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**The Privatization of the Telecommunications Sector in Latin America:
A Comparative Study of Argentina and Brazil**

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Submitted to the Committee on Undergraduate Honors of Baruch College
of the City University of New York
in partial fulfillment of the requirement for the degree of
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History with Honors

Approved:

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ABSTRACT

This study investigates the privatization of the telecommunications sector in Argentina and Brazil, in the late 1980s and late 1990s, respectively. My hypothesis is that Brazil succeeded in achieving a better outcome in its privatization than Argentina because the Brazilian government succeeded in establishing a stable institutional environment during the privatization process, therefore heightening its credibility with investors and its bargaining power. The hypothesis lays on a causal relationship, which, I argue, starts with the institutional design of the privatization. The institutional design will influence foreign investors' perception of the credibility of the state, which, in turn, may potentially enhance the bargaining power of the state.

The hypothesis was assessed based on an analysis of the historical narrative of the two transactions. From this historical analysis I inferred indications of each country's bargaining power, primarily based on the stability and quality of the institutional reform carried out by the each government. In addition, premiums, the length of the exclusivity rights periods and performance targets were established to measure the state's bargaining power.

This study borrows the conceptual framework provided by New Institutional Economics (NIE) to analyze the impact that a country's institutional environment has on policy making and business climate. According to the NIE approach, investors will most likely invest in countries where there is a favorable perception of the strength and reliability of institutions; conversely, an unstable institutional environment will lead investors to bargain with the state in order to lower prices and curtail competition. Institutional instability may negatively influence the net results of privatization, by either prompting investors to pay less and/or by simply transferring a monopoly from the state to the hands of private owners.

I found that the Argentine and Brazilian cases differed markedly both in terms of the institutional environment and net results of their respective privatizations. The institutional environment in Argentina was more unstable than in Brazil and that negatively affected Argentina's perceived credibility and its bargaining power. Following the hypothesis' proposition, Brazil yielded a much higher premium during the sale, while establishing a more competitive market following the privatization. However, I also found that the historical context has a remarkable influence on the policies chosen by each government. It appears that, in developing countries, the design and outcome of economic policies, such privatization, is determined more by the historical context than by pure economic rationale and business expertise (an assessment that, in fact, echoes some of NIE's main claims).

It appears that there is a strong causal relationship linking the quality of the institutional environment, and the perceived credibility and bargaining power of the state. Most definitely, however, the main lesson to be taken from this study is that, in Latin America, a fair assessment of privatization cannot be complete without bringing the historical context into the scope of analysis. Congruent with the main claim by NIE scholars, issues such as political turmoil, economic instability, and other historical conditions surrounding the privatization process, are crucial to the understanding of the institutional choices made by the privatizing state, and consequently, to the results of privatization as a macroeconomic policy.

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Finally, I would like to dedicate this work to my family members, in particular to my mother, brother and sister, for their love and care; and to the memory of my beloved father.

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INTRODUCTION

This study investigates the privatization of the telecommunications sector in two Latin American countries: Argentina and Brazil. The historical period under investigation ranges from the late 1980s, the years during which the Argentine privatization was implemented, to the late 1990s, when the Brazilian privatization occurred. The main purpose of this study is to assess how the institutional design of each transaction influenced the bargaining power of the state while negotiating with international investors. I argue that the net gains of privatization to society at large depended on the state's bargaining power during negotiations with investors. The bargaining power of the state may be enhanced by the implementation of an institutional environment that maximizes investors' perception of the stability of institutions and the credibility of the state. This hypothesis is analyzed using the conceptual framework provided by the New Institutional Economics (NIE). NIE is a useful analytical tool for this project because it considers the historical context as one of the determinants of economic performance. Furthermore, NIE offers concepts that illustrate the role of institutions in shaping business decision-making and a country's investment climate.

Telecommunications services in Argentina in the late 1980s were substandard, to say the least. Telephone network connections relied on outdated equipment. In 1989, 46 percent of the telephone lines were out of service and, because the maintenance crews at the *Empresa Nacional de Telecomunicaciones (ENTEL)* were shrinking, it took at least eleven days to have them fixed.

Ironically, while maintenance workers were dismissed at a rate of more than 40 percent over the course of the decade, executive hiring rose by 35 percent.¹

The situation of the Brazilian telecommunications sector was equally discouraging in the 1990s. Consumers formed lines outside soccer stadiums, hoping for a chance to be placed on a waiting list to become eligible to buy residential telephone lines. Under the purchase contract, consumers would pay US\$1,200 for a single residential telephone line and wait at least two years to have it installed.² In 1994, there were 8.6 telephone lines per 100 inhabitants in Brazil; a cellular phone sold for some US\$25,000 (the contract sold for about US\$22,000 and the phone itself for US\$3,000).³ Owning a telephone line was an emblem of socio-economic status. For the middle class, a regular telephone represented a lifelong investment, only equated with the almost unattainable prospect of buying a house.

Two characteristics link these two privatizations, although they stand a decade apart: both ENTEL and Telebrás were state-owned companies, representing the state's monopoly over basic telecommunications services, and were sold to help reach their respective countries achieve macroeconomic stability.

A wave of privatizations swept through Latin America in the late 1980s-1990s. These privatizations were part of a set of liberal adjustments prescribed by the international financial community in light of severe fiscal imbalances and external debt most Latin American countries were experiencing. Privatization of state-owned enterprises (SOEs) appeared challenging politically, but an eminent necessity, after all. It seemed to be the only means available for

¹ Ben Petrazzini, "Privatization in a Hurry," in Ravi Ramamurti, *Privatizing Monopolies*. (Baltimore: The John Hopkins University Press, 1996), p. 116.

² To give the reader a standard for comparison, the minimum wage in Brazil was less than US\$100/month at that time.

³ Renato Navarro Guerreiro, "*Mensagem do Presidente: Acima de Tudo, Resultados*" (*President's Message: Above All, Results*), *Revista da Anatel*, 31 de outubro de 2001. Retrieved March 31, 2005 from Anatel's webpage www.anatel.gov.br, 16 [translation mine].

financially failed states to receive massive inflows of foreign capital needed to reach macroeconomic balance. It also signaled to foreign investors that the once highly interventionist Latin American states were willing to liberalize their markets by letting private owners operate important infrastructure sectors such as telecommunications. This study, however, departs from the somewhat more common assessment of whether governments should have engaged in privatization or not. Instead, it describes two of the most important privatization projects in Latin America, and it assesses how the choices of institutional design influenced the outcomes of these privatizations.

Argentina privatized its state-owned telecommunications firm, ENTEL, in 1990, as part of an emergency economic package aimed at attracting foreign direct investments (FDI) and to help reduce its external debt. President Carlos S. Menem put the privatization program in place during his first few months in office. Menem assembled a group of experts and gave them fourteen months to develop a complex privatization plan for ENTEL. The privatization plan divided ENTEL geographically into two companies: one to explore the northern and the other the southern regions of the country; the greater Buenos Aires area was to be divided between the two companies. From an initial pool of fourteen, the Argentine government ultimately found itself left with only two buyers just before the date the sale was set to occur. The rate at which potential bidders dropped out of the process was unusually high in Argentina. As it will be discussed in more detail below, this may be attributed to the instability of institutions during the privatization process. It will be argued, thus, that the institutional instability in Argentina reduced the country's credibility before international investors and, consequently, its bargaining power during the privatization.

The Brazilian government's plan to privatize Telebrás was also driven by a macroeconomic agenda and, as much as the Argentine program, it included the desire to attract FDI to help cover public deficit. However, Brazilian president Fernando Henrique Cardoso began implementing an institutional reform in the telecom sector early in his first term, in 1995, and privatized a few months before his re-election, in 1998. Several consortiums of foreign investors participated in the Telebrás auction on July 29, 1998. Differently from the Argentine case, the Brazilian government received much more than it expected for Telebrás.⁴

One of the distinguishing features of the Telebrás privatization was the set of reforms the state was able to implement before the privatization. One such reform was the drafting, prior to the privatization, of a comprehensive new law to govern the telecommunications sector and the creation of a regulatory agency, the *Agência Nacional de Telecomunicações*, Anatel (National Telecommunications Agency). It will be argued that investors perceived the Brazilian process to be more stable and transparent; this perception enhanced the government's credibility, and, therefore, its bargaining power.

The focus here is the perception of investors with respect to the state's credibility, and the effect of such perception on the state's bargaining power. It is important to highlight that perception does not necessarily reflect reality. In other words, the question is not whether the Brazilian government was in fact, more credible than the Argentine; the question is how and why the privatization process in Brazil was perceived to be more credible and stable by the international investor community.

The decision to focus on the history of telecommunications reform is twofold. First, telecommunications is a pivotal industry in Latin America, both in terms of its size and role in

⁴ Argentina attained a premium of 27.36%; Brazil's premium for Telesp, the largest subsidiary being sold, was 64.04%. Please refer to [Table 3](#) and [Table 4](#) for further details regarding the proceeds and premiums of the Argentine and Brazilian privatizations, respectively.

enabling economic development and democracy. Investments in the telecommunications industry are expected to be US\$2,299 million by 2008 in Argentina, and US\$2,578 million in Brazil.⁵ In 2005-06, Argentina was one of the fastest growing telecommunications markets in Latin America; Brazil, on the other hand, is the largest information technology (IT) market in Latin America today (Figure 1 ~~Figure 1~~ shows a pie chart that illustrates the magnitude of the industry in Latin America).

Figure 1: IT market in Latin America

~~[Insert Figure 1: IT market in Latin America here]~~

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The enhancement of telecommunication has the potential to positively impact a country's ability to quicken economic development by enabling entrepreneurs to connect with one another, and with the global markets. Furthermore, improving telecommunications can potentially strengthen democracy. Democracy is reinforced by telecommunications because it facilitates citizens' engagement in civic life.⁶ *UNESCO's World Communication and Information Report of 1999-2000* states that an enhanced telecommunications infrastructure is desirable to promote democracy because it enables the emergence of what is called "teledemocracy" or, "...the adaptation of Internet-based information tools by government, business, and civil society to create an advanced participatory form of democracy."⁷ Thus, an improved telecommunications infrastructure may, in fact, facilitate democratic transition and/or consolidation. Finally, since

⁵ Source: Pyramid Research; Economist Intelligence Unit (retrieved from Business Source Premier, March 2006).

⁶ The concept of teledemocracy has been embraced by the United Nations as one of the social goals globalization. Please see *UNESCO's World Communication and Information Report 1999-2000*, November 11, 1999. The report may be accessed at: www.unesco.org/webworld/wcir/en/pdf_boxes/boxes.pdf.

⁷ For more information on the impact that enhanced telecommunications infrastructure has on democracy, please visit *Unesco's World Communication and Information Report 1999-2000* at www.unesco.org/webworld/wcir/en/pdf_boxes/boxes.pdf. The definition cited on this paper was retrieved from this web site on October 10, 2005.

Brazil and Argentina were experiencing very different historical circumstances, a comparison between them is appropriate to highlight the influence of history in shaping the design and outcomes of economic policies.

This paper is divided into five chapters after this Introduction. Chapter I discusses the general hypothesis of the paper, and provides a summary of certain NIE concepts that are relevant to the cases under investigation; Chapter II presents an overview of the recent economic history of Latin America; Chapters III and IV describe the Argentine and Brazilian cases, respectively. The concluding chapter assesses the validity of this paper's hypothesis and the lessons learned from these case studies. The conclusion also comments on the relevance of New Institutional Economics to the study of economic development in Latin America.

CHAPTER I – HYPOTHESIS AND THEORETICAL FRAMEWORK

The objective of this study is to investigate the influence of institutional reform in the state's bargaining power during the privatization of the telecommunications sectors in Argentina and Brazil. The central question motivating this study concerns not why the telecommunications firms were privatized, but rather how the institutional environment influenced the outcomes of privatization. The pivotal difference between the two cases under investigation was the ways in which the governments of Argentina and Brazil carried out their respective institutional reforms: for instance, while Brazil succeeded in framing its regulatory landscape prior to the sale, Argentina did not; while in Brazil the process was perceived as stable, in Argentina the rules were constantly changing and often the government did not comply with its own rules.

The main goals of these privatizations were to attract inflows of FDI and liberalize their telecom markets (i.e.: open competition and promote investments). Thus, this investigation

focuses on the relationship between how successful each government was in achieving these goals and the institutional design implemented during the privatization process. To the privatizing state, achieving both these goals is an optimal outcome. Under the investors' perspective, however, these goals are seemingly conflicting. That is, higher competition after privatization will curb investors' willingness to pay more for the companies. More often than not we see developing countries settling for less than favorable deals with foreign investors simply because they have low bargaining power. With these two opposing interests under negotiation, the dilemma for the privatizing state is to maximize its bargaining power so a satisfactory settlement may be achieved.

My hypothesis derives from the following assertion: the Brazilian government enjoyed greater bargaining power during negotiations because investors had a more positive perception concerning the credibility and predictability of its institutions than they did in Argentina. Conversely, Argentina could have attained a greater bargaining power, and therefore, enhanced the net results of privatization, had it emphasized institutional stability as a means to heighten its credibility. Perhaps this assertion is better explained through a hypothetical diagram – please refer to [Figure 2: Hypothetical scheme](#) for a schematic overview of the hypothesis.

The first issue in assessing this hypothesis is how to measure the state's bargaining power. Since this study is, essentially, a historical one, the focus will be on the investigation of how the transactions unfolded, and what indications of the state's bargaining power can be inferred from this historical account. From the historical account of the two transactions, special attention will be paid to the stability and quality of the institutional reform carried out by the government. For instance, a consensus exists about the idea that a strong and autonomous

regulatory body should be created prior to the divestiture.⁸ This increases the possibility that the newly created institutions (i.e.: laws, antitrust regulations, etc) will be respected, favoring a healthy investment climate.⁹ Moreover, an effective regulator demonstrates the state's commitment to the new market structure, and this commitment, in turn, heightens investors' perception that their property rights will be protected after privatization.¹⁰

Since measurable variables are always desirable, the following elements will serve as measures of the state's bargaining power: high premiums paid at the time of sale, and the characteristics of the competitive landscape agreed upon with investors. In this study, the competitive landscape will be analyzed based on measures such as the length of the exclusivity period granted by the government, interconnection requirements, and service performance targets.

Premium, in this context, equals the difference between the minimum price established by the government to sell the company and the price the winning bidders actually paid. Thus, the higher the premium the government was able to obtain, the higher the state's bargaining power will be deemed to be.

⁸ "Organizations" include political bodies (political parties, the Senate, a city council, a regulatory agency), economic bodies (firms, trade unions, family farms, cooperatives), social bodies (churches, clubs, athletic associations), and educational bodies (schools, universities, vocational training centers). Douglass C. North. Institutions, Institutional Change and Economic Performance. (Cambridge: Cambridge University Press, 1990), p. 5.

⁹ John Hariss, Janet Hunter and Colin M. Lewis. The New Institutional Economics and Third World Development. (New York: Routledge, 1997), p. 25. See also Samuel P. Huntington. Political Order in Changing Societies (New Haven: Yale University Press, 1968), chapter "*Political Order and Political Decay*," for a discussion on the institutionalization of political organizations.

¹⁰ This is particularly relevant in Latin America given its long history of state-driven expropriation of foreigners' assets and lack of continuity of public policy (rules are changed with each incoming president). For an extensive discussion on the impact of a strong and independent regulator in the privatization process, please see Brian Levy and Pablo T. Spiller (eds.), Regulations, Institutions and Commitment (Cambridge: Cambridge University Press, 1996).

Shorter exclusivity periods create the conditions for a healthier competitive environment to be established sooner rather than later.¹¹ Increased competition after privatization is used as a positive measure because it enhances the probability of competing firms to seek to achieve optimal supply levels and lower prices for consumers.¹² Furthermore, the strength of the competitive regime designed by the government can be assessed by the ease of system interconnection.¹³ Finally, a classification of the net results of the privatization should take into account the improvements experienced in the services after privatization. For purposes of this paper, a parameter to assess this variable will be the performance targets agreed upon between the government and investors: the higher the performance targets agreed upon by investors – in comparison to other telecom privatizations in the region – the greater the state’s bargaining power.

The hypothesis will be confirmed if (i) I can demonstrate that the institutional environments in Brazil and Argentina differed markedly with respect to the stability and quality of institutions; and that (ii) the measurable variables were positive in Brazil in comparison to

¹¹ In a newsletter entitled “Telecommunications Reform – How to Succeed,” the World Bank makes the following statement: “In Latin America...countries that granted monopoly privileges of six to ten years to the privatized state enterprises saw connections grow at 1.5 times the rate achieved under state monopolies but only half the rate in Chile, where the government retained the right to issue competing licenses at any time.” See Björn Wellenius. “Telecommunications Reform – How to Succeed.” Public Policy for the Private Sector, The World Bank Group Finance, Private Sector, and Infrastructure Network, Note No. 130, October 1997.

¹² Overwhelmingly, the literature on privatization (in particular of public utilities, as it is the case here) links heightened competition to positive net social welfare gains in developing countries. Please see Carsten Fink, Aaditya Mattoo and Randeep Rathindran. “An Assessment of Telecommunications Reform in Developing Countries.” Policy Research Working Paper 2909 The World Bank Development Research Group Trade, October 2002.

¹³ Interconnection is defined as the physical connection of the telephone networks owned by two different operators in order to allow customers connected to different networks to communicate, to ensure the interoperability of services. Please see Intven, Hank, Jeremy Oliver and Edgardo Sepulveda. Telecommunications Regulation Handbook. World Bank Privatization Toolkits. Washington, DC. November 2000, Glossary. This handbook may be downloaded from the World Bank’s website at <http://rru.worldbank.org/Toolkits/TelecomsRegulation/>.

