parallel case study method of inquiry is that the researcher is able to incorporate his or her detailed knowledge of the specific cases into the design. That is, I have suggested cookbook lists of factors that ought to be considered for each of the cases below--but also have tried to ensure that the coded outcomes have been consistent with descriptions of each administration arrived at by those using more intuitive assessment methods.

(1) "Intrinsic Economic" incentives to privatize turn on the assertion that the unit or sector to be privatized itself will be directly benefited, either by more efficient management or improved access to resources. The presence of intrinsic reasons to privatize implies the expectation of improved performance within the sector, firm, or organizational task. For example, sales to private owners can maximize (a) competitive efficiency by increasing the power of the profit motive for firm managers and decreasing the temptation for public sector bureaucrats to treat their employment as a sinecure or to engage in corrupt practices such as exacting bribes from customers for services to which they are legally entitled.[5] Privatization also can permit entry into previously closed arenas, thus exerting competitive pressures on the SOE (or former SOE) and improving efficiency in the sector.[6] An intrinsic disincentive to privatize exists if policymakers judge that specific policies of privatization will result in private monopolies in the sector, and

thus less competition, or that it will be more difficult to regulate the new private firm(s) than it had been to police the old public firm or sector.

A related intrinsic economic argument embodies the hope that privatization will (b) improve access to resources, usually of capital and/or technology, to a fundamentally sound but undercapitalized state productive activity. Policymakers do not necessarily need to be convinced that the state has been a poor manager of the sector, firm, or organizational task in the past. The sole salient point implied is that private owners are richer, and thus more able to invest. Particularly if they are foreign, private investors also may have access to new technology. The most significant intrinsic reasons not to privatize in this category occur when policymakers fear that the new private owners plan restructuring that may be more efficient in generating profit, but less effective in providing the good or service that policymakers believe society "needs."

One would like to measure the expected efficiency gains from privatization by comparing factor productivity between private and public firms in similar sectors over time, then aggregating these results by administration and country. The data are unavailable. I therefore use a composite indicator. The first component is the general reputation of the SOE sector for efficiency, as measured by a qualitative synthesis of reports of SOE performance. Also relevant to assessing SOE performance is growth of the gross national product (GNP) because, in each of these countries, the role of state firms explicitly was to operate at the "commanding heights" of the econony, thus ensuring high levels of growth and industrialization, in the private as well as public sector. GNP growth performance is assessed comparatively, with allowance for regional downturns. Where available, I also consider information on the productivity of investment. The second component of the composite indicator is trends in public investment; where this is very low or has fallen sharply, SOEs' future performance prospects probably have been compromised. The third component is a qualitative assessment of the degree to which those local actors favoring privatization stressed access to new technology as the crucial issue. Where all three of these elements (SOE reputation, public investment, and SOE technological neediness) indicate a strong reason to privatize, the administration has "high" intrinsic economic incentives to privatize. The presence of two indicates "moderate" intrinsic incentives, and one or none suggests "low" intrinsic incentives. Table 2, placed at the end of the essay's empirical discussion below, summarizes the indicators in each of these composite variables for each administration examined.

(2) "Pragmatic Economic" incentives to sell or otherwise open hitherto state-owned production rights to private owners exist when policymakers value privatization for its contribution to other economic goals of the administration, goals not directly related to improved performance in the units privatized. The crucial point is that these other economic goals can have more immediate political payoffs for political incumbents than does a successfully completed privatization that, over the medium-term, raises productivity in the firm or sector privatized. One such reason to sell SOEs is the belief that sales will (a) help government finances. Clearly, no chief executive can be an effective leader if the government treasury is empty. The

sale of valuable state assets can bring revenue to a depleted treasury--even if the new private owners are not better managers. Conversely, a reason not to privatize by firm is that, once assets are sold, governments no longer will have access to that revenue stream. In addition, if the primary reason for the sale of state assets is to raise revenue, it is impractical to proceed enthusiastically in a depressed market.

Another pragmatic economic incentive to privatization is to (b) aid the balance of payments. External payments crises can bring on politically damaging outcomes, ranging from devaluations to inability to import to heightened foreign pressures from creditors to make unwelcome and domestically unpopular "reforms." Privatization that includes debt-equity swaps can reduce foreign debt directly. Alternatively, privatization by sector can attract net new inflows of foreign capital. Reasons not to privatize by sector include several of the classic objections to foreign direct investment. For example, once the initial investment has been made, the foreign company may become a net foreign exchange drain because of profit and dividend repatriation and a high propensity to import. Similarly, if the subcontractor is a foreign firm, privatization by organizational task may lead to increased imports of good and services.

I assume that most types of privatization can have positive revenue implications, at least in the short-term. Even privatization by sector may be a logical precursor to, for example, pushing SOEs to feel the need to compete by raising funds from private investors via sales of minority equity, thus reducing the demands for budgetary transfers from the center.[7] To gauge the strength of pragmatic economic incentives to privatize I use a composite of indicators of macroeconomic hardship or looming crisis: central government budget balance, difficulty in financing budget deficits, size of the foreign debt relative to gross domestic product (GDP), the trade balance, and inflation. In each case, the quantitative indicators are measured as they stand when the incoming chief executive assumes office.

If the central government budget shows a balance of -8.0 percent or less of GNP (that is, a deficit of 8 percent or more), then privatization looks attractive.[8] If institutional arrangements are such that government deficits cannot be financed without generating inflation or huge increases in future deficits (as in all three of the Latin American countries, but not in India through 1992), then this is a second incentive to privatize. An accumulated foreign debt of more than 30 percent of GDP provides a third incentive.[9] Finally, a trade balance of $-3.0 billion indicates that the country will have difficulty in financing foreign debt payments, possibly even if the total debt is not large.

Inflation is assessed only in terms of whether or not, in the context of the country concerned, hyperinflation is present or imminent. The relationship between privatization and inflation reduction, while it probably exists in most high-inflation countries, is far less direct than that between asset sales and government deficit/debt reduction. Comparing absolute levels of inflation in Latin America and South Asia makes little empirical sense, due to very different financial structures and reigning economic ideas. Annual consumer price inflation of 15 percent provokes food riots in India; 30 percent might incite revolution. In contrast, Brazilians between 1980 and the close of 1992 would have felt great relief if policymakers achieved stable annual inflation of 30 or even 40 percent. However, in both Argentina and Brazil in 1989 inflation reached a four-digit annual level. At that level, policymakers were under great pressure to try radical economic policy changes, including drastic privatization, even where their direct link to lowering the price level was tenuous.

An incoming administration encountering three or more of these five difficult circumstances has "high" pragmatic incentives to privatize, while two indicate "moderate," and one or none "low" incentives. Table 3 below summarizes the indicators in each of these composite variables for each administration examined.[10]

(3) "Domestic Political" incentives come into play when policymakers privatize in order to attract or reward crucial domestic constituencies or punish political opponents. One goal may be to (a) appeal to a mass electorate. Under certain circumstances, as in Eastern Europe after the dramatic fall of the communist state, transferring production from the state to private owners may have wide positive political appeal to voters. Another common domestic political reason to privatize is to (b) woo the business community. To the extent that businesspersons, domestic and/or foreign, rightly or wrongly associate privatization with generic "good economic management," central government privatization policies can signal "seriousness" about economic reform to skittish investors. In particular, if the government has a credibility problem because of a past record of interrupted or reversed austerity policies, then privatization can broadcast a willingness to burn bridges (since renationalization always will be more costly than merely retaining a firm in the state sector). On the other hand, business may feel threatened by some types of privatization, as of infrastructure or large SOEs with whom they have had long and cosy relations as preferred suppliers.

A third domestic political motive to privatize is to (c) shore up the incumbent's political coalition or position within it. For example, political incumbents engaged in a power struggle within a single party that has dominated the machinery of government for a long time may find selective privatization is a convenient way to weaken the rank and file supporters of rival national leaders whose base lies in the civil service or one branch of it. On the other hand, leaders elected by leftist or working class parties typically have a disincentive to privatize. Furthermore, if military officers hold prestigious (and lucrative) positions as directors of state industrial firms, then privatization may be a dangerous strategy for the political incumbent. Disincentives to privatize (that is, high expected domestic political costs) also figure into policymakers' calculations. Thus, for example, a weakening of public sector unions due to some unrelated factor (such as a structural change in the manufacturing profile away from heavy industry where unions historically have been strong) can make privatization more attractive than before, all other things being equal, by lowering its probable costs. The single score for "domestic political incentives" to privatize assigned to each administration, of course, is a product of inevitably subjective aggregation by the researcher.

(4) "International Political" incentives also confront national politicians. Because developing countries are, at most, middle powers in the interstate system, policymakers in developing countries usually

experience larger potential benefits (and costs) from foreign pressures and opportunities than do leaders of advanced industrial countries. Policymakers may feel pressure from abroad to respond to (a) international political pressures falling equally on all developing countries. In the late as compared to the early 1980s, givers of foreign aid were significantly more likely to insist upon privatization as a necessary condition for assistance. A comprehensive list of typical World Bank policy recommendations as of 1981 omits privatization, as does a similar catalogue of International Monetary Fund (IMF) recommendations as of the early 1980s. (Feinberg, 1988:551; Walton, 1985:10.) But a list of IMF policies from 1986 includes privatization, while the 1986 report of a standard-setting international conference on Latin American development taps privatization and state-enterprise reform as one of three core policies needed, the others being outward orientation and an increase in domestic savings. (Feinberg, 1988:551; Belassa, et al., 1986:24.) In the late 1980s the U.S. Labor Department sent at least one economist to Latin America to explain to governments and the business community how to pitch privatization to public sector unions; he was in India on the same mission in the early 1990s. (Accolla, 1989.) In 1990 John Williamson, senior fellow of the Institute for International Economics, referred to the existence of a rough but potent consensus in the Washington, D.C. policy community, on ten policy reforms needed in most developing countries, including privatization. (Williamson, 1990:9.) The degree of a country's compliance with the Washington consensus had consequences, as a country's access to aid and investment flows largely depended on Washington's image of a country's policy soundness.[11]

Leaders also respond to (b) specific international linkage attempts directed at them. For example, a wealthy country may make bilateral aid, trade access, or other benefits conditional on its firms gaining access to investment opportunities in profitable but previously off-limits sectors in the developing country. Evaluation of the strength of such pressures depends on whether international actors have strong preferences about privatization in developing countries, as well as on structural or conjunctural factors that make the developing country more vulnerable under some conditions than under others.[12] As with domestic political incentives, assignment of a single score for international political incentives necessarily is subjective.

Thus far, I have described how I intend to measure my independent variable: politicians' motives to privatize. Before proceeding, four research design caveats are in order. First, this essay uses a neoclassical definition of "intrinsic economic" reasons to privatize: low microeconomic productivity and lack of allocative efficiency are taken as evidence of an objective need to divest. There are, of course, perfectly legitimate developmental and social reasons for the creation of SOEs, and/or of economically "inefficient" degrees of state regulation. Nonetheless, evaluating the performance of the state productive sector on purely economic grounds provides a necessary baseline for thinking about its costs and benefits. Second, the research design brackets the actual thought and decision processes of politicians in the proverbial "black box." The investigation simply compares the presence or absence of probable benefits to the incumbent (as assessed by the researcher) from privatization in a given situation to privatization outcomes. Conclusions thus can shed light on apparent motives to privatize, but cannot claim to have examined the actual reasons policymakers themselves believed that they pursued certain policies. Third, I explicitly assume that the actual extent of privatization reflects the strength of chief executives' preferences. Shrinking the state was on the political agenda in each of these semi-industrial countries by the early 1980s. Had any of these national leaders been willing to spend his political capital for this purpose, significant privatization could have occurred. Fourth, there is no control for length of administration, except for the fact that two extremely short tenures, of Indian Prime Ministers Singh and Shekhar, have been joined into one observation. In three of four countries, the later years of the last administration have been ignored; the comparison ends in late 1992. Given that the later administrations, although shorter, tended to privatize more, inequality of time periods seems comparatively unimportant.