Argentina (e.g.: a greater premium and significant performance targets for telecommunications services were agreed upon with investors in Brazil, in comparison to Argentina).

This study is grounded on the conceptual framework provided by New Institutional Economics (NIE). According to the approach taken by the new institutional economics to explain inflows of FDI, investors will most likely invest in countries where there is a favorable perception of the strength, transparency, and reliability of institutions.¹⁴ Conversely, when investors perceive the privatization process and the investment climate to be unclear and unstable, they will most likely bargain with the state in order to lower prices or obtain a longer exclusivity period (or both), in the case of the privatization of state monopolies. Consequently, the instability and lack of a clear regulatory landscape may negatively influence the net results of privatization, by either prompting investors to pay less for the shares being sold and/or by simply transferring a monopoly from the state to the hands of private owners.

Overview of New Institutional Economics (NIE)¹⁵

Traditionally, the neo-classical economic theory has assumed that “transactions between buyers and sellers are costless, instantaneous, and based on perfect information,” and that, therefore, actors make perfectly rational and informed choices.¹⁶ The field of NIE has departed from this neo-classical ideal to consider that institutions are not always effectively in place and

¹⁴ “Institutions” are the combination of formal constraints (e.g., rules, laws, constitutions), informal constraints (e.g., norms of behavior, conventions, self-imposed codes of conduct), and their enforcement characteristics. Unless otherwise noted, references to “institutions” in this paper shall be interpreted as “formal constraints” only. The definition above was taken from Douglass C. North. “Economic Performance Through Time.” *American Economic Review* 84, 359-368, in John N. Drobak and John V. C. Nye (eds.) *The Frontiers of the New Institutional Economics* (New York: Academic Press, 1997), pp. 21-22.

¹⁵ New Institutional Economics (NIE), institutional economics, and institutional theory will be used interchangeably in this paper.

¹⁶ Lee J. Alston, Thráinn Eggertsson and Douglass C. North (ed.) *Empirical Studies in Institutional Change*. (New York: Cambridge, 1996), p. 97.

that actors make irrational choices based on limited pieces of information. NIE builds on the apparent failure of neoclassicists to take into account deficiencies of less developed economic systems, such as high transaction costs, and weak property rights.¹⁷ Most importantly, NIE explores the question of how institutions may influence economic performance and business decision-making. Douglass C. North, a Nobel Prize winning economist and one of the most renowned researchers in the field of institutional economics, has stated that the “[neo-classical theory] evolved in the context of the highly developed, efficient markets of the Western world...characterized by the exceptional condition of low or negligible transaction costs” and as such “[it] is...simply inappropriate...to analyze and prescribe policies that will induce [economic] development.”¹⁸

Before analyzing the impact of institutions in a business environment, it is helpful to clarify certain concepts from NIE that are relevant to this study. Property rights, transaction costs, institutional policy, and institutional reform are essential concepts for the understanding of the relevancy and analysis of these two case studies under NIE. In this paper, property rights are defined as “social institutions that regulate the use of scarce resources by assigning and enforcing rights and duties.”¹⁹ Closely related to property rights is the concept of transaction costs. Author Thráinn Eggertsson defines transaction costs as “the costs of control in a social system...[transaction costs] arise when individuals try to acquire new ownership rights, defend their assets against transgressions and theft, and protect their resources against opportunistic behavior in exchange relationships.”²⁰ Institutional policy, on the other hand, is the “art” of

¹⁷ Hariss et. Al (1997), p. 3.

¹⁸ Alston et al (1996), p. 342.

¹⁹ Thráinn Eggertsson. Imperfect Institutions: Possibilities and Limits of Reform. (Ann Arbor: University of Michigan Press, 2005), p. 27.

²⁰ Ibid.

creating new institutions or remedies for existing ones.²¹ Finally, of relevance to us is the concept of institutional reform. The definition that suits this analysis best is that institutional reform involves creating institutions, or changing existing ones, based on a policy makers' goals. The quality of an institutional reform is thus determined by the relation between the policy makers' goals and the instruments (institutions) created to achieve those goals.²² More specifically, the idea of "quality" of the institutional reforms carried out during the two privatizations under investigation emphasizes how institutions to govern the privatization process were created – democratically or undemocratically, how often they changed, and the effect these characteristics had on the perceived credibility of the state and its bargaining power.

Let us examine how institutions can have an impact on the business environment and in attracting FDI to a particular country. In an environment where the state is highly interventionist (i.e. most Latin American states until the 1990s), the formal rules of the game (i.e. institutions) are determined by only one of the parties – the state – yet they affect the interests of all parties in the market. Lack of consistency, transparency, and stability in the laws, regulations, and in the management of any given sector of the economy increase transaction costs, threaten property rights and send a message of instability and uncertainty to investors.

Such climate increases transactions costs because it encourages corruption (i.e. bribery) and increases risk margins since it is more difficult for investors to predict the outcome of investment decisions. It also threatens property rights because investors have little faith in the ability of the state in protecting their investments and assets in the country – to be sure, in Latin America, often the state have expropriated the assets of foreign investors, creating a very

²¹ Ibid.

²² Ibid.

common precedent for such a fear.²³ All of these conditions contribute to increase the so-called “political risk,”²⁴ which will be discussed in more detail below, and to a less-than-favorable investment climate. Authors L.J. Treviño, J.D. Daniels, and H. Arbelaez stated in very plain terms:

“[T]he role of institutions in an economy is to reduce transactions costs²⁵ by reducing uncertainty and by establishing a stable structure that facilitates interaction and empirical results support the superiority of the institutional construct (rather than other theoretical approaches, such as macroeconomics, which focuses on currency exchange and inflation rates) to explain FDI into developing and transitional economies.”²⁶

So, states competing to attract FDI should design policies that would strengthen institutions and therefore lower transaction costs. Quan Li and Adam Resnick assert that “attempts to increase bureaucratic competence or provide enhanced contract enforcement could go a long way toward setting a country apart from competitors for FDI.” In this scenario, the net welfare benefits to the state are higher because this model requires “less sacrifice of state resources” and benefits extended to the society at large by virtue of “clearer costs and incentives.”²⁷

²³ Almost every book on Latin American economic history makes reference to large nationalization programs whereby governments suddenly announce that the foreign investors could no longer claim ownership of their assets in the country. To be sure, in Bolivia today investors live under the constant fear of nationalization by president Evo Morales, who has been threatening to expropriate the assets of foreign companies in key sectors such as oil and gas.

²⁴ Political risk may be defined as “the risk that a host country government will unexpectedly change the institutional environment within which businesses operate.” K.C. Butler and D. C. Joaquin. “A Note On Political Risk and the Required Return on Foreign Direct Investment.” Journal of International Business Studies 29, No. 3 (1998): 599-608 in Treviño et al. Arbelaez (2004), p. 236.

²⁵ An alternative definition of transaction costs is to consider them “the costs of finding out what the relevant prices are, of negotiating and...concluding contracts, and then of monitoring and enforcing them. See Harris et al, p. 3.

²⁶ L.J. Treviño, J.D. Daniels, and H. Arbelaez. “Market Reform and FDI in Latin America: An Empirical Investigation.” Transnational Corporations, Vol. 11, No. 1 (2002), p. 29-48, in Len J. Treviño and Franklin G. Mixon Jr., “Strategic Factors Affecting Foreign Direct Investment Decisions by Multi-National Enterprises in Latin America,” Journal of World Business, Vol. No. 39 (2004): 234.

²⁷ Quan Li and Adam Resnick. “Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries.” International Organization, Vol. 57, Winter 2003, p. 203. Retrieved from Cambridge Journals Online February 14, 2005: <http://www.journals.cambridge.org>.

Scholar Thráinn Eggertsson rightfully asserts that Latin America has a record of asymmetric patterns of economic policies.²⁸ The perception of inconsistency of policy and instability of political institutions contributes to create political risk and to increased transaction costs (e.g.: investors purchase insurance to cover political risk before investing in a country; therefore, the perceived level of political risk is an important determinant of investment decisions).²⁹ Len J. Treviño and Franklin G. Mixon Jr. have linked institutional reform aimed at increasing transparency and reducing political risk to increased inflows of FDI, while North has linked it to lower “transaction costs.”³⁰ Hence, lower levels of perceived corruption, and increased stability and reliability of institutions (elements associated with political risk and transaction costs) is likely to attract foreign investors.³¹

It should be acknowledged that, besides institutional theory, macroeconomics (i.e., inflation, exchange rate behavior and national income) is another major theory explaining FDI inflows to developing countries. However, recent studies presented empirical evidence suggesting that, while the macroeconomic and institutional theories are complementary in explaining FDI, the “institutional approach presents a stronger relationship with FDI than does the macroeconomic theory.”³² That said, it may just be reasonable to argue that countries interested in enhancing economic performance via FDI inflows, which was the case of Argentina and Brazil, should make an effort to catalyze institutional reform to enforce rules and regulations that are more transparent and stable. This could potentially lower transaction costs, strengthen property rights, and create a regulatory environment congruent with that of more developed

²⁸ Treviño et al (2004), p. 12. See also the *Institutional Investor* magazine (various issues) for data concerning a country’s political risk and the levels of FDI inflows.

²⁹ R. Hoskisson, L. Eden, C.M. Lau and M. Wright. “Strategy in emerging economies.” Academy of Management Journal, Vol. 43, No. 3 (2000): 249-267, in Treviño et al (2004), p. 234.

³⁰ Treviño et al (2004), 233-235.

³¹ Treviño et al (2004), 239.

³² Len J. Treviño and Franklin G. Mixon Jr. (2004), p. 237.

markets from which capital may flow. NIE does appear to validate the claim that the commitment to implement a stable institutional environment during privatizations helps create a positive perception in the eyes of investors, and may, therefore, enhance the state's bargaining power during negotiations.

CHAPTER II – ECONOMIC HISTORY OF LATIN AMERICA IN THE LATE 20TH CENTURY³³

In order to understand the relevance of privatization in Latin America in the 1990s, one must first understand the recent economic history of the region. This chapter offers a concise overview of Latin American development policies throughout the second half of the 20th century. This overview will cover policies ranging from the import substitution industrialization (ISI) implemented in the post-War period through the liberal market reforms that helped push forward the two privatizations under investigation.

Before World War I, Latin American countries implemented development policies by applying a model based on the export of raw materials, the so-called export-led growth. Latin American governments adopted a stance that fostered and protected those industries where each country had a comparative advantage producing raw materials. However, the export-led model

³³ This chapter draws extensively from the following works: Thomas E. Skidmore and Peter H. Smith. Modern Latin America, 6th ed. (New York: Oxford University Press, 2001); Howard Handelman. The Challenge of Third World Development, 3rd ed. (New York: Prentice, 2002); Carlos Waisman. Reversal of Development in Argentina: Postwar Counterrevolutionary Policies and Their Structural Consequences. (Princeton: Princeton University Press, 1987); Jeffrey A. Frieden and David A. Lake. International Political Economy: Perspectives on Global Power and Wealth 3rd. ed. (New York: St. Martin's Press, 1995), pp. 298-318; Victor Bulmer-Thomas. The Economic History of Latin America Since Independence, 2nd ed. (New York: Cambridge University Press, 2003), esp. chapters 1, 4, 9-11; Sebastian Edwards. Crisis and Reform in Latin America: From Despair to Hope. (New York: Oxford University Press, 1995), esp. Introduction, Part I and pp. 69-87; Kurt Weyland. The Politics of Market Reform in Fragile Democracies. (Princeton: Princeton University Press, 2002), pp. 71-167; Robert A. Pastor (ed.), Latin America's Debt Crisis: Adjusting to the Past of Planning for the Future? (Boulder: Lynne Rienner Publishers, Inc., 1987).

of growth became increasingly unstable and risky due to the extremely volatile prices of raw materials. In the early 20th century, with the Great Depression, the latent weakness of this policy became apparent. As prices of primary products fell, the impact on Latin American countries' balance of payments (the difference between what a country imports and what it exports over the course of one year) was tremendous, especially because the export-led model relied heavily on the import of industrialized products.³⁴

The instability of the prices of raw materials, and the subsequent impact on the countries' trading accounts, triggered a response from Latin American countries. This response took the form of a new model for economic development, based on the domestic production of the industrialized products that were once imported from developed countries. This policy came to be known as the Import Substitution Industrialization (ISI).³⁵ ISI, its outcomes, and the policies and trends that followed it are discussed in more detail in the subsections below.

Import Substitution Industrialization (ISI)

Generally speaking, when referring to inward-looking economic policies in Latin America, the most common idea that comes to mind is that of statist and nationalistic economic policies. The quintessential representation of this economic orientation is the import substitution industrialization policy, or ISI. In fact, most Latin American countries have adopted this policy, to varying degrees, at some point during World War II or in the period following it. ISI was mainly adopted as a reaction to both the decline in the prices of raw materials in the international

³⁴ Bulmer-Thomas (2003), pp. 82-152.

³⁵ The term "inward-looking" development is commonly used to refer to the nationalistic tendency of Latin American countries to focus on domestic production of industrialized goods; ISI is an inward-looking development policy.

market and, in part, due to the influence of policy strategists such as Raúl Prebisch, head of the *Comisión Económica para América Latina y el Caribe*, CEPAL.³⁶

This development strategy relied on the idea of fostering domestic industrial production for domestic markets. Because private investment levels in Latin America were minimal, the government was the largest investor in the infant industrial sector. It is from this ISI era that large state-owned enterprises were created, or companies were “nationalized,” meaning the state would become their sole owner. The capital invested came mostly from international financial institutions, such as commercial banks, the World Bank and the International Monetary Fund (IMF). To be sure, ISI did produce economic growth during its initial stages, but its foundation rested on flawed economic rationale, which over time, proved to be unsustainable.³⁷

The economic rationale of ISI can be summarized as follows.³⁸ The pillars of the ISI are radical protectionism for domestic industry (mostly through high tariffs on imports), state participation in productive activities (either through strong intervention or through ownership of firms, the so-called state-owned enterprises), provision of subsidies to manufacturing sector (usually capital-intensive industries, and not, as it should have been the case, labor-intensive industries), and focus on selling to domestic markets only, as opposed to also focusing on the export of outputs.

Domestic manufacturers, however, relied heavily on imported inputs. This proved to be a great flaw, and greatly contributed the failure of ISI because domestic entrepreneurs depended on prices set in the world markets.³⁹ Therefore, a vicious cycle was created where the state subsidized (directly or indirectly) and protected an industry that became capital-intensive, and

³⁶ Bulmer-Thomas (2003), pp. 268-280.

³⁷ Weyland (2002), pp. 73-75.

³⁸ Michael P. Todaro. Economic Development in the Third World. 4th ed. (New York: Longman, 1989), pp. 427-449.

³⁹ Bulmer-Thomas (2003), pp. 313-352.

which could not absorb the growing labor force. This relationship between employment and production provided the conditions for a static national consumer market, that is, a market incapable of absorbing the goods being produced. Furthermore, domestic industries could not take advantage of the economies of scale⁴⁰ because demand was low due to limited consumption within domestic markets. This trend, coupled with the high cost of imported inputs contributed to transform the domestic industries into mammoths draining money from the state. [Table 1](#) illustrates the dramatic increase in public spending during the 1970s in Argentina and Brazil, and the proportions of SOEs alone.

[Insert [Table 1: Growth of Public Sector in Argentina and Brazil](#) ~~Table 1: Growth of Public Sector in Argentina and Brazil~~ here]

The state solved this demand for capital by reaching out to international lenders, or by, at times, simply printing money. The excessive borrowing those Latin American countries incurred in the second half of the 20th century, to finance ISI projects eventually culminated with a widespread crisis of continental proportions. This trend, associated with other external conditions (i.e.: oil shock of 1973), led to two consequences that became chronic problems in Latin America during the 1980s: the debt crisis and hyperinflation.

⁴⁰ Economies of scale (or increasing returns on sale) occur when average total cost falls as output expands. With increasing returns to scale, an increase in all inputs leads to a more than proportional increase in output. Economies of scale mainly occur because of economies of specialization and from better utilization of large capital equipment (for example, a large farm can make better use of a tractor than a one-acre farm). See Walter J. Wessels, [Barron's Economics Business Review](#), 3rd ed. (New York: Barron's Educational Series, Inc., 2000), p. 332.

The Debt Crisis and Hyperinflation⁴¹

As discussed in the previous section, governments implementing ISI projects looked abroad to cover most of their capital shortages.⁴² Coupled with Latin America's lack of investment capital was ease with which international commercial banks, in particular, extended credit to them.⁴³ Authors Robert A. Pastor and Sebastian Edwards point out to the dangerous combination of excess supply of money in developed nations, in particular oil-producing ones, and the excess demand for money in developing nations, in particular those funding costly state-owned enterprises.⁴⁴ This combination led to an exponential increase in Latin America's foreign debt. [Table 2](#) provides a snapshot of the increase in Latin American and the Caribbean debt between 1970 and 1985.

[Insert [Table 2: Latin America and the Caribbean: External Debt, 1970-1985](#) here]

The crisis officially began in August 1982, with the announcement by Mexican Finance Minister, Jesús Silva-Herzog, that his country could not keep servicing its debt as of that date. However, what was initially thought to be an isolated event, quickly spread throughout the entire region. With the Mexican announcement, commercial banks severely reduced, or ceased completely, all loans to Latin American countries, triggering a domino effect reaction whereby

⁴¹ This section draws extensively from the following work: Barbara Stallings and Robert Kaufman. (eds.) *Debt and Democracy in Latin America*. (Boulder: Westview Press, 1989), esp. chapters 2, 3, 6 and 11.

⁴² Pastor cites a speech given by George Shultz at a conference of the American States, on December 2, 1985, in which he estimated that approximately “three-fourths of the overall fiscal deficit of a sample of developing countries were attributable to public enterprises.” In Pastor (1987), p. 19.

⁴³ Edwards (1995), p. 17.

⁴⁴ Pastor (1987), p. 7.

all other highly indebted Latin American countries began soliciting a rescheduling of their debt service payments.⁴⁵

Author Sebastian Edwards identifies certain external and domestic historical causes of the debt crisis. External causes were the slow rate of growth in industrialized countries, an increase of world real interest rates, and a sharp decline in world commodity prices. All of these causes resulted in the dramatic increase of Latin America's trade deficits, and increased debt service. The main domestic cause of the crisis, Edwards argues, was the tendency of Latin America countries to over-valuate their national currencies against the dollar.⁴⁶ It should be noted that excessive government spending and an over-valued currency produce excess money supply in the economy. This state of affairs contributed to the scenario of hyperinflation some Latin American countries experienced in the 1980s.

The debt crisis and hyperinflation led some Latin American countries to experiment with unorthodox adjustment programs. These policies emphasized exchange rate and price controls, and deemphasized demand management and fiscal discipline.⁴⁷ Both the Austral Plan, in Argentina, and the Cruzado Plan, in Brazil, are clear representations of the rise and fall of heterodox economics in Latin America during the so-called "lost decade."

Argentina's heterodox plan, the Austral Plan, was implemented in June 1985.⁴⁸ It focused on the management of prices, wages and exchange rate (public services and public workers' wages were frozen and exchange rate fixed), and a mild fiscal adjustment (prices of public services were raised, import tariffs increased). Finally, a monetary reform was also implemented, and the peso was replaced by a new currency, the austral. Although the initial

⁴⁵ Pastor (1987), p. 9.

⁴⁶ Edwards (1995), pp. 1-27; 69-114.

⁴⁷ Edwards (1995), 18.

⁴⁸ Stallings and Kaufman (1989), pp. 100-102. See also Judith A. Teichman. The Politics of Freeing Markets in Latin America. (Chapel Hill: The University of North Carolina Press, 2001), pp. 103-107.

results of the Austral Plan were positive⁴⁹ (most heterodox plans succeed in the short-run), in April 1986 the government decided to adopt a “price flexibilization” regime, allowing prices of public services and wages to be raised.⁵⁰ Along with the failure to ignite substantial and sustained fiscal adjustment, this increase in prices brought the brief success of the Austral Plan to a halt.

February 1986 was Brazil’s turn to experiment with its own heterodox plan – the Cruzado Plan.⁵¹ A monetary reform replaced the currency, from cruzeiro to cruzado, with its value fixed to the dollar and, similarly to the Austral Plan, the Cruzado Plan also involved a generalized price freeze. The main goal of the government was to promote what is referred to as the deindexation of the economy. Because economic actors anticipate hyperinflation rates, they usually incorporate an adjustment index rate to contracts. This causes a phenomenon known as “inflation by inertia,” triggering a hyperinflationary vicious cycle in the economy. Because of its emphasis on deindexation, the plan succeeded in bringing inflation down in the short-term.⁵² However, as the Austral Plan, the Cruzado Plan failed to stipulate controls over demand and fiscal adjustments. In September 1986 the fixed exchange rate regime was abandoned and by 1987 wages and prices were adjusted, and the old scenario of escalating “inertial” hyperinflation returned.⁵³

⁴⁹ Public deficit was reduced from 15% of GDP to 7% by late 1986; inflation lowered from 350% in the first half of 1985 to slightly over 20% in the second half. See Edwards (1995), p. 35.

⁵⁰ Edwards (1995), p. 19.

⁵¹ Stallings (1989), pp. 94-96. See also Juarez Brandão Lopes. “Obstacles to Economic Reform in Brazil,” in Carlos H. Waisman and Arend Lijphart. *Institutional Design in New Democracies*. (Boulder: Westview Press, 1996), pp. 195-218.

⁵² Inflation was reduced from 450 percent annual rate during the first two months of 1986 to 2.1 percent in the third quarter of 1986. See Edwards (1995), p. 37.

⁵³ Edwards (1995), pp. 36-37.

The first official recognition of debtor nations' inability to service their foreign debt came with the creation of the Baker Plan, in 1985.⁵⁴ The underlying assumption of the Baker Plan was that the problem of Latin American countries' debt was one of illiquidity, rather than insolvency.⁵⁵ A new plan was devised after the Baker Plan failed to stop countries, such as Brazil, from declaring a moratorium in 1987.⁵⁶ The Brady Plan was put in motion in 1989. The plan went farther than the previous Baker Plan in that it established certain adjustment measures debtor nations should follow in order to access any additional loans. The main financial feature of the Brady Plan was the ability of private creditors to exchange their nominal Latin American debt for bonds with lower face value, backed by U.S. Treasury bonds.⁵⁷ The Brady Plan offered some relief, though temporary, to the crisis initiated in 1982. The focus was on the macroeconomic adjustment measures prescribed by international financial institutions such as the International Monetary Fund and the World Bank. Among the main recommendations was the privatization of state-owned enterprises as a means to generate capital to Latin American debtor nations.⁵⁸

Overall, it can be said that the main characteristic of the response from international finance community to the debt crisis was the establishment of tighter requirements for the provision additional loans. By the late 1980s, lenders began to pressure governments to perform economic adjustments so that countries could achieve economic performance targets, such as balance of payments ratios, reduction of public expenditures and fiscal responsibility. In the 1990s, the adjustment recommendations coming from the international financial community

⁵⁴ Bulmer-Thomas (2003), pp. 360-361; Waisman and Lijphart (1996), pp. 224-230; Stallings, pp. 60-73.

⁵⁵ Bulmer-Thomas (2003), p. 360.

⁵⁶ In this case, a moratorium means the temporary, yet indefinite, suspension, of payments of a liability or obligation.

⁵⁷ Bulmer-Thomas (2003), p. 361; Teichman (2001), pp. 51-56.

⁵⁸ Bulmer-Thomas (2003), pp. 360-61; Teichman (2001), pp. 44-64.

became more incisive. Eventually, creditors and the financial community in general, set out a specific “agenda” that Latin American countries should adhere to in order to receive further loans and foreign investment; this agenda was eventually termed the “Washington Consensus.”⁵⁹

Washington Consensus

By the late 1980s, the economic thinking in Latin America began to change, following the problems associated with the state’s mismanagement of the economy. The view based on heavy state interventionism and inward-looking strategy that neglected macroeconomic sustainability was replaced by a new way of thinking that emphasized macroeconomic concerns, such as market liberalization and the reduction of state interventionism.⁶⁰

There was a general agreement that the economic role of the state needed to be redefined starting with the idea that the state should refrain from owning the means of production. This redefinition of the role of the state in the economy gave rise to the wave of privatization programs throughout Latin America. Those political leaders who had been supporters of heterodox policies changed their orientation, and began supporting reforms to tackle fiscal imbalances, promote trade and financial liberalization, and privatization. Carlos S. Menem, of Argentina, was one such politician. Edwards points out that, from a historical perspective, “...the convergence of views [in Latin America] was a remarkable event, comparable only to changes that took place in Eastern Europe in the late 1980s.”⁶¹

⁵⁹ Author John Williamson first used the term “Washington consensus” in his book Latin American Adjustment: How Much Has Happened?, in 1990. Williamson defines “Washington” as an ad-hoc group of financial institutions, policymakers and think tanks interested in Latin American economic issues; the consensus comprises a set of ten policy areas prescribed by “Washington.” See John Williamson. “Latin American Adjustment: How Much Has Happened?” (Washington, DC: Institute for International Economics, 1990), Introduction.

⁶⁰ Edwards (1995), pp. 58-65.

⁶¹ Edwards (1995), p. 43.

The Washington Consensus comprises a well-defined set of orthodox reform propositions. These propositions served as a roadmap to Latin American countries wishing to re-establish themselves in the world economy and enable macroeconomic development. According to author John Williamson, the main policy prescriptions of the Washington Consensus emphasized the following issues: fiscal deficits, public expenditures priorities (reducing expenditures vs. raising tax revenues), tax reform, interest rates, exchange rate, trade policy, foreign direct investment, privatization, deregulation (i.e.: price controls, restrictions on inflows of foreign investments and outflows of profit remittance, labor laws, etc), and property rights.⁶² It is against this historical backdrop – vis-à-vis the liberal reforms and the Washington Consensus – that the privatizations under investigation take place.

CHAPTER III – ARGENTINA

Throughout most of the 1980s, Argentina was unable to approve a budget, control inflation, collect taxes appropriately, and win the confidence of both the international and financial communities. By 1989, Argentina was at the height of an unprecedented economic crisis.⁶³ One common argument for the effectiveness of reforms under turbulent political circumstances is the concentration of power within the executive branch. This is perhaps a distinguishing feature of the ENTEL privatization. A strong executive branch will likely be more effective in carrying out unpopular reforms by using its decree power. Guillermo O'Donnell coined the term “delegative democracy”⁶⁴ to describe this particular kind of democracy; one in which the executive acts independently of the legislature, i.e.: legislating

⁶² Williamson (1990), pp. 1-20.

⁶³ Javier Corrales, “Why Argentines Followed Cavallo: A Technopol Between Democracy and Economic Reform, in Jorge I. Domínguez, Technopols, (University Park: The Pennsylvania State University Press, 1997), p. 51.

⁶⁴ O'Donnell, in Corrales (1997), p. 52.

through decree. Most of this chapter is dedicated to demonstrate how Argentina's credibility was diminished during the ENTEL privatization due to Menem's abuse of decree power, and how this abuse made institutions unstable and unreliable throughout the entire privatization process.

By the late 1980s Argentina was coping with hyperinflation and external debt problems by implementing market-oriented reforms. Privatization was one of the pillars of this reform project. In fact, the first attempt to privatize Argentina's largest public utility company, the *Empresa Nacional de Telecomunicaciones* (ENTEL) was during the Raul Alfonsín administration, in 1987. At the time, the Alfonsín administration was faced with a mounting and unprecedented economic crisis in the Argentine economy, with deep fiscal imbalances and hyperinflation. It has been reported that President Alfonsín secretly negotiated a deal with Telefónica de España at that point. It would cost Telefónica US\$3.5 billion to have exclusive and monopolistic rights over all Argentine telecom services, including cable television, for twenty years, with an option to extend this period to thirty years. The deal was rejected in the Argentine Senate.⁶⁵

The second privatization attempt occurred in 1990. This time around, the ENTEL privatization was markedly affected by historical conditions such as the ongoing economic crisis and domestic political instability. In fact, the privatization was opposed by a large portion of the general public and by many political actors. These circumstances seriously impaired the ability of president Carlos S. Menem to carry out his privatization program without creating serious

⁶⁵ *Latin America Regional Reports: Southern Cone*, "What Peronists Propose for Argentina: Menem Tells Europeans that There is 'Nothing to Fear'." Trends Section; RS-88-07; p. 4; September 8, 1988; see also Alice Hill and Manuel Angel Abdala. "Regulations, Institutions, and Commitment. Privatization and Regulation in the Telecommunications Sector." World Bank Policy Research Paper 1216. Washington, D.C.: World Bank Policy Research Department Finance and Private Sector Development Division, November 1993, pp. 10-12.

friction that could damage his political career and even threaten his presidency. The scenario may have led Menem to think that using decree power was the only way to move the privatization forward. In any case, the decision to privatize through decree had a negative impact on the state's bargaining power because the result of this institutional design was a rushed sales process, marked by low instability, partiality and secrecy during the privatization process.

Menem's Macroeconomic Policy

In Argentina, as in most Latin American countries such as Brazil, the privatization of telecommunications services was tied to a series of liberal economic policies. This new liberal economic program called for improvements in government's fiscal position and fostering of market-oriented policies as a way to boost economic growth.⁶⁶

Argentina is a major player in Latin American politics. However, its history is marked by political instability and military coups. In fact, the change of presidents in 1989 was the first peaceful one since 1928. The Argentine economy is split between the greater Buenos Aires region and the rest of the country. Industries are highly concentrated in Buenos Aires, and the agricultural sector dominates the economic landscape in the rest of the country. Because of this underlying economic cleavage, the country is also politically divided along those same lines.⁶⁷

Argentina's political structure follows the classic division of power system, with the executive, legislative and judicial branches.⁶⁸ The voting system is based on electoral colleges, which, because of the political split outlined above, grants greater importance to voters residing

⁶⁶ See John Ward, Latin America: Development and Conflict Since 1945, 2nd ed. (New York: Routledge, 2004), pp. 38-57

⁶⁷ Waisman (1987), chaps. 5-6.

⁶⁸ This section draws extensively from the following works: Alice Hill and Manuel Angel Abdala, "Argentina: The sequencing of privatization and regulation" in Brian Levy and Pablo T. Spiller (eds.), Regulations, Institutions and Commitment, (Cambridge: Cambridge University Press, 1996), pp. 202-249; Waisman (1987), pp. 9-11; 86-93; Waisman and Lijphart (1996), pp. 46-54.

in the Buenos Aires area. Congress is divided between the upper house, the Senate, and the lower house, the Chamber of Representatives. Senators are elected for a 9-year term, by provincial legislatures, with two senators from each of Argentina's twenty-three provinces. The two senators from the capital Buenos Aires are elected following the same Electoral College mechanism as the president. The Representatives are elected by universal adult suffrage from a closed party list for a term of four years. A national election involving half the seats in the lower house occurs every other year.

Party diversity is not a tradition in Argentine politics since historically only two major parties dominated the political landscape: The Radicals and the Peronists. The Radicals' base is composed of a mainly middle-class constituency, whereas the Peronists' support comes from urban, unionized working class. After the 1983 elections, the Radicals controlled the presidency and the Chamber of Representatives, and the Peronists controlled the Senate.

The election preceding the ENTEL privatization took place in May 1989 to select the successor to president Raúl Alfonsín, of the Radical party. The newly elected president was Carlos S. Menem, from the Peronists party. Menem won the election embracing a platform that called for the articulation of the classic Peronist-populist doctrine, which emphasized "economic nationalism, strong state regulation of the economy, economic growth through direct government investments and financing of the private sector, and social justice favoring workers through income distribution."⁶⁹ At the time of his election, Menem was a three-time governor of *La Rioja*, one of Argentina's poorest provinces. As governor, he succeeded in creating government jobs and managed to include almost half of the working population in the province's payroll. Menem's long-standing populist tendencies can be shown by his decision, as governor of *La*

⁶⁹ Atilio Borón. *El Menemato* (Buenos Aires: Letra Buena, 1991); Gary Wynia. *Argentina: Illusions & Reality*, 2nd ed. (New York: Holmes & Meier, 1992, in Luigi Manzetti, *Privatization South American Style*, (New York: Oxford University Press, 1999), p. 71.

Rioja, to unilaterally print currency, when the Alfonsín government cut off federal aid to his province.⁷⁰

The gravity of the situation prompted Peronists and Radicals to strike a deal to let Menem take office five months ahead of schedule. Surprisingly, and in spite of the Peronist party's long-standing tradition of adopting nationalistic, inward-looking economic policies, Menem took a liberal-oriented and reformist approach to reform the Argentine economy.⁷¹ That is, the Menem administration sought to tackle Argentina's economic crisis not through nationalization and other populist policies, but through a firm resolve to implement free market policies, geared toward attracting FDI.

However, this change in direction did not come without a political cost, since by taking this new approach to solve economic problems, Menem substantially departed from his party's tradition. One week after Menem became president, he met with leaders of his party, including Antonio Cafiero, who Menem defeated in the dispute for the Peronist party nomination for president. According to an editorial article in the Argentine newspaper *Clarín*, the party leaders "did not hide their displeasure at the fact that the newspapers had been their best source of information on [Menem's initial] decisions and appointments, in which the party had enjoyed no effective participation."⁷²

⁷⁰ Manzetti (1999), p. 71.

⁷¹ However, this change in direction should not have been a complete surprise to those following the president's campaign closely. In a news article covering Menem's tour throughout Europe during his presidential campaign in 1988, he was quoted as saying that he was "against state-oriented policies" and that, as president, he would "seek to take into account the views of both employers and workers" (*Latin American Regional Report*, "What Peronists Propose for Argentina," September 4, 1988).

⁷² See James McGuire, Peronismo Without Perón: Union, Parties, and Democracy in Argentina. (Stanford: Stanford University Press, 1997), p. 244. For an extensive discussion on the relationship of Menem with his party, and with union leaders, please refer to the following works: Carlos H. Acuña. "Political Struggle and Business Peak Associations: Theoretical Reflections on the Argentine Case," in Francisco Durand and Eduardo Silva (eds.) Organized Business, Economic Change, and Democracy in Latin America. (Miami: North-South Center Press, 1998), pp. 51-72; Maria Victoria Murillo. Labor

There was greater, though uneven, support for Menem's measures from the Peronist union base. Author James McGuire states that while some union leaders opposed Menem's reforms (mainly, the unions from state-owned companies, such as ENTEL), the majority, supported and cooperated with the president. McGuire gives two main reasons for this: first, the recognition by some that the Peronist economic model had failed to bring sustainable growth. Secondly, a majority of the unionized workforce seemed to fear hyperinflation more than they did privatization.⁷³ Author Maria Victoria Murillo argues that Menem's change in direction is partly due to this realization of the costs of hyperinflation – “it was a strategy for political survival than ideological conviction.”⁷⁴ The author makes reference to interviews conducted with leaders of the FOETRA (Federation of Telephone Workers and Employees of the Argentine Republic) and of SUPE (Union of State Owned Oil Workers). These leaders recalled a meeting between Menem and union leaders in 1989, during which the president allegedly said: “the Central Bank had run out of reserves, the country was bankrupt, and there was no alternative to structural reforms to save democracy.”⁷⁵

Given the widespread crisis, Argentina's macroeconomic recovery based on a liberal economic program depended on Menem's ability to restore the confidence of investors. Immediately after taking office, the president succeeded in forging a political coalition that allowed him to pass the Economic Emergency Law (Law No. 23,697/89) and the State Reform Law (Law No. 23,696/89), two all-encompassing state reform laws that would serve as a platform for his macroeconomic policy. The Economic Emergency Law covered issues relating

Unions, Partisan Coalitions, and Market Reforms in Latin America. (New York: Cambridge University Press, 2001).