Defining and Measuring Privatization

I define "privatization" to include all types and increments of transfer of ownership, partial or complete, from the government to the private sector.[13] Privatization also occurs when previously excluded persons or groups, such as foreigners or limited liability corporate entities, are recategorized as eligible "private" owners.

Usual practice is to understand privatization to mean "sale of state firms to new owners in the private sector." This definition implies that "ownership" is a dichotomous variable: either the government holds 51 percent of a firm's equity, or private persons do. The drawback is that we then have no way to conceptualize other changes in the percentages of public and private ownership. For example, a shift from 100 percent public ownership to 75 percent public ownership can be a very significant act to reduce the direct productive role of the state. Politically, divestment of 25 percent of equity may signal a new era of opportunity for private entrepreneurs. The purely economic impact may be even more substantial. Suppose the goal of allowing 25 percent private ownership is to increase economic efficiency within the state-owned enterprise (SOE). The requirement of maintaining the value of a bloc of shares freely traded in the country's capital markets easily can be a form of competitive pressure on the firm, even if management and majority ownership remains with the state.

"Privatization" more usefully might be thought of as a continuum of policies which share the characteristic of transferring ownership of production of goods and/or services from the state to the private sector. The continuum begins with near total government ownership of the firm and of the sector within which it operates. Defense industries, or electricity generation and distribution, are typical examples of state monopoly sectors even in many advanced capitalist societies. Not only is the firm itself government owned; all of its competitors and potential competitors are state-owned as well. The mid point on the continuum shows a wholly-owned public sector firm competing with private firms; entry to the sector is free (that is, privatized), but the firm itself is entirely public. The ownership continuum's far end shows minority state equity participation in one or more firms within a sector that also contains large, dynamic private firms. If the shares held by private owners are dispersed, a firm with state equity holdings of as little as 30 percent may operate under effective government management. On the other hand, if more than 30 percent of the 70 percent of equity in private hands is closely held by one entrepreneur or group, then the government's same 30 percent holdings may not yield de facto state managerial control.

Strong functional similarity exists among three activities, each of which is "privatization" in terms of this essay's definition. These are: a) liberalization of the right of entry into an economic sector previously reserved to state production only, b) sale of equity in a state-owned and managed firm, and c) subcontracting out an organizational task previously performed by state employees, either within a state-owned enterprise or by a government administrative agency. In each case production of goods or services previously owned and controlled by the government passes to the profit-seeking private sector. Privatization of the sector or the organizational task implies the possibility of increased competition from potential new suppliers. Full or partial sale of equity in a state firm implies an enhanced role for transparent, market-based judgments about the true profitability of the unit. When either increased competition or transparency occurs, enterprise managers should be pressured into becoming more efficient. That is, the economic efficiency argument in favor of privatization applies with equal validity to opening up the space for private ownership in the sector, the firm, or the organizational task.

In fact, variations in cross-national use of the language of privatization reinforce the intuition that these are similar processes. Indian policymakers in the early 1990s talked of "privatizing" the steel sector: what they meant was for the first time permitting private entrepreneurs to open steel mills to compete with mills owned by the government. Argentine President Menem, meanwhile, boasted of his intention to "privatize" bill collection for urban utilities, that is, to contract out an organizational task. Interestingly, understanding the functional similarities of private entry into sector, enterprise, and organizational task, allows us to recognize privatization occurring even when governments have political reasons for preferring their transfer of production to the private sector to go unheralded.

Privatization has another dimension that also may go unnoticed. A nation's understanding of "private" owners often is continuous rather than dichotomous. A country's corpus of business law, in fact, usually distinguishes between three categories of enterprise owners: the state, nationals resident in the country, and other private persons. For example, Brazilian governments from the 1950s through the 1970s developed the public relations of managing the public-private, and simultaneously the national-foreign, ownership dichotomies into an art form with Brazil's famous "four-thirds" formula. The Brazilian government's contribution to equity investment was announced to be both "public" and "national." Similarly the multinational investor's contribution was dubbed both "private" and "foreign." Thus, the ideal-typical new heavy manufacturing plant in which the investment was a third foreign, a third state, and a third private local capital could be sold as promoting both Brazilian control of industry ("two-thirds Brazilian") and private ownership ("two-thirds private").

Countries also may discriminate among private owners on the basis of ethnicity. For example, countries such as Ireland, India, and Taiwan extend an intermediate category of privileges to expatriate nationals, former nationals, and their descendants, giving them access to certain kinds of property rights forbidden to ordinary foreigners. Israel offers citizenship, and thus ownership, privileges on the basis of religion. Finally, the familiar distinction made in every advanced industrial society (but not yet in every developing economy) between individuals as owners of firms (subject to unlimited liability for potential losses) and corporate entities as owners of firms (in which case the individual owners only are subject to limited liability) also illustrates the multiple, rather than dichotomous, nature of "private" ownership. Table 1 illustrates these continua.

Table 1

VARIETIES OF PRIVATIZATION

WHAT IS TO BE PRIVATIZED?	**WHO FITS WITHIN THE DEFINITION OF ALLOWABLE "PRIVATE" OWNERS? ****
THE SECTOR:	**ROUGH CONTINUUM:**
Private entrants are allowed into a sector previously reserved to the state. (Note: A variant is to permit non-resident nationals or foreigners to own or produce in a sector previously reserved for citizen residents.)	Minority participation of citizens, residents only
	Minority participation of citizens, plus non-resident nationals and descendents
THE FIRM: The government sells state-owned enterprises, in whole or in part, to private buyers.	Majority participation of citizens (resident and non-resident)
THE ORGANIZATIONAL TASK: A functional task (e.g., a utility's billing, a raw materials' firm's R & D) or geo-graphic subunit is delinked and given to a private sub-contractor. (Note: Governments may choose not to call this privatization.)	Minority participation of anyone (that is, including foreigners)
	Majority participation of anyone (that is, including foreigners)

** Note: Illustrated by framing possible answers to the question, 'Who can purchase shares in an SOE undergoing privatization?'

Logically, then, one ought to acknowledge as "privatization" all changes in national regulations that expand the allowable participation of private citizens in ownership of production of goods and services--including those policy changes prescribing movement from a more to a less restrictive definition of who is a legally admissible "private" investor. By the same logic, allowing previously forbidden institutional forms for private participation in a sector (or firm or organizational task) also qualifies as privatization. The economic efficiency rationale for favoring privatization operates identically in all of the examples just discussed. Extending the option of participating in entrepreneurship or minority share-holding to a previously excluded category of private citizens increases potential competition by enlarging the pool of potential entrants.

Unfortunately, this essay's suggested definition of the term "privatization" throws up one thorny terminological problem. Suppose entry into a given economic sector, such as commercial banking, previously has been permitted to one level of government (perhaps the central government), but forbidden to other levels of government (such as individual states or cities). What do we call liberalization of the rules of entry into a sector by novel levels of government itself? That is, the definition of who is a "public sector" owner also may not be dichotomous. Furthermore, competition among different public sector owners probably has some of the same economic characteristics as competition among private owners. For the purposes of the present discussion, I ignore the possibility of such "privatization" within the state.

Despite its occasional potential for terminological awkwardness, the suggested definition has two important virtues. First, it highlights the similarities in terms of competitive pressures that should result from expansion of ownership opportunities in all the ways listed. Second, the broadened definition proposed here is more helpful for comparative analysis of complex empirical cases, who may begin with differing degrees of state ownership of production, than is the simple dichotomy of "state" <u>versus</u> "private" typically employed. The usefulness of a flexible definition should become apparent in the empirical discussion contained in the paper's second half.

In one respect, however, this essay argues for a narrow definition of "privatization." It has become fashionable to speak of "privatization of management" in countries or industries where greater efficiency in enterprise operation is desired, but actual transfer or liberalization of ownership is shunned, usually due to political considerations. For example, the literature on "privatization" in China, and until recently also in Eastern Europe, contains ample discussion of "privatization of management." However, I will discuss privatization of ownership only. The empirical status of a) the rules governing who legally is <u>permitted</u> to be a "private owner," and b) who actually <u>is</u> an owner at any given point in time, is relatively straightforward to measure. That is, the concepts are unambiguous, although the data may not be readily available. On the other hand, "managerial autonomy" probably is both more difficult to specify conceptually and more difficult to measure empirically. In addition, granting managerial autonomy to state-enterprise managers is at least as problematic in its effects in terms of increasing competitive pressures on the firm as is full or partial sale to private owners. Sale of an SOE to its main private sector competitor does not increase competitive pressures, and probably also does nothing to inspire managerial efficiency. Similarly, granting decisionmaking autonomy to managers who have no stockholders to please, and/or who are difficult or impossible to fire, is unlikely to enhance competitive pressures.

Finally, what of other measures of economic liberalization (and enhanced competition) that do not involve expanding the actual, or the legally permissible, amount of private ownership in a sector, firm, or organizational task? That is, one might be tempted to include privatization, as defined here, in the same category as, for example, trade liberalization, or liberalized rules for floating corporate bonds in national or international markets. I submit that private ownership per se is an important enough characteristic, in the realms of both politics and economics, that it deserves to be investigated separately.

I define privatization to have four possible values. "Little or no privatization" has occured when there is very little change during the administration in either the broad regulatory framework governing public versus private activity or in the quantity of production in state hands. "Minor, symbolic privatization" indicates that the regime has gone on record as intending SOE sales or significant regulatory changes, but that, thus far, actual implementation of these policies has been limited. There is reason to believe that the chief executive supports privatization, although he or she may not have been willing to expend much political capital on pushing the policy through. In the three Latin American cases, the pre-existing framework of state ownership of production meant that privatization typically would involve majority sales of state-owned enterprises. For economies of the size studied here, total sales should net, say, more than $100 million but less than $500 or $600 million. For India, or other economies with extensive barriers to private entry into sectors exclusively reserved for either SOEs or for limited categories of private entrepreneurs, the changes indicated by this category would be significant enough to cause political controversy, but would not be large enough to alter, say, the future investment calculations of most private businesspersons.

"Moderate privatization" represents a serious move to reduce the comprehensiveness of reserved productive arenas and/or the quantity of state assets. If SOE sales are involved, they should encompass at least one or more historically state-owned firm; the dollar value of privatizations should exceed $500 million. Privatization by sector or organizational task should alter the rules of the game in a fashion immediately apparent to the country's most dynamic entrepreneurs. Fourth and finally, "vigorous privatization" means that a real change in the nature of the domestic economy has taken place during the incumbent's administration. For economies of the size being discussed here, asset sales above, say, five billion dollars might be seen as a very rough cutoff point. Where privatization by sector or organizational task, or minority sales of SOEs, are the principal reforms, the degree of regulatory change has long-range, and probably irrevocable, consequences for national industrial organization.

I would code privatization in these nine administrations as follows. In 1983, the state sector in **Argentina** included urban utilities (water, sewerage, electricity, the postal service), transportation facilities and companies (railroads, ports, highways, airports and airlines), communications (telephones, television), the state petroleum monopoly (Yacimientos Carboníferos Fiscales, or YPF), development and some commercial banks, and a complex of manufacturing firms (including steel and defense production) in a holding company, Fabricaciones Militares, run by the military.[14] Most sectors were open to both foreign and local private capital.

Under Alfonsín there was little or no privatization. Through 1987, only four state firms were sold, for a total of $32 million. (Ramamurti, 1991:5.) The state opened some organizational tasks to private contractors, the most important of which was to allow foreign oil companies to explore unused YPF oilfields. Although Alfonsín's government announced significant privatizations of the phone company and four historically state-owned firms in steel and petrochemicals in 1985-86, these plans ultimately were not carried out.

Menem, however, privatized vigorously. Sales of state-owned enterprises 1990-1992 raised $9 billion in cash, plus $12 billion in foreign debt reduction via debt-equity conversions. (World Bank, 1993:3.) Foreign buyers were welcome. Major privatizations included the national telephone company, Entel; eight petrochemical firms managed by the military; the airline Aerolineas Argentinas; 3000 kilometers of railroad track; power plants; two television stations; road networks around major cities; first secondary then primary oilfields of YPF;[15] coal mines; the merchant marine; the postal service; the port authority; the Buenos Aires subway system; and storage facilities of the national grain board. Related liberalizing moves allowed foreign banks and international financial operators to participate directly on the Argentine stock exchange. Private firms bid for the contracts for crucial organizational tasks, such as bill collection for urban public utilities and highway maintanence for many interurban routes. As to privatization by sector, the president went so far as to announce that government procurement would be opened up for bidding to multinational firms.

In late 1982 the **Mexican** state controlled all of the economic sectors the Argentine government did, plus all commercial banks.[16] State development banks unintentionally had acquired title to numerous small and medium-sized commercial and manufacturing enterprises as their former owners defaulted. Most of agriculture was in private hands, but the state owned large agribusinesses. Furthermore, the communally owned ejido sector, covering half of the nation's arable land, was characterized by limited private property rights. Farmers had use and inheritance rights, but could not sell or otherwise transfer their plots. Mexico limited the percentage of foreign ownership in manufacturing firms to less than 49% in most sectors, and forbid entry to foreign banks, but permitted foreign portfolio investment in government securities.

De la Madrid was a moderate privatizer. Sales reached around $1 billion. $612 million of this figure, however, represents firms sold in the last six months of 1988, some finalized after de la Madrid left office in early September. With the prominent exception of one large, historically state-owned firm, the airline Aeroméxico, which sold for $330 million, the great majority of the more than 120 firms sold represented re-privatizations of small, non-strategic commercial and industrial firms that had come to be owned by the state because of defaults on debts owned to public sector development banks. (Schneider, 1990.)

Through 1992, Salinas accomplished vigorous privatization. Funds raised totaled $21 billion. (Bazdresch and Elizondo, 1993:52.) Firms sold included a second airline, Aerolíneas Mexicanas; the copper mining firm, Cananea; Telmex, the telephone company (in which the government sold a controlling, although minority, interest for $1.76 billion plus $8 billion in promised investment); seven commercial banks (including, Banamex, the country's largest, for $2.3 billion); several large steel plants; and much of the state's interests in food processing and distribution, including sugar refineries worth $700 million. Privatizations of organizational tasks included exploration and development of oilfields owned by PEMEX, the state petroleum monopoly; and highway maintenance concessions. The electricity regulatory authority (CEF) contracted with foreign manufacturers for them to build and/or renovate factories in Mexico to produce generators, that CEF then would lease back. For the first time since the Mexican revolution, foreign investors were welcome as joint private owners (up to 25% of total equity) in the banking sector. In early 1992 Salinas moved to permit a market in land on the large, communally owned but individually farmed, estates formed in the 1930s, the ejidos. Mexican peasants had fought the bloody Mexican Revolution (1911-1917) over land, much of which big Mexican and North American landowner-investors had stolen during the nineteenth century. To privatize ejidal land was deliberately to retire an important symbol of twentieth century Mexican political economy.[17]

Brazil's state sector as of 1985 looked like Mexico's except that television and most airlines were private, as was about half the financial system and over half of petroleum distribution.[18] The larger state presence overall in Brazil mainly resulted from its role in heavy manufacturing in sectors such as steel, petrochemicals, aircraft, and armaments. In 1980, the top fifty SOEs, as compared to the five hundred largest private, nationally owned, firms, generated the equivalent of 43 percent of sales and 44 percent of profits, held 151 percent of assets, and owed 145 percent of corporate debt.[19] As in Argentina and Mexico, the largest single public firm was the state petroleum company, Petrobrás. Brazilian agriculture and agribusiness largely were in private hands, with the exception of state trading enterprises in a few very important traditional commodities, notably coffee and sugar. State firms, including commercial banks, routinely raised capital from the private sector via minority share and debenture issues; many entered joint ventures with multinationals. Foreign investors encountered relatively heavy taxation on repatriation of profits and dividends, but were free to enter most sectors. Legislation forbade most direct foreign participation in local capital markets.

Sarney presided over minor, symbolic privatization. His administration raised $475 million through reprivatization of six manufacturing firms acquired by BNDES, Brazil's industrial development bank. (Schneider, 1990:328.) There also were three noteworthy liberalizations of entry. From 1986, multinationals could lease exploration and development contracts for oilfields from Petrobrás. From 1987 foreign owned and operated "country funds" could trade corporate securities directly in Brazilian capital markets. The Sarney administration also opened the computer, or "informatics," sector to new foreign direct investment.

Collor accomplished moderate privatization. By late 1992, the government had sold industrial firms to the private sector for $3.9 billion. (World Bank, 1993:9.) The largest sale was of Usiminas, a historically state-owned steel mill that raised $1.5 billion. Other large firms included three additional steel mills, Cosinor, Piratini, and Tubarªo; a shipping firm, SNBP; the fertilizer and petrochemical installations, INDAG, Petroflex, Copesul, and Alcalis; and the heavy equipment manufacturers, Celma and Mafersa. Planned privatizations to end 1993 amounted to an additional $13 billion. (Baer and Villela, 1993:16.) Collor was impeached for corruption in December 1992; his successor, vice president Itamar Franco, suspended most privatizations through 1993.

As of 1984, The **Indian** government dominated all of the sectors its Latin American counterparts did, plus virtually all of the financial sector, including insurance.[20] Its role in manufacturing, from machine tools to heavy electrical equipment to armaments, was large. For example, India was the only country of the four with a large presence in the capital goods sector. Furthermore, the Indian government, unlike Latin American authorities, reserved many sectors exclusively to state production. Its concept of planning since the 1950s had not only encompassed allocating resources to desired uses and geographic regions but also implied preventing the "waste" of scarce capital on "unnecessary" projects. Thus, even most productive activities dominated by private ownership did not have free entry for new entrepreneurs, even if they were resident citizens of India. Instead, would-be producers had to obtain multiple licenses to set up any factory, as well as for even comparatively trivial expansion or diversification of existing production facilities. Many labor-intensive and traditional cottage industry sectors, such as cotton textiles or furniture, were protected from competition by larger firms.[21] In fact, larger firms, and even medium-sized companies with a dominant market share, had to petition the government's Monopoly Commission for its permission for virtually all strategic business decisions. Foreign investors could not own more than 40 percent of companies. Yet, from the late 1970s, the Indian government had begun to rely on foreign capital inflows arising from new kinds of portfolio investments, managed by commercial banks in India, from South Asians resident abroad. Thus there came to be two principal categories of foreign investors, with different rights and duties, the ordinary outsider and the "non-resident Indian," or NRI. Non-citizens, including NRIs, were barred from direct participation in local stock markets.

Rajiv Gandhi oversaw minor, but symbolic privatization. His government greatly expanded the number of manufacturing sectors open to entry for most domestic entrepreneurs under the so-called "open general license." The licensing regime began the switch to a much streamlined "negative list" of reserved sectors, with all sectors not explicitly prohibited to new domestic entrants being, in principle, permitted. His government raised the lower size limit for firms subject to regulation by the Monopolies Commission. "Country funds" directed at NRIs were allowed to invest in Indian equities. Perhaps the most important privatization achievement of Rajiv Gandhi's administration was to make open advocacy of economic liberalization respectable within the dominant Congress Party at the national political level, a not inconsiderable feat.

The short-lived administrations of minority coalition leaders V.P. Singh and Chandra Shekhar[22] engineered little or no actual privatization, although Chandra Shekhar's finance minister in March 1991 announced future plans to divest 20 percent of the equity of selected state firms. Two large public sector industrial development banks, the Industrial Development Bank of India (IDBI) and the Industrial Credit and Investment Corporation of India (ICICI), received unprecedented permission to raise new capital by share issues to be directly subscribed by the general public.

In the year and a half to late 1992 Shekhar's successor, P.V. Narasimha Rao, had privatized moderately. Under Rao, there was further significant liberalization in the licensing regime, the scope allowed for foreign direct investment, and the rules governing SOEs' access to private financing. The government freed investment and production in the steel sector by Indian firms, and also made such investment attractive by loosening price controls on the sector.[23] Privatizations of organizational tasks included opening up competitive bidding contracts for modernization, development, and/or management of ports, oil and natural gas fields, concessions and station amenities for Indian Railways, the largest employer in the country, and urban cellular phone systems. The system of licensing imports was greatly simplified and reduced. Breaking with almost two decades of highly politically symbolic tradition, Narasimha Rao's minority government pushed through amendments to the FERA (Foreign Exchange Regulation Act of 1973) that permitted multinational investors, previously limited to a minority position, to hold 51 percent of equity in most sectors, and up to over 75 percent in sectors deemed strategic for future industrialization, notably those involving sophisticated technology, high export potential, or both. By early summer 1992 about $1.1 billion had been raised through divestment of up to 20 percent of the equity of 31 state-owned enterprises ("public sector units," or PSUs, in Indian parlance). The government announced plans to liberalize entry into commercial banking, allow foreign institutional investors direct access to Indian capital markets, and to fully privatize such traditionally state-owned sectors as power generation.

Incentives to Privatize, from Alfonsín to Narasimha Rao

What explains politicians' diverse records of privatization? This section reviews the evidence on the economic and political "logics" of the possible policy choice of privatization for each administration. Tables 2, 3, and 4, located at the end of this long section, summarize the information on each administration.

Argentina had one government that privatized hardly at all and a second that reduced the state sector vigorously. Under President Raul Alfonsín (1983-1989) intrinsic economic incentives to privatize were high: most observers held a majority of SOEs to be both inefficient and corrupt. In 1980, for example, Fabricaciones Militares alone had losses estimated at $600 million. (Lewis, 1990: 454.) The SOE sector's deficit averaged 5.6 percent of GDP in the early 1980s. Moreover, the state's general economic management of the economy for some decades had been abysmal. Argentina's gross national product (GNP) grew only 2.5 percent annually in the 1970s, as compared to the Latin American average of 5.5 percent, and fell by -2 percent from 1980-84. Frieden (1991:80) constructs an "investment efficiency index" for Latin America for the 1970s and early 1980s, in which higher numbers indicate greater efficiency. The regional mean is 22, but Argentina receives a dismal -1.5 percent. The public sector's ability to invest also was eroding. In the 1970s, public investment as a share of GDP had been 8.7 percent; in the early 1980s, it was only 7.1 percent. Furthermore, chronic problems in urban infrastructure such as the telephones indicated both a lack of funds and an acute need for new technology.