⁷³ McGuire (1997), pp. 216-261.

⁷⁴ Murillo (2001), p. 134.

⁷⁵ Ana Margheritis. “Implementing Structural Adjustment in Argentina. The Politics of Privatization.” University of Toronto, Ontario, Canada. Unpublished doctoral dissertation; in Murillo (2001), p. 134.

to short-term public expenditures and certain structural adjustments to be taken in the medium-term. In August 17, 1989 the Argentine Congress passed the *Ley de Reforma del Estado* (State Reform Law).⁷⁶ This law laid out the parameters for Menem's privatization program, and granted the president an unprecedented decree power to carry it out.⁷⁷ The privatization program Menem devised was, at the time, considered "one of the developing world's most ambitious privatization efforts."⁷⁸ Yet, it was also known for its "...treachery, intrigue, rumours of corruption and impressive brinkmanship."⁷⁹

Because the State Reform Law gave the president unprecedented decree power, it also avoided the need to bargain with Congress – in fact, Menem and his cabinet made every effort not to involve Congress at all. The main rationale of the president's aides was that the process could be concluded faster by avoiding Congressional input. However, as it has been mentioned before, this choice also established a sense of generalized instability. Relying on the president's decree power certainly sped up the process, but also meant that the terms and conditions of the privatization were changed quickly, unilaterally, and often the decision-making rationale was not entirely clear to those outside the immediate circle of bureaucrats involved in the process. This sense of secrecy tainted the process and lowered Argentina's credibility with investors.

One argument commonly made in favor of Menem's choice is that speed was necessary in the case of ENTEL. Hill and Abdala argue: "[T]he Menem government set out to change the reputation of the government and, by extension, the country...[S]peed in implementation was essential for the viability of the entire reform program."⁸⁰ As it has been asserted above, Menem

⁷⁶ Law No. 23,696/89.

⁷⁷ Law No. 23,696/89.

⁷⁸ John Barham. "Argentina On Line to Privatization." *Financial Times*. November 13, 1990. Section I; International Capital Markets; Pg. 37. Retrieved November 11, 2005 from LexisNexis Academic.

⁷⁹ Barham, *Financial Times*. November 13, 1990.

⁸⁰ Hill and Abdala (1993), p. 6.

assured speed by relying solely on his decree power. The privatization was part of a major macroeconomic policy, which depended on the degree of credibility of the government in the eyes of foreign investors. However, if one agrees with this assertion, then the particular privatization design chosen by Menem's team should be questioned: Was speed a condition *sine qua non* to lend credibility to the government's program? Not necessarily so, it would appear. Speed was achieved at the cost of the stability of institutions, which, as it will be discussed in more detail in the following section, severely hurt the overall outcome of the privatization by reducing investors' perception of the government's credibility.

Perhaps, one suitable explanation for the choice of privatization design has to do with the historical conditions in Argentina at the time. Many authors claim that, given the volatility of the political and economic environment in Argentina, relying solely on decree power to privatize was the only possible choice that would make the privatization possible at all. Because the government's goal was to draw foreign investors into the process, one argument in favor of a quick privatization was that investors could be "scared away"⁸¹ by the political environment in Argentina should the process be stalled by political turmoil. In the view of the ENTEL's privatization team, it was necessary to "insulate the process from broad political participation, while allowing private investors a role in the design of the privatization."⁸²

The underlying cause of the turmoil in Argentina in 1989-1990 was hyperinflation because of its dramatic effects on both supply and demand (meaning, the ability of workers to buy goods, and the ability of entrepreneurs to replenish inventories). Since May 1989, Argentina was undergoing economic and social chaos: food and other essential goods such as medicines were absent from shop shelves, gasoline was scarce and the police was extensively patrolling the

⁸¹ Petrazzini, in Ramamurti (1996), p. 119.

⁸² Petrazzini, in Ramamurti (1996), p. 120.

streets to curb the wave of food riots that were occurring in Argentina's major cities.⁸³ By early 1990, Menem was also faced with threats of a military coup. According to an article in *The New York Times*, "military leaders have warned that the country is approaching anarchy and admonished people to close ranks behind their democratic government."⁸⁴ Against this backdrop, many authors find it surprising that the ENTEL privatization occurred at all.

On the other hand, Menem's liberal policies antagonized two different factions within the Peronist party: those who supported traditional Peronismo, based on state-oriented policies, and those who simply supported Menem (and who were not, necessarily, ideologically linked to the market-oriented policies he was implementing). Menem declared, "He did not think he had to make any compromises, whether with the opposition or his own party...it was enough...to form a direct link to the people and their extraordinary wisdom."⁸⁵ This divide mounted over the course of the ENTEL privatization and was exacerbated with the resignation of the party's president, Antonio Cafiero, in August 1990 (although Menem was nominated the new party president, his brother, Eduardo Menem, became the *de facto* party's president). Menem also weakened some union leaders when he issued a decree taking away the constitutional right of workers in the public sector to strike (he issued the decree after Congress had failed to approve it).

⁸³ *Latin America Weekly Report*. "Argentina's Menem Has Little Time to Succeed Where Alfonsín Failed." RS-89-05; p. 1, June 29, 1989; *Latin America Regional Reports: Southern Cone*. "Coup-mongering Spells Danger for Menem in Crisis-ridden Argentina. RS-90-01; p. 1, February 8, 1990.

⁸⁴ Shirley Christian. "Argentina's Military Chiefs Warn of Anarchy. *The New York Times*. Section A, Page 3, Column 1, Foreign Desk. January 2, 1990. Note that a military coup was eventually attempted in December 1990, but it was quickly defeated by troops supporting the government.

⁸⁵ McGuire (1997), p. 245. Author Kurt Weyland offers a very interesting discussion about the populist character of neoliberal leaders in Latin America (esp. Menem and Fujimori). Please see: Kurt Weyland, "Neoliberal Populism in Latin America and Eastern Europe." *Comparative Politics*, Vol. 31, No. 4, Jul., 1999, pp. 379-401.

The ENTEL Privatization

In his book, “Privatizing Monopolies,” author Ravi Ramamurti highlights the importance of planning and implementation to assure the success of any privatization program.⁸⁶ It was precisely in planning and implementation that the ENTEL privatization was an egregious failure.

It has been mentioned elsewhere in this paper that Menem initiated the privatization process shortly after taking office, in September 1989, and had given only fourteen months to the ENTEL privatization team to develop a privatization framework and conclude the sale.

Executive Decree 731/98 of September 12, 1989 established that the government was going to “...demonopolize and deregulate telecommunications services to make them more efficient for the benefit of users....” This decree also provided that the Inspectors of ENTEL⁸⁷ had until

November 30, 1989, to submit a plan for the privatization and the regulatory guidelines for the telecommunications sector (the *Pliegos de Bases y Condiciones Generales y Particulares*,” or simply, *pliegos*) to the *Ministerio de Obras y Servicios Públicos* (Ministry of Public Works).

The Ministry, in turn, had until December 10, 1989, to evaluate and submit the *pliegos* to the president for approval.⁸⁸ Only a few months after receiving the immense task of preparing

ENTEL for sale, the team assembled by the president and headed by the state-appointed *interventora* Maria Julia Alsogaray, presented a privatization plan for ENTEL that touched upon the following issues: (i) the divestiture of ENTEL into several regional operating companies; (ii) partial liberalization of the sector;⁸⁹ (iii) a sale structure specially designed to attract foreign

⁸⁶ Ramamurti (1996), Introduction.

⁸⁷ The taskforce assembled by the president to prepare the privatization plan for ENTEL became known as “*la Intervención de ENTEL*.”

⁸⁸ Please see Decree 731/89, third line and article 1.

⁸⁹ No competition would be allowed in basic phone services for the first five years after the sale.

investors;⁹⁰ (iv) the elimination of cross-subsidies;⁹¹ and (v) the prequalification terms for prospective buyers based on technical expertise and international credentials.⁹² After negotiations with potential investors, the government changed the sales plan and ENTEL was divided into two operating firms, split between the southern and northern regions of the country; the greater Buenos Aires area, which concentrated 59.2 percent of the national traffic, was divided between the two operating companies.⁹³

After revisions to the plan had been approved, the team of ENTEL Inspectors began the process of preparing ENTEL for sale. This process may be divided into the following key areas: (i) institutional reform; (ii) regulatory body and competition; (iii) financial restructuring; and (iv) the sale. These areas will be analyzed in the following paragraphs, and, as it will be seen, all of them contained flaws relating to the implementation of the privatization and the stability of institutions.

Institutional reform. The definition and key features of a positive institutional reform in the context of privatization have been discussed in Chapter I. In this regard, the main characteristic in the Argentine case was the state's failure to develop a regulatory framework for telecommunications before the divestiture of ENTEL. As Petrazzini points out, "[A]part from dividing the company into two regional operating entities, no other major legal, administrative,

⁹⁰ Sixty percent of the company's equity was to be sold to private investors (see [Figure 3: ENTEL sale model](#)).

⁹¹ "Cross-subsidy" means covering the cost of offering some services through excess revenues earned from other services. In telecommunications, the term "anti-competitive cross-subsidy" normally refers to a practice by a dominant firm of offering services in competitive markets at low (e.g.: below-cost) prices, while maintaining overall firm profitability by charging above-cost prices in monopoly markets, or in other markets where the firm enjoys *market power*. See World Bank's Telecommunications Regulation Handbook, Appendix C, Glossary.

⁹² Only consortiums led by private foreign companies with extensive operating experience would qualify. It should be noted here that, although the *pliegos* clearly stated that no companies belonging to sovereign states would qualify to buy ENTEL, the governments of Spain, Italy and France were major shareholders of Telefónica and Telecom, respectively.

⁹³ Petrazzini, in Ramamurti (1996), p. 121.

or financial changes were made” to the existing institutional framework.⁹⁴ Notwithstanding, the president’s team made clear the *pliegos* would prevail in the case of a conflict between it and any other Argentine laws, including the Constitution.⁹⁵

In terms of institutional reform, the emphasis is in how institutions to govern the privatization process were created – democratically or undemocratically, how often they were expected to change – stability or instability of the institutional environment, and the effect that these choices had in the perceived credibility of the state and its bargaining power.

Regulatory body and competition. The government’s decision was to leave basic local telephone services, the core of the privatization transaction, as a monopoly for five years after privatization. After pressure from the only two remaining bidders, the government granted an additional two years of exclusivity. Three years would be added to that should the companies demonstrate that the efficiency targets stipulated by the government had been met. However, considering how modest the Argentine targets were, effectively, the two winning companies were given ten years of exclusivity rights.

The emergence of a competitive environment in telecommunications depends, fundamentally, on the ability of new entrants to interconnect with the existing system. Therefore, one crucial recommendation from the World Bank and the International Telecommunications Union (ITU) concerns the development and enforcement of specific rules covering system compatibility. Ideally, potential buyers should know these rules as early as

⁹⁴ Ibid.

⁹⁵ In fact, Ben Petrazzini titles his article covering the ENTEL privatization as “Privatization in a hurry.” He argues “[S]peed was the main reason for not undertaking any major regulatory or organizational changes.” See Petrazzini, in Ramamurti (1996), p. 123.

possible in the process.⁹⁶ In Argentina, the government required that the two winning companies allowed interconnection of new entrants after the exclusivity period, however, it did not specify what requirements the system should meet. In other words, the two incoming buyers had total freedom to set the system in any way they saw fit. Furthermore, the interconnection fees would be agreed upon by the parties, that is, the two major companies and new entrants. Naturally, this scheme greatly diminished the ability of new entrants to bargain with the two giant operators. The government determined that the regulator, when created, would be the moderator in any dispute between new entrants and the two incumbents. However, Argentina did not have a *de facto* regulator until long after the privatization (a decree issued shortly before the sale created a regulator; however, the regulator was deemed ineffective until 1992).

The government agency responsible for devising a regulatory framework for the telecommunications sector⁹⁶ was the Secretariat of Communications, but, as Petrazzini asserts, “...control of the telephone company was dispersed among various government agencies, leading to an unstable and unpredictable environment.”⁹⁷ The Secretariat was responsible for developing a comprehensive regulatory framework based on the principles outlined in the *pliegos*. Interestingly enough, the head of the Secretariat and his staff opposed the privatization and, therefore, the agency did not respond to the request to produce the regulatory decree until late June 1990, after final bids had already been placed (and despite the fact that the Argentine government had promised prospective buyers that a regulatory framework would be in place by February 1990).⁹⁸ The regulatory decree issued in June 1990, laid out certain regulatory guidelines, and created a government agency to serve as the regulator, the *Comisión Nacional de*

⁹⁶ Please see World Bank’s [Telecommunications Regulation Handbook](#). See also the International Telecommunications Union (ITU) website at www.itu.org for more detailed recommendations with respect to the establishment of a competitive environment following privatization.

⁹⁷ Petrazzini, in Ramamurti (1996), p. 133.

⁹⁸ Hill and Abdala (1993), p. 21.

Telecomunicaciones, CNT (National Telecommunications Commission).⁹⁹ CNT's main function was to "apply, interpret, and enforce laws, decrees, and other norms in the telecommunications sector."¹⁰⁰ Once in operation, CNT restricted its role to simply monitoring compliance of the private owners with the concession contracts signed during the divestiture. Before issuing the regulatory decree, the president fired all personnel at the Secretariat, only to hire them back to staff the newly created CNT (despite the fact they did not support the privatization in the first place). As evidence of the poor governance strategies devised by the Menem's team, the Secretariat not only failed to produce the regulatory framework on time, but it also did not take any action to implement it after CNT had been created. Hill and Abdala state "although a well-defined regulatory framework was legally in place, regulatory practice did not conform to the framework...[T]his created an ambiguous setting for all the participants in the telecommunications sector."¹⁰¹ In January 1992, in light of the ineffectiveness and apathy of CNT's staff, Menem fired all of its board members and replaced them with one inspector and four sub-inspectors.

Financial restructuring. In contrast to the Brazilian case, ENTEL's cash flows were not balanced prior to the sale.¹⁰² The only financial issues the government dealt with before the sale were ENTEL's debt, tariff levels and pricing regime. The government approved the purchase of new equipment for ENTEL as soon as the privatization process was initiated. These purchase

⁹⁹ Decree 1,185/90. According to Hill and Abdala (1993), the World Bank provided assistance in preparing this decree.

¹⁰⁰ Decree 1,185/90, arts. 5 and 6.

¹⁰¹ Hill and Abdala (1993), pp. 24-32.

¹⁰² A company has three key types of financial statements: balance sheet, income statement and cash flows. The balance sheet provides a snapshot of a company's assets and liabilities position at any given point in time; the income statement indicates the firm's profitability during a certain period; the cash flows reconciles both the balance sheets and the income statements, recording the transactions described therein after they have actually occurred. Saying that a firm's cash flows have not been balanced is the same as to say that an outsider will not have the true picture of the firm's cash position; only the estimates provided by the other two statements.

contracts increased ENTEL's corporate debt to US\$862 million; US\$482 of which the government assumed. Initial tariff levels were one of the most crucial issues, and one that was negotiated until shortly before the sale. Buyers threatened to withdraw completely from the process if the government did not grant an additional 27 percent increase over the 190 percent that had already been aggregated to the local pulse price as of June 1990. Finally, the pricing regime was the only one in which Congress was involved. Initially, Congress accused Menem of inflating the valuation of assets upon which to base the rate of return to be provided to new owners. Menem used an artificial amount of US\$3.2 billion in lieu of ENTEL's real operating assets' value, which Congress demonstrated, was US\$1.9 billion.¹⁰³

A note on basic business valuation principles is required here. The discounted cash flow valuation method is commonly used to value firms where cash flows are more important than actual net income (the case of ENTEL). By using the discounted cash flow method, the value of the business is determined by subtracting the present value of the firm's liabilities from the present value of its cash flows and tangible assets. ENTEL was going to generate the same amount of money regardless of the price investors paid. Menem probably inflated the value to make it seem like buyers were getting a lower return than was really the case – this would please Congress. On the other hand, Congress' intervention in lowering the asset value of ENTEL pleased investors, since this valuation serves as one of the criteria (not the main one) for setting the minimum floor price investors would pay. In the end, the manipulation by Menem's team of such an important issue may have only reinforced the negative perceptions of investors.

The sale. The *pliegos* determined the structure for the sale of ENTEL and determined that the final transfer should take place on October 8, 1990. [Figure 3](#) illustrates the ENTEL the sale structure.

¹⁰³ Petrazzini, in Ramamurti (1996), p. 125.