Alfonsín's pragmatic economic incentives also were high. The government budget balance in 1983 was -13.9 percent of GNP. The government's maladroit attempt to finance itself through "nationalizing deposits" (instituting 100 percent reserve requirements) in the early 1980s could not be sustained against the opposition of both banks and their erstwhile borrowers. (Bekerman, 1986.) Other options implied either immediate inflation or paying very high rates of interest, thus worsening the deficit over the medium-term. As of 1980, the ratio of external debt to GDP already was 35 percent; by 1985 it had risen to 57 percent. However, the trade (in goods plus non-financial services) balance was slightly positive, in transition from $-3.2 billion in 1980, to $4.7 billion in 1985.

Furthermore, domestic political incentives to privatize were low. Alfonsín faced the difficult task of restoring the credibility of government after years of repressive, bloody military rule (1976-1983). As the leader of the confusingly named Radical Party, heading a centrist coalition of business and the urban middle class, as well as economic nationalists, Alfonsín confronted a splintered but powerful Peronist movement--ranging from populist, agrarian economic nationalists to militant industrial workers to leftist intellectuals--loosely arrayed to his left. The business community, which favored privatization, generally supported Alfonsín in preference to the Peronist alternative, but he needed to tread gingerly with the country's potentially volatile industrial workers, the best organized of whom worked for the state. During his term Alfonsín faced several military rebellions and coup attempts. (Pion-Berlin, 1992; Huser, 1994.) He was aided by the triply discredited condition of the military, vilified by much of the public as abusers of human rights, losers in battle, and failures at economic management. Still, an additional reason to avoid rapid privatization was the fact that many senior officers retained lucrative sinecures in the government oil monopoly and throughout the public productive sector.

Finally, external political pressures were low. Given the economic and political disasters of the final years of military rule, policymakers in the advanced industrial democracies and the international financial organizations they dominated were willing to be supportive of any Argentine democratically-elected government. In fact, these international actors were delighted not to be dealing with a Peronist president. Thus Alfonsín was able to pursue a comparatively confrontational international debt negotiating strategy culminating in a partial moratorium in 1988, which helped him consolidate domestic political support. Although creditor country governments and international agencies such as the International Monetary Fund (IMF) were becoming increasingly critical of Argentine state firms, they were reluctant to pressure Alfonsín too much.

Carlos Saúl Menem (inaugurated 1989) also had high intrinsic economic incentives to privatize. SOEs in the late 1980s were no more efficient and only slightly less deficitary than they had been when Alfonsín came to the presidency. Phone service and other essential urban infrastructure continued to deteriorate, although there was a problem of finding potential buyers. The major bidders for Argentina's public utilities were either oligopolistic private competitors or foreign SOEs including the Spanish and Italian telephone companies, neither of whom had terribly good service records in its home market. Economic growth, at the debt crisis level of -2.1 percent in the early 1980s, had recovered to only -0.4 percent in the late 1980s. Public investment fell dramatically, to only 4.9 percent in the late 1980s. Politicians claimed to be driven by the objectively urgent need for new technology. On the other hand, the administration's decision to accept bids from foreign parastatals with mediocre service records casts doubt on how much importance policymakers actually placed on solving this problem. (Manzetti, 1992.)

Menem's pragmatic economic incentives were high. Alfonsín's administration had adjusted economically, although the president had not dared challenge the powerful interests tied to the large SOEs. The government balance for 1989 was only -0.5 percent of GNP, the best result of all the nine administrations surveyed. However, the institutional arrangements for financing even this low deficit were poor. The trade balance was positive, reaching $7.8 billion by 1990. The foreign debt was drifting down, and would be "only" 44 percent of GDP in 1990. Of course, the economic outlook overall hardly was rosy. Menem had assumed office four months early because the economy, and political confidence in Alfonsín, were deteriorating very rapidly: the country was entering hyperinflation. Given the acute economic crisis, the new government was under great pressure to do something dramatic to wrench the economy back on track.

Domestic political incentives also were high. Menem won the 1989 election as the representative of the working and middle class Justicialist (Peronist) Party. Voters did not expect him to privatize. What happened? Despite several coup attempts, democracy had survived two presidential elections. Menem probably could count on controlling the military so long as he retained the support of the business community and the urban middle class.[24] But, in the Radical Party, Menem faced in the Radical Party a credible alternative multiclass political coalition located, on the whole, somewhat to his right, or at least seen as less threatening by both Argentine businesspersons and foreign investors. To compete politically, Menem himself moved rightwards, in policy choice if not immediately in rhetoric. He appointed as a senior economic advisor Alvaro Alsogaray, a widely known and economically liberal former army officer and minister. Menem's later elevation of Domingo Cavallo to become economy minister was an appointment in the same vein. Winning over the business community remained a challenge. Capital flight long had been a problem in Argentina. The quadruple digit annual inflation of 1988 and 1989 was unprecedented and frightening. Privatization had the political advantage of signaling "seriousness" to the capitalist class. (Pinheiro and Schneider, 1993; Bazdresch and Elizondo, 1993:74.) Argentina's middle classes, many in government jobs, also historically had not been supporters of a small state. Their gradual, reluctant shift on this issue followed over a decade of bad economic news.

Even if Menem's move toward neoliberal economics brought him the support of capitalists, we also must explain why Menem felt comfortable abandoning his own party's historic constituency: public sector unions. As a Peronist, Menem did <u>not</u> have intra-organizational incentives within his own committed support group for moving to the right on economic issues.[25] By August 1990, just over a year into Menem's term, a total of 900,000 workers were out on strike to protest wage restraint and privatization in August, 1990, many from public sector unions in telecommunications, oilfields, and state mortgage and investment banks. (The real purchasing power of wages had fallen between 30 and 64 percent in the previous six months.)[26] Although workers cursed Menem, they had few political alternatives. The military's "dirty war" against subversives in the 1970s and early 1980s had decimated Argentina's non-Peronist leftists. Overall, Argentine workers were unlikely to secure for themselves a better deal by following any or politician or political party with a viable chance of coming to power: the political costs to Menem of disregarding worker preferences were not great. Thus, as a rational politician seeking to broaden and strengthen his support, Menem faced strong domestic political incentives to privatize.

Finally, Menem's international political incentives to privatize had increased to the <u>moderate</u> level. International pressures increased on all four of the countries in this study, as privatization became an important symbol of economic sincerity to both the Bush administration and the IMF. Moreover, Argentina was less shielded from normal foreign political pressures in the very late 1980s, after the maintanence of democracy <u>per se</u> appeared assured, than it had been in the early and mid 1980s. In January 1989 the World Bank had suspended its loan program, because of Argentina's failure to meet agreed upon economic targets. Argentina needed the approval of both the IMF and the U.S. on a variety of international economic issues, most importantly debt relief and trade.

The first **Mexican** administration studied oversaw moderate privatization; the second was a vigorous privatizer. <u>President de la Madrid (1982-1988</u>) had comparatively <u>low</u> intrinsic economic incentives to privatize. The most visible symbol of public sector production, Petróleos Mexicanos

(PEMEX), the state petroleum conglomerate, remained a credible symbol of state control of the "commanding heights" of the economy. Furthermore, under state leadership, Mexico's economy had done well: GDP growth in the 1970s had averaged 6.3 percent annually. Frieden awards Mexico in the 1970s a score of 23 on his "investment efficiency index." The financial problems of the SOE sector as a whole were relatively serious: SOE deficits were high, at just under 6 percent of GDP in 1980 and over 9 percent in 1981. (Pinheiro and Schneider, 1993:13.) Nonetheless, public investment as a share of GDP, uniquely among the six Latin American administrations profiled, was rising as de la Madrid took office. It had averaged 7.6 percent through the 1970s, but rose to 9.3 percent in the early 1980s, suggesting that it had not yet become a serious problem. In fact, many observers saw the problems of Mexico's large, historically public sector firms as ones of liquidity and international prices for PEMEX's oil, rather than as indicator's of fundamental incompetence. Nor was there an urgent need for access to new technology; much had been imported during the flush 1970s, and close ties to the United States ensured Mexico relatively easy future access as well.

De la Madrid encountered <u>high</u> pragmatic economic incentives to divest. The central government's balance for 1982 was -16.0 percent of GNP, and financing it would be problematic, particularly given the traditional ease of capital flight northwards. This situation required the Mexican government to issue bonds with high interest and, worse yet, often denominated in dollars. 1982's debt to GDP ratio was 49 percent. Still, the trade balance had just become positive, passing from $-4.3 in 1980 to $7.8 billion in 1985.

Domestic political incentives to privatize also were <u>low</u>. In contrast to Alfonsín and Sarney, de la Madrid did not have to worry about keeping the military in line, nor, or so it appeared through the 1980s, about regional rebellions, as did Rajiv Gandhi. De la Madrid belonged to the Institutional Revolutionary Party (PRI), which had reigned over Mexico's soft authoritarian political system since the 1920s. His predecessor, Lopez Portillo, had been an economic expansionist who, in the last days of his term, sddenly nationalized all commercial banks and their associated empires, blaming them for the foreign debt crisis. However, many victims of bank nationalization long had been important, albeit surreptitious, financial backers of the PRI, a party whose rhetoric exalted industrial workers and the peasantry, but in practice was on cozy terms with the business community. Consequently, a major challenge for the new president was to reinforce the PRI's informal links with big business, especially entrepreneurs located in Northern Mexico. Immediately after assuming office, de la Madrid moved to woo big business by reprivatizing the non-bank businesses that had belonged to the conglomerates headed by the now-nationalized banks. In 1986, Mexico joined the GATT (General Agreement on Tariffs and Trade), a step that implied phased dismantling of a long-established structure of industrial protections and was popular with internationally-oriented business. In addition, many middle class voters, and small and medium-sized businesspersons producing for the domestic market began to gravitate in the 1980s to the National Action Party (PAN), a conservative, pro-clerical and private sector party that did surprisingly well in local elections in 1983. The need to solidify ties to big business and to manage attrition losses to the PAN were both forces pulling De la Madrid's policies rightwards.

At the same time, De la Madrid also had to watch his left. The PRI's traditional corporatist organization into peasant, labor, and "popular" sectors (the latter a catchall category dominated by white collar public sector unions, such as teachers), no longer reflected real power realities. Structural changes in the economy since the 1960s had made both industrial labor and, especially, peasants less and less important economically and thus increasingly less likely to be considered by the central government power brokers. Furthermore, post 1982 economic austerity meant the central government had many fewer resources to distribute, weakening regional party bosses' ability to dispense patronage to their clients (Heredia 1994: 279-283). These constituencies, plus disaffected urban intellectuals, opposed economic liberalization and had coalesced around the PRI faction led by Cuauhtemoc Cárdenas, son of one of Mexico's best-loved presidents. De la Madrid therefore wooed workers, farmers, and the urban middle sectors by reaffirming the sacred nature of state monopolies in petroleum, mining, telecommunications, and the new task of commercial banking. Reprivatization of hotels and such was one thing, but threats to PEMEX were not to be borne.

International political pressures were <u>moderate</u>. Pressures from abroad heated up after 1985, when the U.S. began pressing Mexico to sign on to its "Baker Plan" for modest creditor concessions on debt rescheduling in exchange for market-oriented domestic economic reforms. The Reagan administration was pleased with Mexico's economic adjustment in the form of gradual trade liberalization and massive wage compression. Nonetheless, the tremendous economic leverage the U.S. had over Mexico meant that, as privatization became popular in Washington policy circles, Mexico would be among the first to be proselytized.