[Insert **Figure 3: ENTEL sale model** ~~Figure 3: ENTEL sale model~~ here]

Formate

Fourteen consortiums purchased the bidding kit for US\$20,000 at the beginning of the early spring of 1990; however, by April 19, 1990, only seven submitted applications for prequalification; and by June 1990, only three remained (Telefónica, Spain; Stet and Cable et Radio/Telecom, Italy and France; and Bell Atlantic Corporation, United States).¹⁰⁴ The rate at which potential bidders withdrew from the process was unusually high. This may be attributed to the inconsistent, and often conflicting, set of norms that the several decrees issued by the president created early in the process. In March 1990, the SIGEP (*Sindicatura de Empresas Públicas*), in Argentina, prepared a report to assess the extent to which the decrees issued by Menem in the ENTEL privatization were conflicting within themselves. According to the report, there were a number of contradictions even within the same presidential decree. For instance, the first article of Decree 62/90 sets forth certain conditions for a company to qualify for the bidding process. However, article 3.1.11 of the same decree provides that any pre-qualified company could be replaced by a subsidiary, even if such subsidiary did not meet the conditions set forth on article 1. Article 3.2.2 of the same decree determined that no disqualified company had the right to file a complaint against the rejection, however, articles 3.10 and 5.8.1 stated that rejected companies had up to five days to file a complaint against rejection.¹⁰⁵

Even though the *pliegos* prohibited both operating companies from being awarded to the same buyer, the Telefónica consortium placed a bid for both the northern and southern companies; it was eventually awarded the southern company. After matching Telefónica's offer, Bell Atlantic was awarded the northern company. However, U.S. laws imposed restrictions on Bell Atlantic's ability to participate in foreign investments. According to American legislation,

¹⁰⁴ The "bidding kit" is a commonly used term to refer to the set of documents prepared by the government, which contains the terms and conditions of the privatization.

¹⁰⁵ Petrazzini, in Ramamurti (1996), p. 126.

Bell Atlantic could only participate with 4.9% in its consortium, and that was against the provisions in the *pliegos*.¹⁰⁶ At the last minute Menem issued a decree, changing the terms of the *pliegos* to accommodate Bell Atlantic's constraint. Bell Atlantic's consortium, however, ultimately withdrew its offer because its main investment bank was unable to raise enough Argentine foreign debt to fulfill its bid. Thus, the government was left with no choice but to award the northern company to Telecom.¹⁰⁷

A crucial issue in the privatization was the price to be paid by investors, and the terms of payment. During the prequalification process, some members of the Menem cabinet said that they would only accept cash in payment for the companies. However, after long debate and pressure from the prospective buyers, the government settled on a debt-equity swap¹⁰⁸ as the primary method of payment. Thus, the final structure was set as follows: a minimum cash payment of US\$214 million was set as the ceiling (see figure above), US\$380 million in ENTEL's corporate debt payable over three years (see figure above), plus any additional amount in Argentine foreign debt as each consortium wished to bid (a floor of US\$3.5 billion was established). The final sale price of the sixty percent stake of ENTEL was US\$214 million in cash, US\$380 in corporate debt and US\$4,620 million in Argentine sovereign debt and associated interest at face value.¹⁰⁹

¹⁰⁶ Banks, financial institutions, ad-hoc investors, and at least one operator, with the operational infrastructure and expertise to provide the services being privatized, usually form consortiums to buy privatizing companies. Bell Atlantic entered the consortium as the main "expert" in the provision of telecommunications services. Pursuant to the provisions in the *pliegos*, a member serving in the "expert" capacity in the consortium should have a participation of more than the 4.9%.

¹⁰⁷ *La Nación*. "En Una Tensa Jornada, se Ajudico al Grupo STET la Zona Norte." October 8, 1990.

¹⁰⁸ A refinancing deal in which a debt holder gets an equity position in exchange for cancellation of the debt. In the case of ENTEL, a great portion of the payment was in the form of sovereign Argentine debt.

¹⁰⁹ Numbers taken from the World Bank's Privatization Database on October 5, 2005. Please see <http://rru.worldbank.org/Privatization/Results.aspx?countryid=9&startyear=1988&endyear=1991§ors=1>.

Investors were able to realize huge savings with the debt-equity financing structure. Argentine foreign debt instruments were quoted in the secondary market at 19 cents of the dollar at the time of sale; this meant that the actual price investors paid for the US\$4,620 million worth of Argentine debt was, in fact, US\$877 million. In November 1990, the Northern and Southern companies were transferred to their respective new owners (please refer to [Table 6](#) for a list of all members of the winning consortia). The premium earned by the state was not impressive. Market analysts usually place a premium of at least 40 percent on the sale of company of this magnitude, and with a significant exclusivity rights period after the privatization.¹¹⁰ In the case of ENTEL, the government attained 27.36 percent – and that is the case because the assumption was that investors paid the actual US\$4,620; instead of the market value the Argentine debt, which as of the date of the sale, was equivalent to US\$877.¹¹¹ [Table 3](#) shows the proceeds and premiums paid for both the Northern and Southern companies.

[Insert [Table 3: Proceeds and Premium: ENTEL Privatization \(in US\\$ million\)](#) ~~Table 3: Proceeds and Premium: ENTEL Privatization (in US\$ million)~~ here]

Corruption scandals emerged following the ENTEL privatization. After the sale it became public that, in the end, the other two consortiums also failed to gather enough debt financing.¹¹² On March 23, 1991, the Argentine federal police arrested several members of a gang led by managers of both Telecom and Telefónica. According to an article on the *Latin*

¹¹⁰ Based on this author's conversations with investment bankers in the area of telecommunications.

¹¹¹ Note that banks that were creditors of Argentina at the time participated in the deal (e.g.: J.P. Morgan) because swapping Argentina's debt instruments for ENTEL's equity was the only way they saw would enable them to collect the debt.

¹¹² Manzetti (1999), p. 110.

American Report, this gang illegally installed 5,000 telephone lines in the capital, Buenos Aires.¹¹³

As seen above, the sale of ENTEL went on with much commotion: It was rushed, the rules were unstable – the government either created conflicting rules, or did not comply with the rules that it had created. Ricardo Zinn was the second-in-command in the ENTEL privatization team, after Ms. Alsogaray. On April 4, 1990, Mr. Zinn resigned from his post, stating “[T]o invest in Argentina is to run a very high risk because the rules are changed every two or three months.”¹¹⁴ In addition to the discontent of some members of the government, the constant changes in the requirements for the debt-equity swap that took place during the sale annoyed bankers involved in the project; consumers, on the other hand, were overwhelmed by the 2,400 percent increase in telephone bills between January and May 1990. In the end, the privatization of ENTEL was marked by what was then considered a characteristic of the Argentine government: “unreliability when it comes to sticking to the rules.”¹¹⁵ In the end, the ENTEL privatization was almost entirely done via the so-called “decrees of necessity and urgency.” Manzetti summarizes well the tone of this privatization program:

“[T]hrough such decrees the executive assumes legislative powers without congressional approval...[F]rom 1853 and 1989 this type of decree power was exercised twenty-five times. Menem, between 1990 and 1994, used them over 300 times...and to prevent Congress from changing important legislation affecting the privatization program, Menem also made an unprecedented use of total and partial presidential vetoes.”¹¹⁶

By 1991, despite the successes of reforms carried out by Menem and his newly appointed Finance minister, Domingo Cavallo (i.e.: inflation at ten percent per month and foreign reserves

¹¹³ *Latin American Weekly Report*. “Do-it-yourself Privatization,” Politics; Argentina; WR-91-13; Pg. 12, April 4, 1991. Retrieved November 11, 2005 from LexisNexis Academic.

¹¹⁴ Gary Mead. “Crossed Lines Over Privatisation” *Financial Times*. Section I; American News; Pg. 8, May 25, 1990. Retrieved November 11, 2005 from LexisNexis Academic.

¹¹⁵ *Ibid.*

¹¹⁶ Manzetti (1999), p. 110.

at the record level of US\$2.8 billion, for instance), Argentina "...continued to be a case of reform non-credibility and societal noncooperation."¹¹⁷ One important question that could be raised is whether Menem's personal profile and past as a populist politician influenced the way he was perceived by the international investor community. In contrast to Brazilian president at the time of the Telebrás sale, Fernando Henrique Cardoso, who was generally seen as an accomplished scholar before being a politician, Menem was famous for being a career politician with rather strong populist tendencies. So, perhaps, investors simply did not "buy" into his sudden change of direction when the time came to put reform in motion.

The message Menem wanted to convey to international investors was one of an Argentina "...serious about business, economically competent, fiscally responsible and internationally linked...everything that Menem himself was not."¹¹⁸ While one may argue that amidst acute crises, reforms are only possible with a strong executive exercising decree power, a government wanting to achieve credibility might indeed have more chances of achieving it by going through democratic channels, instead of bypassing them. Economic governance is often defined as the capacity of state leaders to accomplish their self-declared goals. As was the case of Menem in the ENTEL privatization, the very goals of the liberal reform he set out to achieve were contradicted by the way in which he chose to carry out those reforms to begin with. Incoherence and instability in the process only augmented investors' perception that Menem did not truly believe the liberal principles he so vehemently defended.

Recall from Chapter I that the state's bargaining power can be measured by its ability to negotiate the most favorable terms with investors. Besides the general analysis of the transaction and the institutional environment surrounding it, some measurable variables to assess the degree

¹¹⁷ Corrales, in Dominguez (1997), p. 61.

¹¹⁸ Corrales, in Dominguez (1997), p. 60.

of the state's bargaining power are the premiums obtained with the sale, performance targets agreed upon by investors and the length of the exclusivity period granted by the government. Compared to other Latin American countries privatizing at the time, Argentina received the lowest price per line in service. CANTV, of Venezuela, received US\$2,900 per line; Teléfonos de México (TelMex) received US\$1,653; while ENTEL received only US\$800 per line in service.¹¹⁹ Again, relative to other Latin American countries privatizing around the same time, the Argentine targets were minimal. Mexico, when privatizing TelMex, granted 7 years of exclusivity to the new owners, but in return, it required a network growth rate of at least 12 percent per year, while Argentina required only 6.5 percent (dropping to 2.8 percent between 1995 and 1996). Mexico required that the new owners install digital networks in twenty-two Mexican cities and 9 miles of fiber optic network throughout the country; the Argentine government was silent regarding the introduction of digital technology.¹²⁰ As for competition, it suffices to say that the telecom market in Argentina today is still dominated by the two winning bidders of 1990: Telefónica and Telecom.¹²¹

Perhaps, one of the most incisive statements concerning the flaws of the ENTEL privatization came from Domingo Cavallo, Menem's powerful Finance Minister. According to an article in the *Latin American Report* (December 12, 1996), Mr. Cavallo declared, "...the privatizations of ENTEL and Aerolíneas Argentinas were flawed inasmuch as they represented replacing state monopolies with private ones."¹²²

¹¹⁹ Petrazzini, in Ramamurti (1996), p. 129.

¹²⁰ For more details on this, please refer to the International Telecommunications Union website at www.itu.org.

¹²¹ *The Economist Intelligence Unit*. "Telecommunications Industry Forecast, Americas," June 2005, p. 21.

¹²² *Latin American Weekly Report*. "Cavallo Lists 'Mistakes.'" Argentina; Economy; WR-96-48; Pg. 574, December 12, 1996. Retrieved November 11, 2005 from LexisNexis Academic.

CHAPTER IV – BRAZIL

The literature concerning the privatization of public utilities praises the Telebrás case as one of the most successful privatizations in Brazil, both in terms of proceeds earned, improvements in the performance of telecom services and competition.

President Fernando Henrique Cardoso's macroeconomic policy depended on increasing inflows of FDI, and, under the president's view, a plan to insert Brazil into the circuit of major players in a globalized economy depended on the modernization of the country's telecommunications sector.¹²³ To that effect, during his first term in office, the president took measures to deregulate and privatize the state-owned telecom company, *Telecomunicações do Brasil*, Telebrás (Brazilian Telecommunications Company).

One of the distinguishing features of the Telebrás transaction is the institutional reform implemented before the privatization. The reform included measures to break the existing state monopoly, foster competition, and phase out an archaic and expensive system of state subsidies. In addition, it included the drafting of a comprehensive new law to govern the telecommunications sector and the creation of a regulatory agency, *Agência Nacional de Telecomunicações*, Anatel (National Telecommunications Agency) — all prior to the privatization, in contrast with the Argentine case.

Before going into the analysis of this case, it is paramount to acknowledge that this privatization occurred under considerably different historical conditions. The Brazilian transaction occurred almost a decade after the ENTEL deal. Intuitively, this leads one to think

¹²³ See João Resende-Santos. "Fernando Henrique Cardoso: Social and Institutional Rebuilding in Brazil," in Dominguez (1997), pp. 145-94.

that the Brazilian government had the opportunity to learn from other governments' mistakes when dealing with privatization.

In addition, Brazil was living in a very different historical moment: the economic, political and social circumstances surrounding the Telebrás privatization were unquestionably more favorable. The root of this study lies precisely in acknowledging this historical difference when analyzing economics: the influence of historical conditions in the way institutions shaping policies are designed and implemented. The remainder of this chapter discusses Cardoso's macroeconomic policy and the historical conditions surrounding his reform program, and the Telebrás privatization transaction in detail.

Cardoso's Macroeconomic Policy

Brazil is the third most populous democracy in the world, after India and the United States. It is both a wealthy (2004 GDP: US\$452.4 billion) and unequal country (one of the most unequal distributions of income in the world), with a past of authoritarian regime.¹²⁴ Brazil is a federative republic composed of twenty-six, each with own governor. The Constitution of 1988 establishes the presidential system and three independent branches of power: Legislative (House of Representatives and Senate, at the federal level), executive and the judiciary. In Brazil, party formation and membership is very volatile and fluid; estimates are that, at the time of the privatization, there were approximately fifteen active political parties in Brazil. Contrary to Argentina at the time of the ENTEL privatization, one of the characteristics of the Brazilian political system is party diversity and fluidity. As João Resende-Santos point out, the Brazilian party system is "highly fragmented...nonprogrammatic... uninvolved in policy formulation,"

¹²⁴ World Bank General Country Information, Brazil. Retrieved on April 29, 2005: <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/BRAZILEXTN/0,,menuPK:322351~pagePK:141132~piPK:141107~theSitePK:322341,00.html>.

and “dominated by personalities and ephemeral factions rather than well-defined philosophies or stable policy coalitions.”¹²⁵ The exceptions are the leftist Workers’ Party (*Partido dos Trabalhadores, PT*)¹²⁶ and the Brazilian Social Democratic Party (*Partido da Social Democracia Brasileira, PSDB*), the party co-founded by Cardoso in 1988, and of which he remains the main intellectual leader. These two parties present a strategy somewhat aligned with certain political principles and themes that appear recurrently in their political rhetoric (for instance, the Workers’ Party present itself as inherently leftist, with internal divisions showing different degrees of leftist radicalism; while the PSDB demonstrates an alignment with social-democratic, and economic liberal principles).

Cardoso, who in the 1970s was one of the creators of the associated-dependent development theory, sustained his position through the 1990s, arguing that Latin American countries should take advantage of the dynamic nature of the international markets in order to ‘catch up’ in their level of development.¹²⁷ He asserted that, notwithstanding the negative socio-economic position that the periphery (underdeveloped) countries occupy in relation to the center (developed) countries, there are ways whereby the two could integrate and function within the global economy.

Cardoso won the presidential election in 1994 with fifty-four percent of the vote against leftist opponent Luís Ignácio Lula da Silva, from the Workers’ Party. His victory was attributed

¹²⁵ Resende-Santos, in Dominguez (1997), p. 164.

¹²⁶ It should be noted, however, that the current president of Brazil, Luis Ignacio Lula da Silva, is from the PT, and contrary to what observers had anticipated, he has adopted an economic policy that leans toward the continuation, rather than break, of Cardoso’s policies.

¹²⁷ Fernando Henrique Cardoso became internationally acclaimed in the 1970s due to his contributions to the development of the “dependency theory,” which maintains that third world countries’ underdevelopment is based on their reliance on foreign capital and technology. See Handelman (2002), p. 21; see also Fernando Henrique Cardoso and Enzo Faletto, Dependence and Development in Latin America (Berkeley: University of California Press, 1979).

to the optimistic wave brought about by his successful economic plan, the *Plano Real*.¹²⁸ As Minister of Finance during the Itamar Franco administration (1992-1994), Cardoso (who is a sociologist¹²⁹) headed the team that designed the economic plan that brought down inflation rates (i.e. price stabilization) based on a tightly controlled exchange rate, trade liberalization, and high interest rates. This macroeconomic policy increased current account imbalances due to raising trade deficits. The need for excess capital to cover deficits made privatization and investment (foreign, that is, since domestic savings were low) the pillars of Cardoso's macroeconomic policy.

Because of the success of his economic plan in 1994, Cardoso became a political celebrity. His party won gubernatorial elections in six states (Minas Gerais, São Paulo and Rio de Janeiro being the most important). However, to secure these victories his party, the PSDB, forged a coalition with the center-right parties, such as the *Partido Frente Liberal* (PFL) and the *Partido do Movimento Democrático Brasileiro* (PMDB). These coalitions were decisive for PSDB to reach a large base of voters, but it also meant that Cardoso had to offer compromises in many reforms he had hoped to accomplish during his first term, such as administrative, tax and social security reforms. Nevertheless, voters gave Cardoso a mandate in the 1994 elections, and his political coalition granted him a solid base in Congress that seemed strengthened by his victory.

There were political, ideological and historical (both internal and external) elements pushing for privatization at the time of Cardoso's first term. The political trade-off with the

¹²⁸ William C. Smith and Nizar Messari, "Democracy and Reform in Cardoso's Brazil: Caught Between CliENTELism and Global Markets?" *The North-South Agenda* 31, No. 33. The North-South Center, University of Miami, September 1998, p. 3.

¹²⁹ Resende-Santos offers a careful analysis of dependency theory as it was conceived by Cardoso, and warns against oversimplification of his ideas, in such as the cycle of development-of-underdevelopment suggested by André Gunder Frank. See Resende-Santos, in Dominguez (1997), p. 153.

center-right parties came when Cardoso had to pace his privatization program. These parties (the PFL, in particular) had long supported the privatization of strategic sectors such as telecommunications. Even though the president shared this idea, he was pressured to accomplish privatizations at a much faster pace than he would have hoped given his concern with the “socially necessary” criteria—that is, to privatize with careful planning to attend to the social impact of privatization (i.e.: the creation of a safety net for workers displaced by the new private owners).

This is not to suggest that, however, that Cardoso’s reforms did not face resistance in the political arena. The Workers’ Party, in particular, offered fiery opposition to the president’s reform package. The president had to bargain with Congress. In order to secure votes for the reforms needed in the telecom sector, the president had to make concessions such as postponing parts of the administrative, tax and social security reforms.¹³⁰ Even though, the government was able to pass the reform in the telecommunications sector, it was not by a majority in Congress; and again, most of the opposition came from the Workers’ Party and PMDB.¹³¹

Still, congruent with Cardoso’s associated-development ideology, he saw the need to pursue a policy that would plug the economy into the world markets and reduce the technology gap brought by the inefficiency in the state-owned telecom company, Telebrás. In addition, he fostered the idea of seeking development through increased efficiency and productivity growth, instead of the simple accumulation of capital by the state. This way, it made little sense for the state to continue to hold large public utilities monopolies such as Telebrás. Furthermore, Cardoso’s privatization plans enjoyed public support, not only because the general public viewed

¹³⁰ Weyland (2002), pp. 228-231.

¹³¹ *Latin America Weekly Report*. “Stock Exchanges Have a Bad Week: Concern About Argentina and About Privatization Plans,” February 23, 1995. Section: Brazil; Economy & Politics; WR-05-07; p. 82. Retrieved November 11, 2005 from LexisNexis Academic.

FDI inflows in a positive light, but also because of generalized skepticism with respect to state-owned monopolies. During a meeting with a group of businessmen in Brasilia, in 1995, Cardoso, asserted, in rather forceful terms, “the people have realized that monopolies have become obstacles to progress and not contributions to it.”¹³²

Another force rushing privatizations came from the historical conditions of the global markets. In the 1990s, at the height of the Washington consensus agenda, developing countries were competing with one another for increasing flows of FDI. A country seeking to win the battle for FDI had to convey to investors that it would adhere to at least some of the recommendations of the Washington consensus agenda, which was heavily based on privatizing SOEs and redefining the role of the state in the economy.

Domestically, historical developments were also favorable to privatization. The change in the macroeconomic scenario — meaning, inflation under control — sparked Brazilians’ interest in macroeconomic issues.¹³³ Perhaps because of rather simplistic connections suggested to the general public in the popular media channels, most Brazilians associated privatization with foreign “money” and the latter with more jobs and opportunities. So, political capital (in the form of the center-right coalitions forged in Congress), ideological background, and historical conditions combined to create the momentum needed to push Cardoso’s institutional reform and privatization plan for the telecommunications sector.

Privatization signaled to foreign investors that the state was committed to downsizing its interventionist capacity and to adopting a more market-friendly model of economic

¹³² *Latin America Weekly Report*. February 23, 1995.

¹³³ At the time there was a common saying in Brazil which was: “Every “true” Brazilian should know “everything there is to be known” about two things in the world: soccer and the national politics.” The economy just turned into *conversa de bar* (bar’s talk), along with soccer and politics.

development.¹³⁴ As mentioned before, the government's plan was to attract foreign investors and maximize the margin of profits in the sales of SOEs in order to obtain the most cash for the privatized monopolies to finance public debt. The design and implementation of a comprehensive and transparent institutional framework for the privatization of Telebrás was in the interest of the state insofar as it could potentially maximize the state's credibility and, therefore, its ability to earn higher proceeds at the time of privatization. Thus, investors' *perception* of stability and reliability of the privatization process greatly contributed to enhance the government's bargaining power and, consequently, the net returns obtained with the sale.

The state monopoly over public utilities was determined in the Brazilian Constitution. Therefore any attempt to privatize the telecommunications sector had to begin with a constitutional amendment. The first act toward the creation of an institutional framework for the privatization of public utilities came with the *Lei de Concessões* (Concessions Law, No. 8987, of February 1995), which amended article 175 of the Brazilian Constitution of 1988 and introduced rules concerning the concession of infrastructure services in general, including telecommunications.¹³⁵

The Concessions Law was the first milestone on the path toward a more transparent and predictable institutional framework for potential investors in the privatization of public utilities.

¹³⁴ Armando Castelar Pinheiro and Kiichiro Kukasaku, "Privatization in Brazil: The Case of Public Utilities." *Ensaio BNDES* 10, 1999. (In English)

¹³⁵ Among other things, the Concessions Law sets forth that (i) tariffs should be determined in the concession contracts and should not be based on the cost-of-service; (ii) concessions could no be granted indefinitely, and could be renewed periodically; (iii) performance and tariff rates would be the main elements and evaluating a concessionaire, (iv) it prohibited public subsidies, entitled consumers to participate in the process of supervising bids, negotiations and concessionaires' performance.

The Telebrás Privatization

The main goals underlying the privatization of Telebrás, as the government proclaimed, were universality, competition and quality of telecom services.¹³⁶ Earning the highest possible price for Telebrás at the time of the sale was also among the government's top priorities, however, under investors' perspective, this goal conflicts with the other three. For instance, investors will pay more money for longer periods of exclusivity (this appears to have been one factor in the Argentine case, for instance).

The government designed a plan with the following key features for privatization of Telebrás: (i) institutional reform,¹³⁷ (ii) regulatory body and competition,¹³⁸ (iii) financial restructuring,¹³⁹ and (iv) the sale. Argentina's plan had the same key features; however, they were only partially implemented, or else, were neglected altogether during the ENTEL negotiations.

Institutional reform. The Constitutional Amendment No. 8, of August 15, 1995, ended the state monopoly over telecommunications services. The amendment, however, provided that there should be a new law detailing the role of the state and the new principles governing the telecom sector before the privatization. In July 16, 1997, the Brazilian Congress enacted the *Lei*

¹³⁶ According to the World Bank's Telecommunications Regulation Handbook, "universality" refers generally to "universal access" and "universal service." Universal access refers to a situation where every person has a reasonable means of access to a publicly available telephone. Universal access may be provided through pay telephones, community telephone centres, teleboutiques, community Internet access terminals or similar means. The "universal services" concept refers to a policy focused on promoting or maintaining "universal" availability of connections by individual households to public telecommunications networks. Other important concept in assessing universality is "teledensity, which is defined as the number of main telephone lines per 100 inhabitants. The concept of teledensity is closely related to that of "penetration," which is a measurement of access to telecommunications, normally calculated by dividing the number of subscribers to a particular service by the population and multiplying by 100. Definitions taken from Telecommunications Regulation Handbook, Appendix C, Glossary.

¹³⁷ This reform included a constitutional amendment to change the role of the state in the telecom sector.

¹³⁸ In Brazil this included setting the regulatory framework and establishing and regulating qualitative and quantitative standards for the provision of telecom services after privatization.

¹³⁹ Included eliminating cross-subsidies and rebalancing Telebrás' cash flows.

Geral das Telecomunicações (General Telecommunications Law, GTL, Law No. 9472), which changed the role of the state from provider to regulator of telecommunications services. The law also established the general principles that would govern the telecommunications sector,¹⁴⁰ created the regulatory agency, Anatel, laid out the new structure of the telecommunications sector and established the parameters for the restructuring and privatization of Telebrás.¹⁴¹

Regulatory body and competition. Besides determining that the telecom sector would be open to competition after privatization, the GTL also outlined certain terms and conditions that should be incorporated into all concession contracts to be signed with private owners after the privatization. The law established that Anatel would be “administratively and financially independent,” with most of its revenues deriving from fees paid by new private owners of Telebrás. Scholar Armando Castelar Pinheiro states: “the most successful case of privatization *cum* regulatory reform [in Brazil] is, undoubtedly, telecommunications...” because “...when privatization took place, the entire regulatory structure was already established and the regulatory agency responsible for the sector was functioning at full steam...” adding that “...the new owners knew exactly what rules would be in force after privatization.”¹⁴² Pinheiro contrasts this scenario with that of the Brazilian energy sector, where the regulatory agency, Aneel, was only created two years after privatization. This tardiness, Pinheiro observes, curtailed the ability of the regulatory body to operate and, as a result, Aneel enjoys “limited prestige in the eyes of the public” and investors.¹⁴³

¹⁴⁰ The law reads: “Article 6. The telecommunications services shall be organized based on the principle of free, ample and fair competition among all providers, having the Government to act towards promoting them, as well as to correct the effects of imperfect competition and to repress violations against economic order.”

¹⁴¹ Please see the full text of the General Telecommunications Law at Anatel’s webpage.

¹⁴² Pinheiro and Kukasaku (1999), p. 22.

¹⁴³ Pinheiro and Kukasaku (1999), p. 23.

The autonomy of Anatel contributed to imprint a sense of transparency and reliability upon the institutional components of the new telecommunications sector. In fact, a case study by the International Telecommunication Union (ITU) praises Anatel's effectiveness by saying that its autonomy increased regulatory responsiveness to the sector and investor confidence in the transparency and fairness of the regulatory process in Brazil.¹⁴⁴

A word is due here about the staffing and oversight of Anatel, to demonstrate how it was stronger and more independent than Argentina's regulator. Anatel enjoys independent legal status and operates under the authority of the Head of State (the president, who appoints the members of Anatel's Board of Directors). However, the agency is connected to the Ministry of Communications for the approval of its budget, and matters coming from the agency to the president must first go through the Ministry. The oversight of Anatel is done through the Advisory Council, which is comprised of representatives from society, and not affiliated with Anatel. These include, but are not limited to, members of the Federal Senate, House of Representatives, telecommunications services providers, consumer-protection groups and entities representing society at large. Each segment of representatives is limited to having two members in the 12-member Council; each member can only serve in the Council for three non-renewable terms. Finally, Anatel was deemed an example of "regulatory independence and effectiveness" in a survey conducted by the International Telecommunications Union (ITU).¹⁴⁵

Anatel started operating immediately after the enactment of the GTL. Among Anatel's first tasks was the drafting of a General Concessions Plan for telecommunications and a General Universalization Plan (these two regulatory milestones still serve as the backbones of the

¹⁴⁴ "Effective Regulation Case Study: Brazil 2001." This case study may be accessed at www.itu.int/itunews/issue/2001/10/effective.html.

¹⁴⁵ The ITU is the United Nations body responsible for fostering telecommunications development and services around the world. This quote taken from "Effective Regulation Case Study: Brazil 2001." This case study may be accessed at www.itu.int/itunews/issue/2001/10/effective.html.

regulatory landscaper to date). The principles of the GTL, namely universality, competition and quality, were at the core of the regulatory documents Anatel drafted. The General Concessions Plan divided the country into four major concession areas and established that licenses to explore telecommunications services, including those created by the privatization of Telebrás, would not be exclusive. The Universalization Plan set forth quantitative and qualitative goals for the new owners of Telebrás (the universalization goals), which also served as standards that should be observed by post-privatization newcomers. These goals established numbers and a schedule for private and public telephones to be installed throughout the country, and determined other standards of quality for the services to be provided to consumers. The government's diligence in providing very detailed standards, which were in synchrony with the industry's current trends worldwide, helped lend credibility to Anatel's management team and, as result, to the privatization process as whole. In that way the government increased investors' perception of its credibility by making sure the rules of the game were known months before the public bid took place.

To foster a competitive environment in the sector, the GTL divided telecommunications into *public* and *private* regimes. Public and private regimes were simply operational definitions the government used to delineate the market after privatization. Those companies being sold during the privatization (i.e.: operating under license to use the old Telebrás system) were deemed to be operating under the public regime; whereas the new companies receiving licenses to operate and compete with the privatized companies were said to operate under the private regime. The government announced, prior to the privatization, that it would authorize "mirror companies"¹⁴⁶ to enter and to operate in the market, under the *private* regime, immediately after

¹⁴⁶ Companies that the state would authorize to operate in the telecommunications sector after privatization under the private regime or the "restricted interest" services (GTL, Article 62).

the privatization of Telebrás. In doing so, the government made clear to Telebrás' buyers that some type of competition would be initiated immediately after the privatization. The mirror companies were required to submit proposals to Anatel complying with all goals and standards established by the Universalization Plan. Antitrust regulation in the post-privatization environment would be under the auspices of CADE,¹⁴⁷ the antitrust regulatory agency in Brazil, and Anatel should be informed, prior to settlement, of any merger or acquisition in the telecommunications sector, including cross-country mergers.¹⁴⁸

Financial restructuring. The Telebrás privatization required a much more complex operation than ENTEL's. ENTEL was an operational company; Telebrás was a holding company. As such, its main role was to raise and transfer capital to its twenty-six subsidiaries, distributed among the twenty-six Brazilian states, and to Embratel, its long distance and international phone carrier.¹⁴⁹ In fact, it is mainly because of this holding structure that an inefficient tariff system and excessive cross-subsidies existed (the holding company would switch revenue streams from more profitable subsidiaries to fund less profitable ones, all by keeping below-cost prices).¹⁵⁰ Because of this system, the subsidiaries' cash flows were

¹⁴⁷ Law No. 4,137 of September 10, 1962 created CADE. It was revamped and given the status of federal independent agency (*autarquia federal*), acting under the Ministry of Justice pursuant to Law No. 8,884 of June, 1994.

¹⁴⁸ The intention in regulating cross-border mergers was to avoid the so-called *monopoly leveraging* by international partners. Monopoly leveraging occurs when a firm leverages its monopoly power by designing a merger from one market onto another where it is subject to tighter competition, therefore eliminating the possibility of newcomers. (See I. Vogelsang and B. Mitchell. Telecommunications Competition – The Last Ten Miles (Cambridge: MIT Press, 1997) in José Claudio Linhares Pires and Mauricio Serrão Piccinini. “A Regulação dos Setores de Infra-Estrutura no Brasil.” Papéis BNDES (in Portuguese), pp. 217-260 (translation mine)

¹⁴⁹ The federal government held 52.2 percent of the voting stock; 23 percent of the company's total capital; foreign investors held 27 percent of total capital (these numbers changed at the time of sale, to 51.79 percent of government-held voting stock; 19.26 percent of total capital; and 40 percent of total capital held by foreign investors) in Ana Novaes. “The Privatization of the Brazilian Telecommunications Sector.” BNDES Essays, February 2000.

¹⁵⁰ In Argentina, international and long-distance calls were priced above-cost in order to fund below-cost local calls.

overestimated (i.e.: more cash was recorded than the subsidiary could actually generate by operating under normal conditions), distorting the true financial condition of the system. It was necessary to rebalance the system prior to the sale as to provide investors with a clear picture of the subsidiaries' operating conditions. A detailed explanation of this part of the transaction involves complex financial and accounting concepts, and such discussion is outside the scope of this paper. It suffices to say that the government informed investors and consumers of the new organization of the Telebrás tariff system months before the privatization. Because the old tariff system was notoriously not unrepresentative of the subsidiaries' financial health, the impact of restructuring the system on subsidiaries' cash flows was a condition *sine qua non* for the government to earn credibility before investors. Conversely, it would be reasonable to argue that Argentina's failure to re-balance ENTEL's cash flows may have had a negative impact on investors' perceptions of its credibility.

The sale. The GTL allowed for any kind of corporate arrangement for the sale of Telebrás (e.g., merger, spin-off, partial liquidation, etc.). The government's advisors considered three models for the sale of Telebrás: selling the government's holdings directly to private buyers, selling the subsidiaries and keeping the holding, and spinning off the Telebrás system into several operating companies and privatizing thereafter. The spin-off¹⁵¹ model followed by privatization was chosen because it allowed the government to break the current monopoly, and not simply transform it into a private monopoly by selling the entire holding company to a single buyer. This model also allowed for the government to boost the development of telecommunications services in more economically underdeveloped areas of the country (for

¹⁵¹ Telebrás was spun-off into 12 companies; four wired telephone companies: Embratel Holding, Telesp, Tele Norte-Leste, Tele Centro-Sul; and eight wireless (cellular) telephone companies: Telesp Celular, Tele Sudeste Celular, Telemig Celular, Tele Sul Celular, Tele Nordeste Celular, Tele Centro-Oeste Celular, Tele Norte Celular and Tele Leste Celular.

instance, a company operating in São Paulo, the richest Brazilian state, would not be allowed to explore the market in the South, the country's second richest region). This strategy illustrates a commitment to fostering competition and improving services across different regions of the country after privatization.¹⁵² ~~Figure 4~~ ~~Figure 4~~ illustrates the model used to spin-off Telebrás into twelve companies.

[Insert ~~Figure 4: Telebrás spin-off model~~ ~~Figure 4: Telebrás spin-off model~~ here]

On July 29, 1998, the twelve companies were sold in an auction at the Rio de Janeiro Stock Exchange (please refer to ~~Table 6~~ ~~Table 6~~ for a list of all members in each winning consortium). Market analysts expected that the government would earn a premium of no more than 40 percent of the value of the 19.26 percent (this was the government's stake on sale (note that Argentina privatized 60 percent of ENTEL in 1990)).¹⁵³ The government earned an astounding 64.04 percent premium (over US\$9 billion for the wired telephone companies; almost US\$7 billion for the cellular companies; and over US\$2 billion for Embratel; the total government earnings were almost US\$20 billion).¹⁵⁴ ~~Table 4~~ ~~Table 4~~ shows the proceeds and premiums earned in the Telebrás privatization (note that only the companies providing fixed residential line services were considered in this analysis).