Six years later, <u>President Salinas (inaugurated 1988</u>) inherited intrinsic incentives to privatize that remained <u>low</u>. The reputation of the big, historically state-owed firms was still sound, at least in comparative terms. Although the debt crisis and subsequent stringent adjustment reduced GNP growth to 0.9 percent annually in the early 1980s, it recovered to 2.1 percent from 1985-89. Public investment, however, plummeted, from an average of 9.3 percent from 1980-84 to only 5.4 percent from 1985-89. Still, foreign investment had began to flood in: access to technology also was not a major problem. Nonetheless, by the end of the period covered in this essay, attitudes slowly were changing. In 1992 a <u>Financial Times</u> reporter interviewed Francisco Rojas, head of PEMEX, then undergoing restructuring as a way to head off demands from some quarters for outright privatization. Rojas admitted that formerly, "[T]here was no maximization of profits, there was no business criteria [sic] in the activities of Pemex. What they demanded of Pemex was that it supply effectively all the hydrocarbon needs of the nation and there is no doubt it did it."[27] This level of official honesty was novel.

Pragmatic economic incentives to privatize, however, were <u>high</u> and rising when Salinas took office. He inherited a central government budget balance in 1985 of -10.8 percent of GNP. The institutional basis for financing government deficits remained fragile, although possibilities for financing showed promise of short-term improvements, as Mexico's liberalizing reforms began to make the country attractive to foreign investors. The foreign debt was 59 percent of GDP in 1988, down from its 1986 high of 76 percent! There was a trade surplus in 1988, although it would become a huge gap of $-18.3 billion by 1992, due to rapid trade liberalization.

Domestic political incentives, meanwhile, had increased to become moderate. It was more important than ever for Salinas to retain the support of large, internationally oriented Mexican business. Despite widely-believed charges of ballot-stuffing, the PRI's candidate, Carlos Salinas de Gortari, predictably had won Mexico's 1988 presidential contest, defeating challenger Cárdenas, who broke with the PRI late in de la Madrid's term. Cárdenas' leftist coalition was greatly weakened by factional fighting after the election, while the rightist PAN won three state governorships, two so overwhelmingly that the government party could not, as had been its wont, disguise the results by fraud. By privatizing, Salinas took advantage of the post-election political weakness of the left and moved to met the challenge from the PAN. Reducing opportunities for patronage-based access to SOE manufacturing jobs also undercut the power of traditional political bosses (the so-called "dinosaurs") within the PRI itself, and thereby to strengthen the mostly foreign-trained technocratic modernizers (literally the "philosophers," but closer in meaning to the "scientific managers") in the Harvard-trained president's own camp. Privatization therefore allowed Salinas to strengthen his own influence, and that of likeminded young reformers, within the long-ruling political party (Langston, 1990.)

Finally, Salinas' international political incentives to sell SOEs were high. Just as international pressure to privatize increased for all developing countries, there was an additional shift in Mexico's international vulnerability. Canada and the United States negotiated, and in 1989 signed, an historic agreement for a Free Trade Area. Suddenly Mexico was in danger of being permanently cut out. To bring Mexico into the renamed North American Free Trade Agreement (NAFTA), Salinas had to woo the new Bush administration, the U.S. border states, and the U.S. Congress, all of whom expected very specific changes in Mexican domestic economic policy, ranging from liberalization and privatization to tough new environmental safeguards.[28] Salinas' decision to pursue NAFTA hard also brought him still closer to the business constituency in Northern Mexico and further from the PRI's historic base among the small, marginal farmers and workers of the economically depressed South. As Salinas burned his bridges to the still powerful Mexican constituency for statist, inward-looking economic policies, his political need for the strong affirmation of the U.S.'s acceptance of NAFTA became intense.

Meanwhile, in **Brazil** of the 1980s and early 1990s, one administration engaged in minor, symbolic privatization and the next was a moderate privatizer. President Sarney (1985-1990) faced low intrinsic economic incentives to privatize: the historic performance of the SOE sector had been quite good.[29] Senior government economists questioned the competitiveness rationale for selling off state firms in oligopolized sectors. Private businesspersons reluctantly credited the state with having shepherded the country's impressive postwar industrial growth. Even prominent economic conservatives seldom directly criticized the performance of large SOEs, instead emphasizing the need for staffing cuts in the civil service and central government ministries. The deficit of the SOE sector averaged a comparatively low 2.8 percent of GDP in the early 1980s. GDP growth in the 1970s had been an impressive 8.1 percent annually, although the early 1980s, with first a local recession and then the region-wide debt crisis, saw growth of only 0.4 percent. Frieden awards Brazil a 32, against the regional average of 22, in "investment efficiency" through the early 1980s.

Nonetheless, public sector investment had dropped, from an average of 8.3 percent through the 1970s, to only 6.8 percent in the early 1980s. Some economists suggested that the central government budget was being augumented by deliberate squeezing of the SOE sector, whose controlled prices lagged substantially behind inflation, and whose capital investment budgets fell. (Afonso and Dain, 1987.) There was not a pressing need for access to foreign technology, particularly since SOEs long had been encouraged to form joint ventures with multinationals.

There were <u>high</u> pragmatic economic incentives. The government budget balance for 1985 was -11.40 percent. Financing the deficit would prove to be one of the Sarney government's greatest long-run failures. By 1984 the accumulated public debt already was over 13 percent of GDP. (Dias Carneiro, 1987:227.) The cost of financing the debt rose as interest rates increased to extraordinary levels. Real <u>monthly</u> interest rates on bank certificates of deposit were about 1.5 percent in 1985; by 1989 they would average 7.23 percent![30] Foreign debt to GDP was high at 39 percent, although down from 63 percent in 1980. A trade surplus of $10.8 billion in 1985 made the foreign debt by far less threatening than the domestic one.

Sarney had <u>low</u> domestic political reasons to privatize. Like Alfonsín, he first had to focus on navigating the transition to civilian rule after twenty years of military authoritarianism (1964-1985). Brazil's redemocratization was made more difficult by the fact that Sarney, trusted neither by his new allies the moderate reformers nor his old friends in the military's tame political party, inherited the top position suddenly and unexpectedly when the popular president-elect died. Maintaining regime stability meant minimizing direct economic threats to those social groups that had supported the authoritarian regime, including the military officer corps and the urban middle class, who had benefited from the expansion of state employment during the previous three decades. Domestic business, and even some multinationals, had grown accustomed to generous indirect subsidies in the form of cheap goods and services from state-owned enterprises, subsidies that would have to cease were private owners to take over. Large-scale privatization potentially also could produce threats of strikes or mass action from the left, provoking a reaction from the right. The new democratic government, unlike military rulers, had to avoid repressive methods of preventing strikes, which easily could occur if workers in the large SOEs felt threatened. Moreover, unlike Menem, Sarney, as an historic conservative himself, did not need to move rightward to reassure a nervous business community, nor did he have a motive to privatize in order to try to consolidate his position within his own party, like Salinas. Finally, capital flight had been less of a problem in Brazil than in either Argentina or Mexico through the mid 1980s: consequently, there was less need to entice home Brazilian funds invested abroad through "responsible" policies such as privatization.

International political incentives were low, but became stronger during the later years of Sarney's term. The U.S. used its "super 301" threat of bilateral trade sanctions to privatize foreign entry into Brazil's computer manufacturing sector. However, Brazil's greater distance from the U.S., as compared to Mexico's, and the superior diversity of both its trading partners and its multinational bank creditors, gave Brazilian policymakers more bargaining freedom. Furthermore, Brazil's ability to transform its trade deficit of the 1970s into a surplus after 1981 was another source of bargaining strength. Throughout the 1980s, Brazil repeatedly failed to live up to its restructuring commitments with the IMF, but escaped serious sanctions.

When President Fernando Collor (1990-92) assumed office, intrinsic economic incentives to reduce the state's directly productive role remained low, although they were slowly increasing. State sector performance remained generally good. (Ribeiro, 1992.) Brazilian elite opinion continued to believe that SOE production in such sectors as petroleum, energy, and telecommunications was essential.[31] Access to foreign technology was a need, perhaps, but not a pressing one. In fact, the overall economy was, by some measures, astonishingly resilient: after GNP growth of 0.4 percent from 1980-84, it had risen to 2.1 percent from 1985-89, quite reasonable for the region in the context of the debt crisis. However, GNP growth in 1990 itself was -4.7 percent. In the late 1980s as compared to the early years of the decade, total public investment was down from 6.8 to 6.0 percent of GDP, in itself a comparatively small drop, but a worryingly low absolute figure. Baer and Villela (1993:6) disaggregate SOE investment, which averaged 4 percent of GDP in the early 1980s, but only 2 percent in the later 1980s. One problem was that redemocratization in 1985 had encouraged leaders to reallocate state investment spending to visible projects such as new school buildings and other public works.

Collor, however, encountered high pragmatic economic reasons to privatize. The central government balance was approaching meltdown, at -16.6 percent of GNP in 1992. Inflationary finance was still in place, although Brazil's means for accomplishing this were unusually convoluted.[32] Worse, Brazil's central government did most of its domestic borrowing not from captive financial institutions, as in India and to a lesser extent in Argentina during the early 1980s, but in the market. Real monthly interest rates on bank CDs fell during Collor's first year in office--but only to 4.1 percent! Slightly more comforting was the fact that the foreign debt in 1990, although at $116 billion in absolute terms still the largest among developing countries (followed by Mexico with $97 billion and India with $70 billion), was only 24 percent of GDP. The external trade balance in the year Collor took office stood at a comfortable $9.5 billion. In fact, the arrangements for the privatizations that occurred under Collor clearly show that the domestic debt was a much bigger problem than the foreign debt. Although the government allowed swaps of foreign debt as one of the "privatization currencies," it was discounted 25 percent. Virtually all buyers preferred paying by means of domestic debt instruments, including Treasury securities and bonds that had been issued by various state-owned enterprises, which were exchangeable at face value. Furthermore, inflation reached four digits in 1989, indicating severe macroeconomic problems, although not necessarily ones that privatization could fix. Although Brazilian policymakers steadfastly maintained that Brazil, unlike its neighbor to the south, was not entering hyperinflation (but rather a vaguely defined but less worrisome "superinflation"), these numbers forced the administration to take some type of drastic action.

Collor's domestic political pressures to privatize were <u>moderate</u>.[33] Despite having won Brazil's first direct presidential contest in nearly thirty years, Collor's authority was weakened by having to work with an extremely rambunctious legislature, fractured among almost thirty mostly novice political parties, in which the president's own party held less than 5 percent of the seats. Collor was popular neither with the working class left nor with most of the Sªo Paulo business community, who had supported him in the run-off election mainly to prevent a win by the Workers' Party, or PT, candidate, Luís Ignácio da Silva, known as Lula. Collor needed to shore up his political base. Meanwhile, Brazil's worsening economic crisis put pressure on the chief executive to "do something." Many Brazilians were prepared to support dramatic economic "shock" programs, a tradition began under Sarney.[34] Collor first tried a macroeconomic shock, which froze over 70 percent of the public's assets in the banking system for the coming eighteen months. "Structural" reforms also were planned, including sale of large, profitable state firms. It is worth noting that middle class state employees tended to work in white-collar bureaucratic jobs, or in service industry monopolies such as the post office or the big state banks--all of which were overstaffed by any efficiency standard. The big privatizations scheduled in Brazil--unlike Argentina, and partly unlike Mexico--were in the state manufacturing sector. These firms largely employed blue collar workers, most of whom had voted for left parties like the PT, not for Collor.