[Insert ~~Table 4: Proceeds and Premium: Telebrás Privatization (in US\$ million)~~ ~~Table 4: Proceeds and Premium: Telebrás Privatization (in US\$ million)~~ here]

In early 1999, the telecom industry, as much as the rest of the economy, suffered from the sharp currency depreciation, and a pattern of weak growth followed. Nevertheless, the Brazilian telecom market was opened to full competition in January 2002, and today Brazil is, by far, the

¹⁵² Please see Novaes (2000), p. 11, for a detailed sketch of the structure of the spin-off operation.

¹⁵³ Market analysts tend to agree that the premium paid for control of a company in the telecommunications sector ranges between 35 and 45 percent (author's conversations with market analysts).

¹⁵⁴ Novaes (2000), p. 22.

largest telecommunications market in Latin America. And in spite of the crisis of 1999, the sector continued to grow and investments remained high. As illustrated by [Figure 5: Teledensity - Argentina and Brazil \(actual and forecast\)](#), teledensity in Argentina is slightly higher than in Brazil, mainly because the sector was privatized almost a decade earlier in that country, allowing for an earlier increase in number of connections available. However, investment levels in Brazil are significantly higher than in Argentina, as illustrated by [Figure 6: Telecommunications Investments - Brazil and Argentina \(actual and forecast\)](#), suggesting that Brazil may offer a more favorable investment climate.¹⁵⁵ Overall, as per a market overview released by *The Economist Business Intelligence Unit* (June 2005) “the telecom sector [in Brazil] experienced sharp growth since privatization...because of continuing liberalization and the state encouragement of the development of new technologies.”¹⁵⁶

An article in newspaper *O Globo*, September 12, 2005, citing a survey conducted that same year by Ogilvy Brazil, states “...cellular phones and the internet are the products that changed the lives of Brazilians the most in the past few years.” The last time such survey was conducted was 1997, before the Telebrás privatization. A cellular phone was considered a luxury item, and was desired by over 60 percent of those interviewed. In 2005, the survey indicated that Brazilians in the classes D and E (lower-middle to low-income) generally asserted that, “as everyone else [i.e.: those in upper classes], I can also have a cellular phone now.”¹⁵⁷

¹⁵⁵ For further details on investment levels, as well as other telecommunications indicators for both Argentina and Brazil, please refer to [Table 5: Selected Telecommunications Data - Argentina and Brazil](#).

¹⁵⁶ *The Economist Intelligence Unit*. “Telecommunications Industry Forecast, Americas,” June 2005, p. 27.

¹⁵⁷ Cleide Carvalho. “Celular e internet mudaram a vida dos brasileiros.” *O Globo*, September 12, 2005. Retrieved April 3, 2006.

Despite the fact that this thesis claims that the Brazilian government was more successful in creating a perception of credibility, it should be highlighted, however, that perception does not necessarily reflect reality. A corruption scandal surfaced shortly after the Telebrás privatization involving the taping of phone conversations among top government officials; thus, the scandal came to be known as the “Telebrás tape” case. The content of these tapes suggest that in the Brazilian case, as in the Argentine case, there was some degree of secrecy and manipulation. Top government officials implicated in the scandal resigned after the tapes became public (for instance, the president of the National Bank for Social and Economic Development, BNDES). BNDES is a federal government bank, and was heavily involved in the negotiations of the Telebrás privatization. An article published by the Brazilian newspaper *Folha de São Paulo* suggested that BNDES had favored the Telecom/Opportunity group, with the approval of president Cardoso.¹⁵⁸

Corruption scandals in connection with the telecommunications sector are making news in Brazil to this date. The most recent developments involve a fiery dispute over the control of Brasil Telecom (the controlling shareholder of Tele Centro-Sul), between Banco Opportunity and its owner, banker Daniel Dantas, and Telecom Italia. Until recently, Daniel Dantas was the controlling shareholder of Brasil Telecom, and Telecom Italia, the second major shareholder. In 2004, Carla Cico, then president of Brasil Telecom and who was appointed by Dantas, hired the corporate espionage firm, Kroll Associates, to investigate the corporate activities of Telecom Italia. Kroll’s work involved even the leaking of e-mails from Luis Gushiken, then Secretary of Communication of Brazilian president, Luis Ignácio Lula da Silva. In April 2005, Dantas and

¹⁵⁸ *Folha de São Paulo*, “Bank president submits resignation over telephone taping case.” May 25, 1999; *Brazilian Financial Wire*. “Cardoso allegedly favored group in Telebrás auction.” May 25, 1999; Mario de Almeida. “Telebrás auction yields bumper premiums, but at a cost.” *Gazeta Mercantil Invest News*, Editorial Page, December 31, 1998.

Cico were indicted for conspiracy, corruption and corporate espionage. Around the same time, the Courts and Anatel determined that Opportunity could no longer be the controlling shareholder of Brasil Telecom, and all directors on the board of Brasil Telecom that had been appointed by Dantas were dismissed. Dantas and Opportunity are also involved in several corruption scandals currently under investigation in Congress, involving the bribery of Congressmen by the current Lula administration.¹⁵⁹

As asserted earlier in this paper, it is crucial that we focus on the issue of how the two privatization processes were perceived by investors. The narratives of the two transactions leave little doubt that the Brazilian government was successful in establishing its credibility during the process, more so than the Argentine government. Furthermore, an analysis of the measurable variables outlined in Chapter I also confirms the hypothetical assertion. First, the institutional reform carried out in Brazil followed the recommendations of NIE to create a positive investment climate. That is, the government's efforts emphasized a comprehensive institutional reform by enacting laws that passed through Congress and the creation of a regulator prior to the privatization. Congruent with NIE principles, all of these attributes contribute to lower transactions costs and strengthen property rights. Furthermore, the Brazilian government was able to attain a higher premium for Telebrás, and investors agreed upon a shorter exclusivity period and significant performance targets to be reached after the privatization. Conversely, the narrative of the ENTEL transaction leads us to believe that there was a great amount of uncertainty embedded in the privatization process in Argentina. Congruent with my hypothesis, the investment climate in Argentina appeared less than favorable to investors, and, as a

¹⁵⁹ *Noticias Terra*. "Briga Entre Teles Envolve ate Espionagem" Terra – Noticias – Retrospectiva 2005. December 8, 2005. Retrieved December 30, 2006 at <http://noticias.terra.com.br/retrospectiva2005/interna/0,,OI788617-EI5867,00.html>.

consequence of this perception, the Argentine government had its bargaining power greatly diminished during the privatization.

It is quite evident, then, that Menem and his team committed mistakes while designing the privatization. However, to demonstrate this by simply asserting that his actions ignited a negative causal chain of events (i.e.: unstable institutional environment \wedge low credibility \wedge weak bargaining power of the state \wedge overall negative outcome) is a great historical insensitivity. Argentina was going through a severe hyperinflationary crisis, and social unrest threatened the very continuity of Menem's presidency. Conversely, Cardoso faced what political scientists refer to as "politics as usual." Although his reform packages faced some opposition, Brazil was going through a relatively stable economic period, with low inflation rates. This historical context enhanced his ability to negotiate a reform with political actors.

It would appear, then, that a fair comparative assessment of the results of these privatizations cannot be complete without bringing the historical context into the scope of analysis. Congruent with the main claim by NIE scholars, issues such as political turmoil, economic instability, and other historical conditions surrounding the privatization process, are as important as classical economic rationale when it comes to explaining the outcomes of privatization as a macroeconomic policy.

CHAPTER V – CONCLUSION

Assessing the hypothesis

The focus of this study is not whether privatization of telecommunications was good or bad. Instead, this thesis looked at the ways in which a state can enhance its credibility (and therefore its bargaining power) when privatizing, and how the choices involved in this process

are influenced by the historical context. Specifically, this thesis compared and contrasted two cases where investors' perception of the state's credibility played a major role in determining the outcomes of privatization. Given the evidence presented in this paper, it is reasonable to argue that the perceived flaws in the ENTEL privatization with respect to institutional quality had a negative effect on the state's bargaining power during the privatization process.

My hypothesis asserts that the gains the state (and potentially society at large) attain at the time of privatization is directly related to the level of its bargaining power while negotiating with investors, and that this power can be enhanced by the adoption of a stable and consistent sector-wide institutional reform prior to privatization. The hypothesis appears to be valid because the evidence presented herein shows that Argentina and Brazil differed markedly with respect to the stability and consistency of institutions in connection with the privatization. Consistent with the hypothesis, Brazil enjoyed greater bargaining power while negotiating with investors given the results it obtained during the sale (higher premium and competition).

The hypothesis appears to be valid because the discussion offered in this paper lends evidence to support the claim Argentina had, in comparison to Brazil, a more unpredictable and unstable institutional environment. For example, Brazil created an active and independent regulatory agency prior to the privatization and opened its market to partial competition immediately after privatization

Furthermore, the measurable variables are better in Brazil than in Argentina. Brazil received a greater premium for a stake of less than 20 percent in Telebrás, than did Argentina, for a stake of 60 percent in ENTEL. More significant performance targets for the provision of telecommunications services were agreed upon with investors in Brazil, than in Argentina.

Finally, Argentina partially opened its market to new entrants in 1999 and full competition does not yet exist.¹⁶⁰

Lessons learned

There are at least two lessons to be derived from this investigation, and they touch upon the concepts of institutional theory and economic history.

Institutional stability during the privatization enhances the state's credibility during the process, and, therefore, it may enhance the state's bargaining power while negotiating with investors. This lesson becomes even more relevant when we expand this assumption to say that the state's bargaining power is directly related to the benefits that privatization will bring to society at large. Consider the Brazilian case, for instance. There, the government was able to reconcile two seemingly conflicting goals (under the point of view of investors negotiating with the government): attain a higher premium for its stake in Telebrás while granting minimal exclusivity period to new owners. In the business world that is called "leverage." So, the first lesson may be summarized as follows: the benefits of privatization are directly related to the state's leverage during privatization negotiations, and leverage is directly related to the quality and timing of the institutional reform the state carries out.

The second lesson to be derived from this study relates to the historical conditions surrounding the privatization. Evidence from this investigation suggests that countries should seek to eliminate critical problems, such as hyperinflation, before privatizing pivotal industries, such as telecommunications. During acute crisis, as was the case in Argentina, it appears that the state loses too much of its room to negotiate with investors. In other words, states will agree to

¹⁶⁰ *Business Monitor International Ltd., The Economist Intelligence Unit Limited.* "Argentina: Key Economic Sectors Report, Argentina Q1 2005," p. 26. See www.eiu.com.

any proposition when there is a desperate need for cash, or debt relief, because the problem (i.e.: privatization) needs to be solved quickly.

Brazil was going through an entirely different historical moment at the time of the Telebrás privatization. There was not a feeling of imminent catastrophe as in the Argentina of the late 1980s. Inflation was under control, and the country was experiencing relatively stable GDP growth. It is worth noting that Brazil tried to implement an ambitious, yet unsuccessful, privatization program in the early 1990s, under president Fernando Collor. Coincidentally, at that point, Brazil too was going through a severe inflationary crisis.

Thus, the second lesson may be summarized as follows: an analysis of an economic policy such as privatization cannot be done detached from an analysis of the historical context. In itself, privatization cannot be assessed as a good or bad policy since its outcomes will depend on the institutional design created to implement it – and, the institutional design, as shown in this study, is markedly influenced by political turmoil, economic instability and other historical conditions.

Relevance of NIE

It appears that even sound economic policies (i.e.: privatization) cannot escape being influenced by the historical context of a country because different historical realities will trigger, or require, different implementation strategies from policy makers. The significance of this assertion relies on the fact that NIE brings the historical and political zeitgeists to the core of the economic analysis. Historically, neo-classical economists have pushed other social sciences away from its scope of analysis, and addressed only what they consider an all-encompassing,

self-sufficient entity, the markets.¹⁶¹ However, many authors have suggested that neo-classical economics may not be sufficient to inform the formulation policies for decaying or underdeveloped economic systems.¹⁶² To let the “invisible hand” work its wonders is certainly the goal of liberal economic reforms. But while a free and developed market is a destination, the road to get there needs to be paved with the right institutional framework, especially in Latin America. NIE is an attempt to understand just what kind of institutions may work best to facilitate economic development. To that end, NIE reaches outside the realm of economics and brings other social sciences back into the analysis. This dialogue between economics and other bodies of knowledge (i.e.: history, political science, psychology, etc) should be welcomed (how well this dialogue is undertaken is another matter altogether).

As I hope this study has suggested, the success of liberal economic policies in developing countries cannot be assessed on the basis of pure neo-classical economic rationale and without bringing history and politics into the picture. Here is where the relevance of NIE for the study of Latin America’s economic development resides.

¹⁶¹ K. William Kapp. “The Nature and Significance of Institutional Economics.” *KYKLOS*, Vol. 29, Fasc. 209-232, 1976.

¹⁶² Kapp (1976), pp. 210-11.

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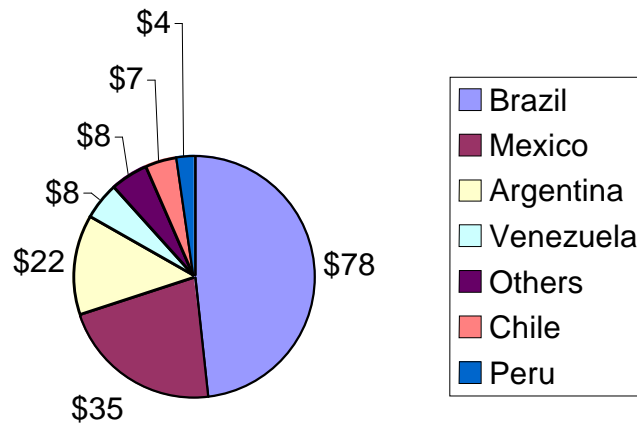
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Figure 1: IT market in Latin America

Source: Gartner Dataquest (retrieved from RDS Table Base database)