International political incentives continued to suggest privatization, but only at a <u>low</u> level. Although the advanced industrial countries were more keen on privatization than they had been when Sarney took office, Brazil under Collor was less dependent upon their good will than earlier, largely because of the country's at least partial successes in managing the balance of payments. By the early 1990s, despite inflation and half-hearted privatization, large SOEs like Petrobrás, as well as private banks and firms, again could borrow in the Euromarkets.

The final country considered here is India. If we find Indian incentives to policymakers to privatize--and privatization outcomes--to operate similarly to those in the larger, more industrialized new democracies in Latin America, then this is a good indicator that any observable patterns are not, for example, culture or region specific. Halfway around the globe, but during these same years, three **Indian** administrations privatized in a minor but symbolic way, then hardly at all, and then, surprisingly, moderately.

Prime Minister Rajiv Gandhi (1984-1989) had moderate intrinsic economic incentives to privatize. A core group of influential economists had argued for over a decade that India's slow GDP growth resulted from the government stifling the economy through over-regulation, via the so-called "permit-license raj [regime]." Several suggested a strong relation between the growth of bureaucratic power and corruption in the distribution of public resources. (See Ahluwalia, 1985; Bardhan, 1984; Jalan, 1991; Jha, 1980.) India had GNP growth averaging only 3.7 percent in the 1970s, slow for a newly industrializing economy. Lack of dynamism in the economy plausibly could be attributed to pervasive government-mandated barriers to entry and expansion throughout the economy. Although growth accelerated to 5.2 percent in the early 1980s, many economists suggested that these results reflected high aggregate investment imposed by government planners, rather than efficient investment, and, possibly, an early entrepreneurial response to limited economic liberalization in the very late 1970s.[35] Certainly, central planning had had some successes: the share of GNP invested, even in this very poor country, steadily rose from 13 percent in 1970 to almost 21 percent in 1985. Furthermore, public investment as a share of GDP climbed from 7.5 percent in the 1970s to 9.6 percent in the early 1980s. The need for access to modern technology was an important reason in favor of liberalization by sector, including by opening up to multinationals, unwelcome since the early 1970s.

Pragmatic economic incentives to privatize were low in 1984, at least by our comparative measures, although some Indian economists might have disagreed. The central government balance for 1984 -6.5 percent of GNP. In any case, Indian leaders had an advantage over Latin American ones in financing deficits: the intrinsic inefficency of India's state-owned financial sector had pragmatic advantages for the central government, which extracted substantial resources from banks via a form of indirect taxation. Indian central government debt securities paid below-market interest, but commercial banks, nationalized in 1969, were obliged to hold large quantities. These coerced "prudential" investments, plus cash reserve requirements, had totaled 27 percent of commercial bank time and savings deposits in 1970, but were up to 46 percent by 1985.[36] The central government also financed itself by borrowing at low rates from the Reserve Bank of India (the central bank) and from banks themselves. In 1970 net bank credit to the state had been only 1 percent of GNP, but by 1980 it was 4 percent, remaining near that level through the decade.[37] In fact, privatization of commercial banking would increase the strain on public finances, at least through the medium term. Foreign debt as a share of GDP ratio had been only 12 percent in 1980, but jumped to 19 percent in 1985. At $-6.6 billion in 1985, the trade balance was the main fly in the ointment. Inflation, though worrisome to Indian leaders, was nowhere near the hyperinflation level.

Meanwhile, Rajiv Gandhi's domestic political incentives to privatize were low. Chosen prime minister within hours of his mother's assassination in 1984, Rajiv Gandhi found his normal political "honeymoon" period extended by public sympathy for his personal loss. The new prime minister energetically deregulated during his first six months in office. An Oxbridge trained engineer, Gandhi himself (like Mexico's Carlos Salinas) believed market-oriented reforms would improve efficiency. However, Rajiv

Gandhi effectively stopped pushing for his government's new economic policies within the first year, as political opposition coalesced. Business depended upon protected domestic markets, and often also upon extensive "sweetheart" contracts with state enterprises as purchasers or as suppliers. Well over half of the middle class held government jobs, as did the unionized (and politicized) workers in state owned manufacturing facilities. The economic basis of entire regions depended upon artificial exclusion of medium and large scale producers using contemporary technology from competing with traditional craft producers, especially in the textile sector. Since nationalization of commercial banks in 1969, and their subsequent enforced move to the countryside, many of the comparatively prosperous farmers of the politically crucial North Indian "Hindi heartland" had come to rely upon subsidized credit from wholly government-owned banks. Consequently, strong and easily mobilized opposition from entrenched interests existed to potential privatization. The Indian state, de facto, remained ideologically and practically committed to employing as many citizens as possible.[38]

International political pressures for privatization also were low. India since independence had delinked substantially from the international capitalist economy, and therefore was less dependent on external goodwill than any of the Latin American countries. Even in 1988, despite a looming balance of payments crisis, Gandhi avoided approaching the IMF, fearing that any hint of bending to foreign pressure would lose him the election planned for early 1989.

Rajiv Gandhi's Congress Party, which had formed all but two post-independence Indian governments, lost the 1989 election. The short-lived administrations of minority coalition leaders Prime Ministers V.P. Singh (1990) and Chandra Shekhar (1990-1991) were similar in their moderately left (in the Indian context) political complexions, and I treat them as a single case. In 1990 intrinsic economic incentives to privatize continued to be moderate. The reputations of state firms and protected private producers were no brighter than before, although historically high economic growth, averaging 6.2 percent from 1985-89, continued into the late 1980s. Nor were investment funds obviously lacking: public investment as a share of GDP averaged an impressive 10.4 percent. On the other hand, renewed economic growth made the strains on the infrastructure more apparent. The need for modern technology to modernize sectors from telecommunications to airlines to electricity generation was becoming acute.

Pragmatic economic incentives to privatize, as V.P. Singh came into office, remained low, although they had worsened incrementally since the previous administration. The central government's balance for 1990 was -7.0 percent. Banking policies continued to support government fiscal needs: by mid 1989 over 53 percent of all deposits were reserved by the central government to its own needs, unfortunate for the efficiency of financial intermediation, but useful for financing the state. The debt to GDP ratio was 23 percent, high by Indian but quite moderate by world standards. The continuing trade imbalance, of $-6.0 billion in 1990, however, made the debt potentially ominous.

Domestic political incentives to privatize were extremely low under Singh and Shekhar. Both men headed minority coalition governments. The political bases of each were among left intellectuals, disadvantaged castes and minorities, and in rural areas, not constituencies normally favoring economic liberalization. Neither leader had anything to gain politically by endangering workers' jobs through privatization.

Events conspired, however, to push international political reasons to privatize up to the moderate level. Iraq's invasion of Kuwait, and the U.S.-led response, propelled Chandra Shekhar reluctantly toward the U.S., even to the extent of granting U.S. war planes refueling rights. The Gulf War caused a double economic shock to India. First, large numbers of Indian guest workers in Kuwait and Saudi Arabia had become refugees, hastily fleeing with few possessions. Many had not the wherewithal even to travel home; eventually the Indian government diverted planes from its national carrier, the SOE Air India, to collect them from camps in Jordan and elsewhere--all at considerable public expense. Moreover, throughout the 1980s India had received about $2 billion annually as worker remittances, overwhelmingly from the Gulf, an amount equal to almost a third of the trade deficit. The Gulf crisis, plus the simultaneous collapse of substantial non-hard currency trade with the Soviet Union, led to a debt crisis in 1991. Chandra Shekhar's leftist government reluctantly accepted a loan from the feared and oft-despised IMF, and traditionally fiscally prudent India saw its international credit rating downgraded. Foreign governments were quick to suggest what regulatory changes might be needed to attract new money.

Chandra Shekhar's government collapsed in turn in early 1991. Separatists in the southern state of Tamil Nadu assasinated Rajiv Gandhi, favored to win the next election, bringing the Congress Party a sympathy victory, and Narasimha Rao (assumed office March 1991), a comparatively unknown party elder, to the office of prime minister. Rao encountered moderate intrinsic economic motives to privatize; very little in the performance or operating conditions of public firms had altered in just over a year. Pragmatic economic incentives, however, had gone from low to moderate, principally because the foreign debt had crossed the symbolic 30 percent of GDP mark during the previous government; now it was 36 percent. Other pragmatic economic conditions were unchanged.

Domestic political incentives confronted by Narasimha Rao remained low, although less so than before. Rao also headed a minority government, dependent upon the support of either the economically conservative, Hindu revivalist Bharatiya Janata Party (BJP) to the right, or the Janata Dal/National Front group of V.P. Singh to the left. While adroitly distancing himself from the divisive religious politics of the BJP, the Congress Party's Rao relied upon BJP support to push through fundamental changes in the Indian political economy. The de facto Congress-BJP economic legislative alliance supported domestic market-oriented changes benefiting business and the urban middle classes (delicensing production, liberalizing imports, phased liberalization of tight foreign exchange controls), but the BJP opposed measures of international liberalization. Typical of the intense political opposition that privatization provoked was the fate of the November 1991 Report issued by the government appointed Narasimha Commission, which urged significant financial privatization by sector. The left parties immediately organized a one day strike, closing banks nationwide. Financial reforms were further delayed by a huge stock market and banking scandal in which local affiliates of multinational banks were prominent players, to the delight of the anti-privatization forces. In 1992 the Confederation of Indian Industry, a major national business association, drew up at Rao's request a novel plan to allow members of the elite civil service, the IAS, to be seconded to private sector managerial positions, thus protecting their jobs in the event of public sector downsizing. Senior bureaucrats opposed the plan, and nothing came of it.

Finally, international political incentives to privatize remained moderate. The collapse of the Soviet Union meant the disappearance of a major trading partner and strategic ally against both China and Pakistan. Although the U.S. tilted less toward Pakistan, Clinton insisted India sign the nuclear Non-Proliferation Treaty, which India considered discriminatory. Once the Rao government made the politically costly decision to pursue domestic economic liberalization, including privatization by sector, greater international economic integration was a logical next step. Pragmatism suggested a softer line toward foreign investment.

Table 2

INTRINSIC ECONOMIC INCENTIVES TO PRIVATIZE

CHIEF EXECUTIVE	Because of poor SOE reputation?	Because of low or falling public investment?	Because of acute need for new technology?	SCORE
ALFONSIN	Yes	Yes	Yes	High
MENEM	Yes	Yes	Yes	High
DE LA MADRID	No	No	No	Low
SALINAS	No	Yes	No	Low
SARNEY	No	Yes	No	Low
COLLOR	No	Yes	No	Low
R. GANDHI	Yes	No	Yes	Moderate
SINGH/ SHEKHAR	Yes	No	Yes	Moderate
RAO	Yes	No	Yes	Moderate

Note: (1) Assessment of incentives is on a comparative basis within the group of four countries, rather than on an absolute scale. (2) Scoring: High = 3 "yes" answers to questions about presence of intrinsic economic incentives; Moderate = 2; Low = 1 or none.

Table 3

PRAGMATIC ECONOMIC INCENTIVES TO PRIVATIZE

CHIEF EXECUTIVE	**Because of govt. budget bal. of -8% of GNP or worse at inaug?**	**Because of inflationary deficit finance institutions?**	**Because foreign debt more than 30% of GDP at inaug?**	**Because of trade deficit of $3 billion or more at inaug?**	**Because hyperinflatio n looms?**	**SCORE**
ALFONSIN	Yes	Yes	Yes	No	No	High
MENEM	No	Yes	Yes	No	Yes	High
DE LA MADRID	Yes	Yes	Yes	No	No	High
SALINAS	Yes	Yes	Yes	No	No	High
SARNEY	Yes	Yes	Yes	No	No	High
COLLOR	Yes	Yes	No	No	Yes	High
R. GANDHI	No	No	No	Yes	No	Low
SINGH/ SHEKHAR	No	No	No	Yes	No	Low
RAO	No	No	Yes	Yes	No	Moderate

Note: (1) Assessment of incentives is on a comparative basis within the group of four countries, rather than on an absolute scale. (2) Scoring: High = 3 or more "yes" answers to questions about the presence of pragmatic economic incentives; Moderate = 2; Low = 1 or none.

Table 4

PRIVATIZATION & INCENTIVES TO PRIVATIZE IN FOUR COUNTRIES

CHIEF EXECUTIVE	PRIVATI-ZATION	INTRINSIC ECONOMIC	PRAGMATIC ECONOMIC	DOMESTIC POLITICAL	INTERNA-TIONAL POLITICAL
ALFONSIN	Little	High	High	Low	Low
MENEM	Vigorous	High	High	High	Moderate
DE LA MADRID	Moderate	Low	High	Low	Moderate
SALINAS	Vigorous	Low	High	Moderate	High
SARNEY	Minor	Low	High	Low	Low
COLLOR	Moderate	Low	High	Moderate	Low
R. GANDHI	Minor	Moderate	Low	Low	Low
SINGH/ SHEKHAR	Little	Moderate	Low	Low	Moderate
RAO	Moderate	Moderate	Moderate	Low	Moderate

Note: "Privatization" is scored as "little," "minor," "moderate," or "vigorous." Each of the four incentives to privatize is scored as "low," "moderate," or "high."

Table 5

CORRELATIONS OF INCENTIVES WITH PRIVATIZATION OUTCOMES

INCENTIVES TO PRIVATIZE	**CORRELATION WITH ACTUAL PRIVATIZATION**
Intrinsic Economic	-0.25
Pragmatic Economic	0.47
Domestic Political	0.73
International Political	0.57
Combined Economic	0.19
Combined Political	0.80

Note:
Correlations are calculated by coding incentives as either 1, 2, or 3, corresponding to “low,” “moderate,” and “high.” Privatization outcomes are coded as 1, 2, 3, or 4, corresponding to “little,” “minor,” “moderate,” or “vigorous.” “Combined economic” and “combined political” incentives are calculated as means of economic and political incentives, respectively.

Analysis

Small sample size and the inevitable subjectivity of the indicators makes my analysis provisional. Even so, several intriguing trends emerge. First, as Table 4 makes clear, later administrations privatized more than earlier ones, irrespective of the country examined. That is, Menem, Salinas, Collor, and Rao privatized more, respectively, than Alfonsin, de la Madrid, Sarney, or Gandhi, Singh, and Shekhar. This probably ought to be taken as evidence of the importance of the global context in which each of these countries policymakers' operated. In three of four countries (Argentina, Mexico, and India) direct international pressures to privatize increased; even in the fourth, Brazil, Collor administration policymakers surely felt some status needs to conform to the latest practices in development circles, which obviously included privatization (see especially Biersteker 1982).

Second, the objective economic situation of the SOE sector was not a good predictor of the amount of privatization. The intrinsic economic, or efficiency-related, incentives to privatize were not stronger in the later administrations, but were roughly constant in all four countries throughout the decade. Furthermore, low, moderate, and high intrinsic reasons to reduce the state productive sector each occurred in conjunction with the moderate to vigorous privatization of the later administrations. Moreover, Table 5 reports a small negative correlation between intrinsic reasons to sell state firms and actual privatization outcomes. If my coding is correct, then, strong intrinsic economic motives to privatize appear to be neither sufficient--nor, surprisingly, even necessary--for active movement by policymakers to reduce the state's economic role. That is, convincing politicians that their state enterprises are poor performers is by no means equivalent to convincing them that public sector firms ought to be sold or previously state monopoly sectors opened to private competitors.

Third, the overall macroeconomic situation of the country, and its central government, also was not a good predictor of the amount of privatization. The pragmatic economic, largely government budget related, incentives to privatize increased for one country (India), but stayed constant, and high, for the other three. Were a larger sample to confirm this trend, it would support the following intuitively plausible statement: pragmatic economic motives to privatize are necessary--though not sufficient--for moderate to vigorous privatization. If a national leader is to brave the inescapable criticism likely to fall on him or her for allowing foreign investors, for example, to make off with the "national heritage" (whether in oil or the rights to open fastfood restaurants), then the leader needs to expect some concrete benefits. The potential to solve--or more likely to ameliorate--such pressing problems as huge budget deficits, large foreign or domestic public debts, or near hyperinflation is a potentially powerful inducement to a senior politician and his/her economic team to bite the bullet. More cynically, looming macroeconomic crisis goads politicians to want to be seen by the general public as "doing something," relevant or not. Nonetheless, if national political leaders believe that they will be punished politically, then they still will not privatize. The correlation between pragmatic economic incentives and actual privatization is positive but unimpressive.

Fourth, both domestic and international political incentives to privatize jumped in three of four countries. In the fourth country, India, international political incentives rose, while domestic political incentives remained constant. Furthermore, each of the two (of nine) administrations that engaged in vigorous privatization had strong overall political incentives, coded "moderate" on one political dimension and "high" on the other, to do so. Thus in Argentina, Menem privatized vigorously and fast because he needed to court the business community, while he recognized that in the short to medium run the unions and the non-revolutionary left would have few viable opinions to achieve national influence were they to abandon him. In Mexico, Salinas sought to bolster his position, first, within the PRI by weakening the patronage resources available to the traditional, machine-politics, party "dinosaurs" and, second, by demonstrating to the U.S. Congress that Mexico was willing to climb out quite far on the free trade limb, thus putting pressure on the U.S. to ratify the North American Free Trade Agreement. Both Menem and Salinas thus expected political benefits from selling state firms.

The data per se do not allow me to rank the relative importance of domestic versus international political motives for emerging democracies to privatize definitively, although Table 5 reports a stronger correlation between privatization and domestic political incentives (0.73) than privatization and international ones (0.57). My speculation, however, is that relatively large countries with fairly extensive domestic markets such as Argentina, Brazil, Mexico, and India enjoy at least some freedom of choice with respect to heeding or disregarding global influences and pressures, at least as compared to smaller countries, such as, for example, Ecuador, Bolivia, or even Sri Lanka. For Brazil and India, in particular, dramatic moves toward privatization, or any other radical economic policy change, are unlikely to occur unless the politician responsible believes he or she can reap some concrete domestic political benefits from the policy shift. (In fact, in the three and a half years after this study ended, the Brazilian government under Itamar Franco, but particularly under Fernando Henrique Cardoso, appeared to be finding more domestic political reasons to press forward with privatization, which in the future looks likely to become vigorous.)[39]

In sum, the empirical evidence clearly suggests economic motives (whether singly, or combined as in Table 5) alone probably will be insufficient to inspire most democratic politicians to brave the political risks associated with privatization. Since the cases did not include any countries in which economic reasons to privatize were absent, we cannot conclude that political motives alone would be both necessary and sufficient to activate state shrinking. Nonetheless, our cases do allow us to argue that political incentives to privatize at least are necessary. Combining the two political incentives yields a strong relationship with privatization (see Table 5).

This essay has provided empirical evidence in support of a central tenet of the "rational choice" school (see Bates 1988): politicians will respond to demands of their key political constituencies before these same politicians will implement "needed" economic reforms that the politicians' core constituencies do not deeply care about. The rational choice model suggests that politicians worry more about their electoral popularity than about economic performance per se. Pragmatic and, especially, intrinsic economic incentives to privatize influence policymakers mainly <u>because</u> economic outcomes themselves eventually (and legitimately) affect citizens' evalutions of their elected leaders. What I have termed "intrinsic economic" incentives to privatize turn only upon the performance of the firm, sector, or organizational task to be spun off, while "pragmatic economic" incentives incorporate larger macroeconomic variables that plausibly might be positively influenced by privatization (government deficits and debt, foreign debt, and hyperinflation): it is reasonable to suppose that pragmatic are stronger than intrinsic economic incentives largely because pragmatic consequences of privatization (or the lack of privatization) are salient to a larger number of voters. Thus, for example, not everyone will be aware that a state-owned mining company is being run very inefficiently. However, serious problems of government finances that result either in a slide into hyperinflation or draconian spending cuts across the board will be widely perceived by voters. Understanding the attraction of continued electoral success for senior political leaders enables us to make theoretical sense of the findings of our empirical investigation that political incentives to privatize appear to be most compelling and powerful, followed by pragmatic economic incentives, and with intrinsic economic incentives bringing up the rear.

I close the analysis with a few comments on an explanatory road not taken. This paper's research design focused on the presence or absence of four types of incentives in the <u>environments</u> of the chief executives studied. Missing from the investigation entirely were the <u>ideas and preferences of political leaders</u> and/or their senior economic policy advisors themselves. Although this study strongly has confirmed the power of the rational choice analytical model, it should not be taken as evidence that ideas and cognitions are irrelevant or epiphenomal. In fact, one aspect of the study suggests that policymakers' ideas were very important: there is every reason to believe that what Goldstein and Keohane (1993) term "causal" ideas also played a significant role in explaining actual decisions to privatize. Through the 1980s internationally visible leaders such as Margaret Thatcher, Ronald Reagan, and Lech Walesa used their bully pulpits to suggest expansion of the private sector as a solution for economic stagnation, corruption, and other ills. The later the date, the more likely it was that these ideas would seem not only familiar, but even reasonable, to decisionmakers in developing countries.

This study might have followed Peter Hall (1989) and colleagues, who analysed the unequal transmission of Keynesian ideas to the United States and Western Europe in the decades following the Second World War. I could have asked, "Why did the <u>idea</u> of "privatization" as a solution to a variety of economic ills make greater headway in Mexico and Argentina through the early 1990s than it did in Brazil or India?" One reason not to investigate ideas is that they are notoriously difficult to uncover reliably. The public statements of politicians usually are unhelpful in evaluating whether changing cognitions influenced policy choices. Menem loudly proclaimed himself a convert to the doctrine of a streamlined, minimalist state in the economic sphere, while Narasimha Rao equally firmly reminded people that he was still a socialist--yet both privatized substantially. Another, more profound, reason not to include the role of ideas in the research design was that, in this case, they probably would not have changed the research findings. Diverse political incentives to chief executives still would explain the differences among the cases.

The potential usefulness of this essay, thus, can be summarized as follows. It has examined privatization outcomes, and the incentives to chief executives and their senior economic advisors to shrink the state's directly productive role, in four large, newly industrializing, developing country democracies, three in Latin America and the fourth well outside the region but whose elected leaders confronted many similar problems. My findings confirm the probably obvious but frequently neglected wisdom that political considerations motivate public policy choices as much, and often more, as do purely economic considerations, even apparently compelling ones such as public sector enterprises that objectively are performing at very low levels of efficiency. Those reformers, both within developing countries and in the international community, who would motivate market-oriented economic liberalization, therefore would do well to take account of the political environment confronted by actual policymakers, whose minds may well be on the next election or other popularity test they must face. Real world politicians, after all, do not live by technical feasibility studies alone.

A Note on Democracy and Privatization

This chapter has explored politicians' motives to privatize, concluding that political incentives, or the need to woo core domestic constituencies, and sometimes foreign governments or international organizations, are usually more important than pragmatic economic incentives. Pragmatic economic incentives, in turn, normally are more compelling to policymakers than are intrinsic economic reasons to shrink the state's direct role in production.