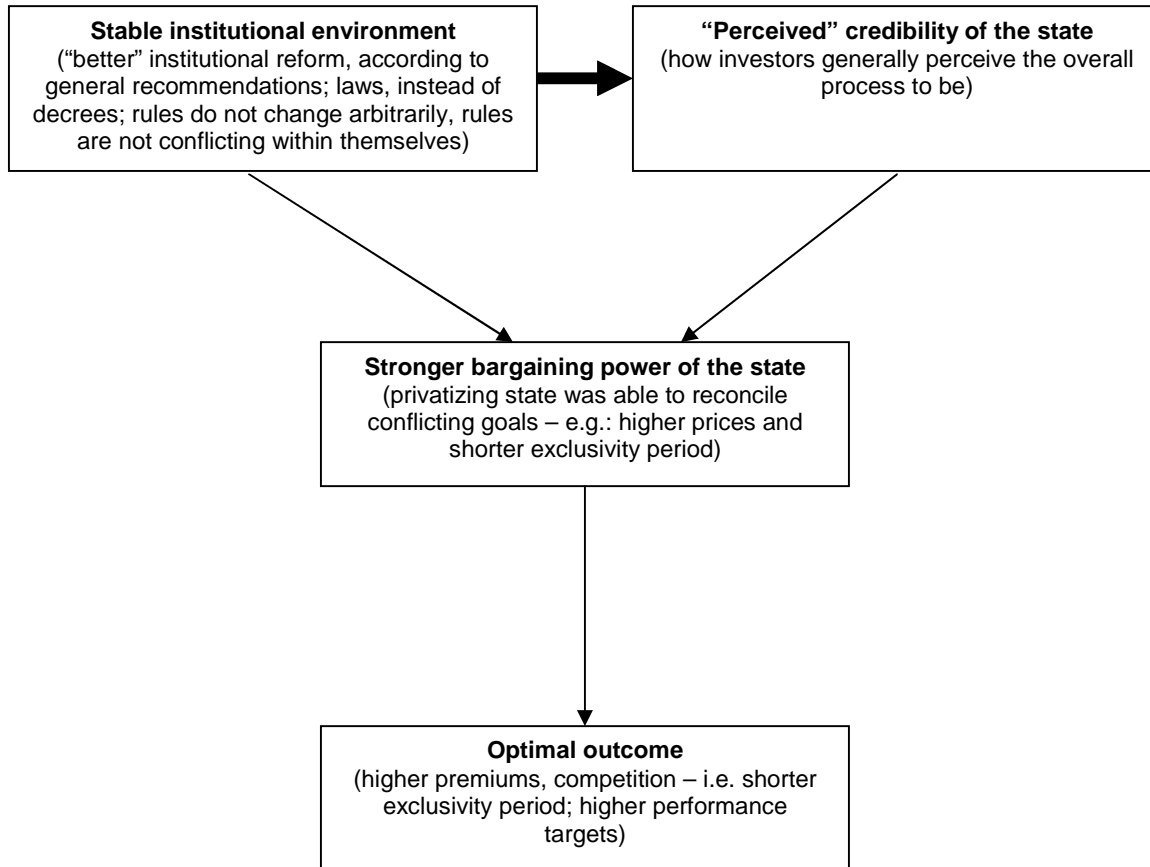
Figure 2: Hypothetical scheme

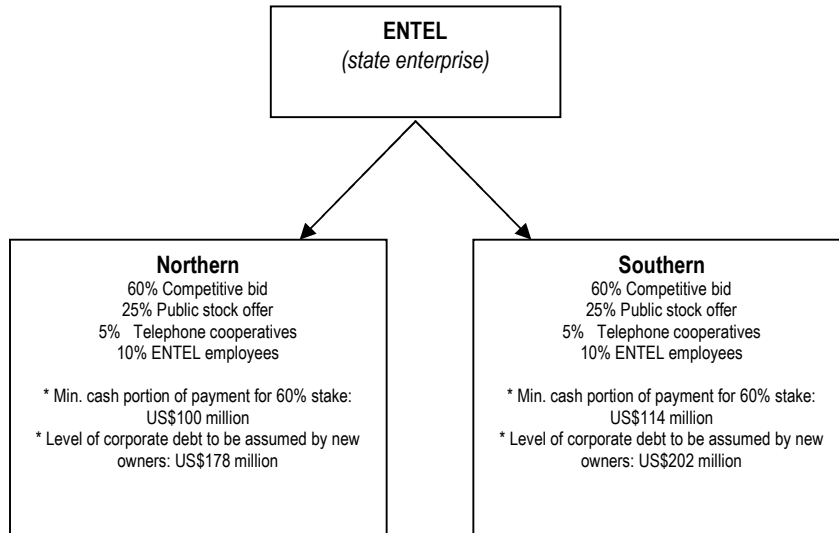
Figure 3: ENTEL sale model

Figure 4: Telebrás spin-off model

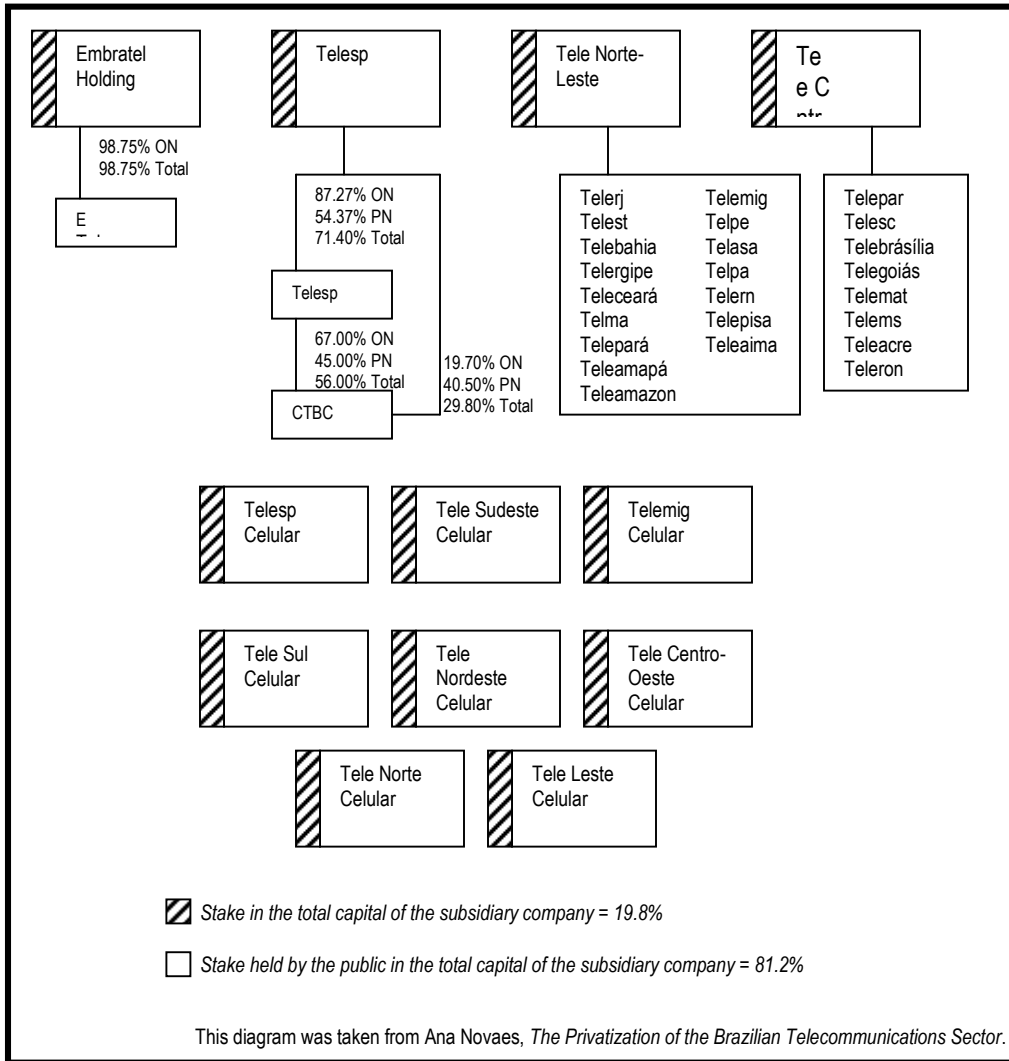


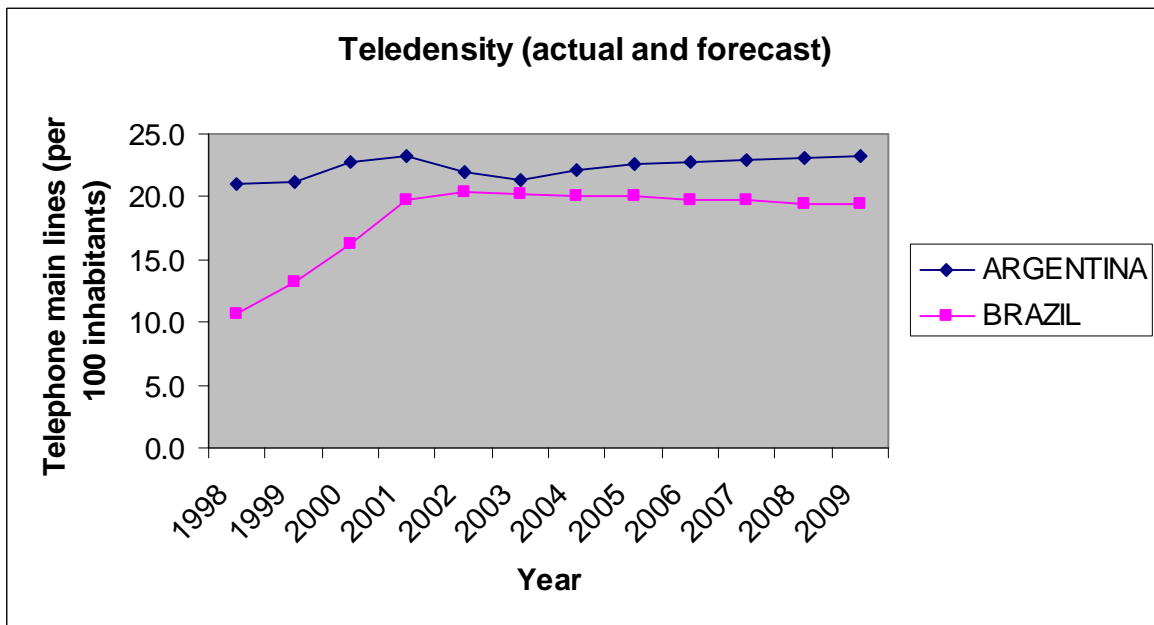
Figure 5: Teledensity - Argentina and Brazil (actual and forecast)

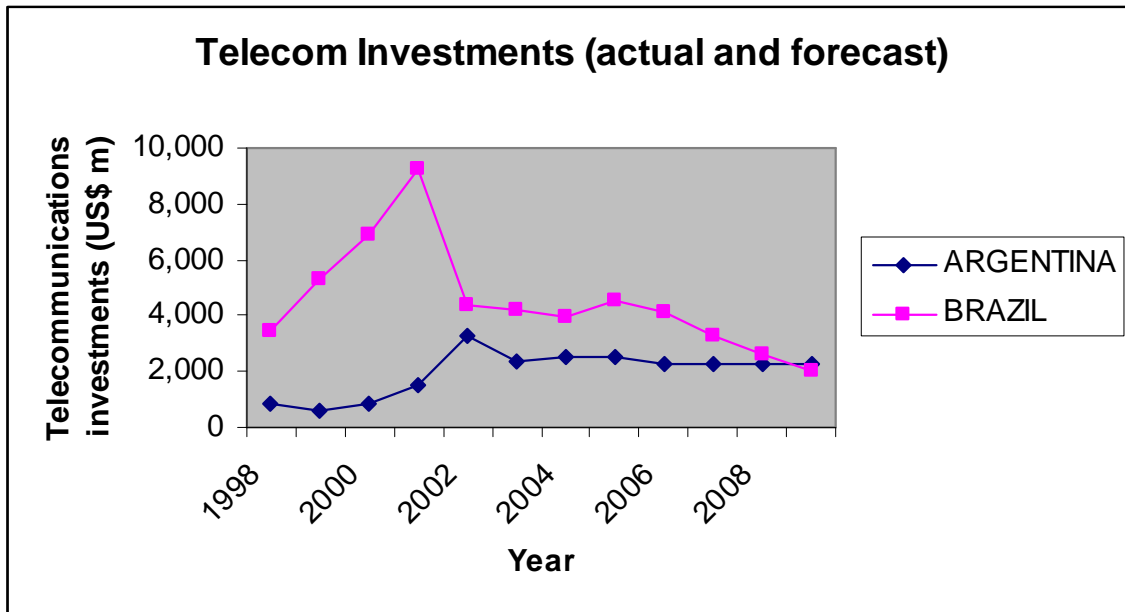
Figure 6: Telecommunications Investments - Brazil and Argentina (actual and forecast)

Table 1: Growth of Public Sector in Argentina and Brazil

	Public Sector Spending				Estimate share of PEs in GDP (%)	Public Sector Deficit as % of GDP	
	as % of GDP		of which PEs* (%)			1978-80	1970
	1970	1982	1970	1982			
Argentina	33	35	11	12	20	1	14
Brazil	28	32	6	11	39	2	17

Source: Pedro Pablo Kuczynski, Latin American Debt. Baltimore: John Hopkins University Press/
Twentieth Century Fund, 1988, 54; in Manzetti, 1999.

* *PEs: Public enterprises*

Table 2: Latin America and the Caribbean: External Debt, 1970-1985

Year	<u>Total Debt</u>	<u>Debt from Official Sources*</u>		<u>Debt from Private Sources</u>	
	(billions of dollars)	(billions of dollars)	(as a % of total debt)	(billions of dollars)	(as a % of total debt)
1970	23	8	36	15	65
1971	26	9	36	17	65
1972	30	10	34	20	67
1973	40	12	28	28	70
1974	56	14	25	42	75
1975	75	16	22	59	79
1976	98	18	18	80	82
1977	116	21	18	95	82
1978	151	25	16	127	84
1979	182	27	15	157	86
1980	223	31	14	198	89
1981	278	34	12	246	88
1982	318	40	12	278	87
1983	344	51	15	293	85
1984	360	57	16	303	84
1985	368	65	18	303	82

* Official Sources mean the International Monetary Fund, the Inter-American Development Bank, etc

Source: U.N. Economic Commission for Latin America and the Caribbean, *The Problem of the External Debt: Gestation, Development, Crisis, and Prospects*, March 6, 1986, Table 4, 8; Robert A. Pastor, 8.

Table 3: Proceeds and Premium: ENTEL Privatization (in US\$ million)

Operating Company	Winning Consortium	Cash Portion	Corporate Debt	Sovereign debt portion of price paid	Proceeds (US\$ mill.)
Northern ENTEL	Telecom Italia	100	178	2,117	2,395
Southern ENTEL	Telefonica	114	202	2,503	2,819
		214	380	4,620	5,214

Min. Price (in US\$ million)*	Proceeds (in US\$ million)	Premium**
4,094	5,214	27.36%

* Cash+corporate debt+Floor amount of sovereign debt required by government, for both companies.

** The premium serves to show how much more than the minimum price was the government able to attain at the time of sale. It is a good measure of bargaining power because it demonstrates a high level of competition among investors to buy the state enterprise.

Premium=(Proceeds - Min Price/Min. Price)*100

Source: World Bank Privatization Database. Table compiled by author.

Table 4: Proceeds and Premium: Telebrás Privatization (in US\$ million)

Operating Company	Winning Consortium	Min. Price (in US\$ million)*	Proceeds (US\$ million)**	Premium
Embratel Participacoes S.A.	MCI	1,548	2,276	47.03%
Tele Centro Sul Participacoes S.A.	Telecom Italia	1,677	1,778	6.02%
Tele Norte Leste Participacoes S.A.	Andrade Gutierrez, La Fonte, Inepar, Macal, local insurance companies	2,924	2,949	0.85%
Telesp Participacoes S.A.	Telefonica	3,028	4,967	64.04%

* Source: Ana Novaes, "The Privatization of the Brazilian Telecommunications Sector," 23. Table compiled by author.

** Source: World Bank Privatization Database. Table compiled by author.

Table 5: Selected Telecommunications Data - Argentina and Brazil

ARGENTINA	Actual						Forecast					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Telephone main lines ('000)	7,594	7,739	8,413	8,713	8,263	8,194	8,535	8,814	9,011	9,167	9,309	9,429
Telephone main lines (per 100 inhabitants)	21.0	21.2	22.8	23.3	21.9	21.4	22.1	22.6	22.8	23.0	23.1	23.2
Phone sets ('000)	12,795	13,116	14,039	14,176	14,184	14,212	14,726	15,731	16,742	17,587	18,474	19,407
Mobile subscribers ('000)	2,728	4,401	6,460	6,637	6,346	7,376	11,488	13,622	14,724	15,386	15,771	15,952
Mobile subscribers (per 100 inhabitants)	7.6	12.0	17.5	17.8	16.8	19.3	29.7	34.9	37.3	38.6	39.1	39.2
Internet users ('000)	518	929	2,193	3,473	3,619	4,148	5,124	6,284	7,214	7,779	8,330	8,849
Internet users (per 100 inhabitants)	1.4	2.5	5.9	9.3	9.6	10.8	13.3	16.1	18.3	19.5	20.7	21.7
Personal computers (stock per 1,000 inhabitants)	44.0	48.0	74.0	87.0	100.0	105.0	111.0	117.0	125.0	130.0	133.0	135.0
Telecommunications investments (US\$m)	810	551	878	1,483	3,245	2,336	2,512	2,480	2,298	2,299	2,299	2,299

BRAZIL	Actual						Forecast					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Telephone main lines ('000)	17,661	22,159	27,577	34,198	35,624	35,989	36,049	36,242	36,416	36,581	36,732	36,903
Telephone main lines (per 100 inhabitants)	10.7	13.2	16.2	19.8	20.4	20.3	20.1	20.0	19.8	19.7	19.5	19.4
Phone sets ('000)	25,961	32,187	39,995	49,601	52,506	55,420	58,082	61,082	63,528	65,628	67,798	70,039
Mobile subscribers ('000)	7,422	14,893	23,110	25,490	34,641	46,036	65,452	77,369	84,192	88,641	91,743	93,811
Mobile subscribers (per 100 inhabitants)	4.5	8.9	13.6	16.5	19.8	26.0	36.5	42.6	45.8	47.7	48.7	49.2
Internet users ('000)	3,384	4,479	8,032	10,815	13,820	16,867	20,032	22,673	24,712	26,429	27,911	29,165
Internet users (per 100 inhabitants)	2.0	2.7	4.7	6.3	7.9	9.5	11.2	12.5	13.5	14.2	14.8	15.3
Personal computers (stock per 1,000 inhabitants)	26.0	42.0	53.0	87.0	97.0	120.0	135.0	147.0	157.0	165.0	172.0	182.0
Telecommunications investments (US\$m)	3,435	5,261	6,882	9,221	4,336	4,240	3,952	4,500	4,142	3,267	2,578	2,033

Source: Pyramid Research; Economist Intelligence Unit

Table 6: Membership of the winning consortia - Argentina and Brazil**ARGENTINA****TELEFONICA - Shareholding in Cointel consortium**

Investor	% Ownership
CVC (Citicorp Venture Capital)	20.00%
Banco Rio de la Plata S.A.	15.26%
Telefonica International	10.13%
Inversora Catalinas	8.13%
Banco Central de Espana S.A.	7.04%
Sociedad Comercial del Plata S.A.	5.14%
Banco Hispano Americano S.A.	5.00%
Telarg Investment Corp.	4.33%
Southtel Equity Corporation	4.22%
Zurich Ltd.	4.16%
The Bank of Tokyo Limited	4.16%
The Bank of New York	4.16%
Other investors*	7.99%

* No one of which owns 4.16 or more.

Source: Hill and Abdala

TELECOM - Shareholding in Nortel consortium

Investor	% Ownership
STET	32.50%
France Cables	32.50%
Perez Companc	25.00%
J.P. Morgan	9.75%
Morgan Capital Corporation	0.25%

BRAZIL**TELEFONICA - Telesp Part. (major shareholders)**

Investor	% Ownership
Telefonica	63.00%
Portugal Telecom	23.00%
Bilbao Vizcaya	7.00%
Other investors (RBS, Iberdrola)	7.00%

TELECOM - Tele Centro-Sul Part.

Investor	% Ownership
Timepart (Citibank, Telecom)	62.00%
STET	19.00%
Techold (<i>Opportunity, and investment funds managed by Opportunity</i>)	19.00%

TELEMAR - Tele Norte-Leste Part.

Investor	% Ownership
BNDESPar	25.00%
Fiago	19.90%
Andrade Gutierrez	11.30%
Macal	11.30%
Inepar	11.30%
La Fonte	11.00%
Alianca do Brasil	5.00%
Brasil Veiculos	5.00%

EMBRATEL

Investor	% Ownership
MCI	100.00%

Source: Pesquisa da BNDESPAR: Telecomunicacoes no Brasil (doc#3478, dated , January 5, 2000); document viewed at BNDES' library in Rio de Janeiro, on January 2000.

** All tables compiled by author.