During the period covered by the study, only India was an established democracy. Argentina and Brazil had recently democratized, while Mexico remained a soft, semi-authoritarian regime undergoing incremental political liberalization. Does this mean that the presence or absence of democracy is irrelevant in politicians' decisions to privatize? Surely not. Political regime type, like privatization, is best understood as a continuum, rather than a dichotomous variable with only two values of "democracy" and "authoritarian regime." At any point along the continuum (or continua) national political leaders make policy choices in accordance with their beliefs about the preferences of their core constituencies. The difference between an elected leader and one who has come to power through a coup or other non-democratic means is not that one must consider the desires of his or her supporters and the other need not. Rather, differences lie in the membership of the crucial regime support coalition. In the extreme case, a military dictator must retain only the loyalty of the senior officer corps and his/her palace guard, which is the relevant constituency. Each of the four countries considered in this chapter either was democratic or democratizing; leaders in each had a multitude of social groups--including both owners of capital and possessors of votes--whose loyalty they had to retain.

The process of democratization, that is, does not alter the structure of incentives confronted by political leaders in making economic policy decisions. It does, however, dramatically shift the identities of the crucial political actors whose support national politicians need. During the period from the mid 1980s through 1992 none of these four countries experienced a dramatic political regime shift--although Argentina had done so in 1983 and Brazil did in 1985. However, a discussion of incentives to privatize in, say, Poland during these years would have highlighted the difference in the relevant domestic constituencies before and after the end of Communist rule. The particular problems of new or fragile democracies with liberalizing economic reforms have to do with the broader constituencies they must please, as compared to many authoritarian regimes, and the propensity of newly politically incorporated groups to expect some material benefits as a consequence of their newfound political weight (see Armijo, Biersteker, and Lowenthal 1994). My finding that politicians assess not only the economic but also the political rationality of alternative public policy choices thus should apply to democrats and authoritarians alike. When making economic decisions, rulers must consider not only the logic of the market, but also the logic of the polity.

ENDNOTES

[1]My thanks to those who made useful comments on various versions of this essay, including, in alphabetical order, Barry Ames, Alberto Bisso, Gregor Binkert, Christopher Bosso, Charles Blakely, Luiz Carlos Bresser Pereira, Eileen Crumm, Kenneth P. Jameson, Luigi Manzetti, Robert McCombs, Eileen McDonagh, Kaizad Mistry, Philip Oxhorn, David Pion-Berlin, Ravi Ramamurti, Carlos Ribeiro, José Serra, and Pamela Starr. Remaining mistakes are mine.

[2]The following introduction to an excellent economic analysis of the achievements of Brazil's privatization program is typical. "The purpose of part of the economic reforms [i.e., privatization] is to make the Brazilian economy more efficient and competitive." Abreu and Werneck, 1993:22.

[3]Except as noted, economic statistics throughout are from statistical publications of the World Bank, including World Development Report , (Oxford: Oxford University Press), various years; World Tables (Washington, D.C.: The World Bank), various years; and Trends in Developing Economies 1993 Extracts, Vol. 2 (Washington, D.C.: The World Bank, 1993). In addition, figures on state enterprise deficits are from Pinheiro and Schneider (1993:13), on public investment as a share of GNP are from Pfefferman and Magassay (1992:14-18), and on the productivity of investment, from Frieden (1991:80).

[4]Figures on the public share in gross fixed capital formation (GFKF) for Argentina, Mexico, and India are from Short, 1984. Short's percentage for Brazil, 22.8%, is taken from Brazil's national accounts, which perversely include state-owned enterprise (SOE) investment with private sector investment. The estimate for Brazil cited here, therefore, comes from Trebat, 1983, p.122, and includes investment by federal government "direct administration," plus large SOEs owned by the central government.

[5]This practice has become known as "rent seeking." See Krueger 1974.

[6]A logically possible variant of this reasoning is: privatization enhances efficiency through less politics. The argument asserts that privatization will improve economic efficiency through reducing the politically determined pressures and temptations faced by state enterprise management. Politicians who oversee state production otherwise may be tempted to pressure public sector managers to misappropriate public sector resources--including government jobs, contracts, and goods and services--to reward the politicians' friends and punish their enemies. At the same time, public sector managers try to extract 'rents,' or bribes, from those in the general public who wish to do business with state firms. These pressures and temptations are assumed to be diminished or absent in privately owned businesses. However, incumbent policymakers should be relatively unlikely to seek efficiency through intentionally reducing their own opportunities to use the state for patronage. This reason should be relatively unimportant, therefore, in policymakers' motives to privatize, and thus is not a part of the research design.

[7]Selling off state assets certainly is not a long-run solution to structural problems of public finances, but it can provide a crucial short-term infusion of funds. For a skeptical view of the efficacy of privatization as a solution to the public sector's resource problems, even in the short to medium run, see Pinheiro and Schneider, 1993.

[8]A budget balance of even -5.0% of GNP is worrisome. For comparison, the U.S. balance was -2.4% in 1980 and -4.8% in 1991. The need to discriminate among these cases, most of whom had fiscal worries, suggested a higher cutoff level.

[9]The World Bank considers a debt to GDP ratio of 30% or more as "moderate" indebtedness, while 50% or greater is "severe" indebtedness.

[10]The coding of quantitative indicators is inevitably somewhat arbitrary. Cut-off levels were chosen with two aims: to accord with my qualitative sense of the relative severity of macroeconomic problems in the different administrations and to discriminate among the cases.

[11]On aid conditionality, see Stallings, 1992; Kahler, 1992.

[12]It is hard to imagine a scenario in which an international actor pressures a developing country government to avoid privatization. This results from an interesting anomaly in the incentive structure surrounding advanced country attitudes toward privatization in abroad. Potential benefits (profits to investors, savings to the government budget, and better service for customers) are shared by both developing country citizens and foreigners. But potential costs (lost

jobs for SOE employees, loss of economic policy autonomy for the central government, and disrupted and sometimes reduced service to customers) almost exclusively fall upon nationals of the privatizing country.

[13]See also Biersteker, 1992; Ghosh, 1991; and Schneider, 1990 for useful attempts at cross-nationally comparative definitions.

[14]The Argentina cases, here and throughout the essay, draw on Armijo, 1994; Erro, 1993; Huser, 1994; Lewis, 1990; Manzetti, 1993; Norden, 1990; Petrecolla, et al., 1993; Pion-Berlin, 1992; Latin American Weekly Report; Latin American Regional Report: Southern Cone; and the Financial Times.

[15]The Argentine government privatized YPF itself in mid 1993 for $3 billion, thus carrying its privatization further in sectoral terms than Mexico's.

[16]The Mexican cases, here and throughout, draws on Bazdresch and Elizondo, 1993; Frieden, 1991; Langston, 1990; Schneider, 1990; Latin American Weekly Report; and Latin American Regional Report: Mexico and Central America.

[17]Peasant participants in the regional rebellion in the southern Mexican state of Chiapas, inaugurated on New Year's Day 1994 and timed to coincide with the implementation of the North American Free Trade Agreement, cited the 1992 end of the land redistribution and ejidal program, along with continued denial of genuine political democracy in the state, as their major grievances.

[18]On Brazilian SOEs and privatization, see Abreu and Werneck, 1993; Baer and Villela, 1992; Pinheiro and Oliveira Filho, 1991; Ribeiro, 1992; Schneider, 1990; Trebat, 1983; Ramamurti, 1991; Latin American Weekly Report; and the Financial Times.

[19]Exame: Melhores e Maiores, Sªo Paulo: Editora Abril, 1993:120-121.

[20]On Indian SOEs and privatization see Chitale, 1992; Echeverri-Gent, 1990; Encarnation, 1989; Kohli, 1990; the Financial Times; India Today; and Economic and Political Weekly.

[21]Another important restriction in Indian law was the lack of free "exit" from most types of production. In order to protect employment, plants and businesses, once operating, could not be closed, downsized, or even relocated without hard to get explicit government permission.

[22]Because Singh and Shekhar both had short tenures, and because they represented largely the same interests to the left of the Congress Party, I treat their administrations as a single period.

[23]A related liberalizing move in early 1992 ended the "freight equalization scheme" by which government-owned railways charged firms identical rates to move specified raw materials (such as iron ore) and intermediate industrial inputs (such as steel) over both long and short distances, for the purpose of spreading industrialization more widely around the country. This change instantly rendered several public sector steel mills, located far from suppliers and/or markets, non-viable.

[24]Menem also found a good mixture of carrots and sticks to use with the military. On the one hand, he pardoned the top brass, imprisoned under Alfonsín for their roles in the Malvinas/Falklands fiasco of the early 1980s (and, implicitly, for ordering the "dirty war" in which at least 10,000 suspected leftist sympathizers "disappeared" between 1976 and 1982). On the other, he reacted strongly against a military rebellion in December 1990, rather than attempting to negotiate as Alfonsín had done in similar situations. Furthermore, persistent rumors suggest that officers in charge of the major SOEs managed by the military may have accepted large payoffs from the government to accept privatization of these firms. See, especially, work in progress by Luigi Manzetti.

[25]Though the Peronist Party long has had "right-wing" elements, this designation primarily refers to social conservatives (including even some neo-fascists), rather than devotees of free trade and small government.

[26]Latin American Weekly Report, August 9, 1990.

[27]Damian Fraser, "Slimmer leopard tries to change its spots," Financial Times, October 8, 1992.

[28]See, inter alia, Keith Bradsher, "Bush Tells Mexico He Wants a Free-Trade Pact Soon," The New York Times, December 15, 1991; "Unease in Mexico rises as economy takes a dip," Financial Times, September 16, 1992.

[29]Trebat, 1983:115-152, concludes that state firms made investment decisions mainly on market (rather than purely political) considerations, that the productivity of SOE investment in terms of value-added was high, and that SOE production was complementary to, not in competition with, private investment.

[30]Economist Intelligence Unit, Country Report: Brazil, 1993.

[31]Lamounier and Bacha, 1993, Table 12. On the other hand, the public also was becoming frustrated with deteriorating levels of service caused by lack of investment. See Pinheiro and Schneider, 1993:22.

[32]See Armijo 1996.

[33]Reasonable observers, of course, can differ. Pinheiro and Schneider (1993:21) write, "Privatization was a major issue in the 1989 election, and President Collor made it one of his top priorities." This strikes me as an exaggeration.

[34]By the end of the third year of the Collor presidency, the opposite was true: the cumulative effect of seven failed shock-style economic reforms in as many years had left the population cynical and uncooperative.

[35]See Ahluwalia, 1991. For an opposing view, see Adams, 1992. Because of the quite poor record for the 1970s, and despite the early 1980s upturn, I evaluate the overall macroeconomic scenario that Rajiv Gandhi inherited as one that provided an incentive to privatize.

[36]CMIE, 1991, Table 17.11, n.p.

[37]CMIE, 1991, "Key Indicators," n.p.

[38]India's distributionist economic policies, while arguably macroeconomically suboptimal, may have been essential to maintaining democracy, an extraordinary achievement in such a poor country. See Armijo, 1997.

[39]In May 1996, as the final version of this essay was being revised, the Cardoso administration pushed forward with its largest ever privatization, that of the Rio de Janeiro based electricity generation and distribution firm, the Light, sold for $2.1 billion to a consortium whose controlling interest was held by a French public sector utility company. See Armijo and Jha 1997.

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