

Law and Business Review of the Americas

Volume 4 | Number 2

Article 9

1998

The Forces of Privatization: The Privatization of Chile's Telephone Industry

Walter Molano

Follow this and additional works at: <https://scholar.smu.edu/lbra>

Recommended Citation

Walter Molano, *The Forces of Privatization: The Privatization of Chile's Telephone Industry*, 4 *LAW & BUS. REV. AM.* 120 (1998)
<https://scholar.smu.edu/lbra/vol4/iss2/9>

This Symposium Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Law and Business Review of the Americas by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

The Forces of Privatization: The Privatization of Chile's Telephone Industry

*Dr. Walter Molano, Ph.D.**

I. Introduction.

The Chilean government commenced its privatization program during the mid-1970s, when military forces under the command of General Augusto Pinochet ousted the civilian government. The coup was a response to the radical transformation of the Chilean economy by the left-of-center Popular Front movement. The military reversed most of Allende's policies and ended the country's short socialist experiment.

The new government immediately initiated a round of privatizations to trim the fiscal deficit and eliminate the macroeconomic disequilibrium that had been introduced by the prior administration. It also initiated a process of privatization. The government divested most of the smaller companies and banks that had been expropriated by the state between 1970 and 1973, except for the large enterprises such as airlines, mining operations, and public utilities that were privatized a decade later.¹ Of the 500 companies that were under state ownership in the early 1970s, only 19 remained under public control by the end of the decade.² However, by the mid 1980s, the Chilean government launched another round of privatizations that included *Compañía de Teléfonos de Chile* (CTC).

* Dr. Walter Molano is the Director of Economic and Financial Research at SBC Warburg. He is responsible for the Latin American region, principally Argentina, Mexico, Brazil, Venezuela, Chile, Columbia, Ecuador and Peru. He is also the author of Latin American Advisor, Morning Commentary, and Country Focus Pieces. Prior to joining Swiss Bank he was a Vice-President and Senior Economist for Latin America at CS First Boston. Dr. Molano completed his Ph.D. at Duke University and was the recipient of the Duke Endowment Fellowship, SSRC Fellowship and Tinker Foundation Grant. Dr. Molano holds a Master of Business Administration (MBA), Masters in International Relations (MA), and a Certificate in International Law. He is a 1983 graduate of the U.S. Naval Academy. He is also the author of *Logic of Privatization* (Praeger/Greenwood Press, 1997). Dr. Molano is a member of the Council on Foreign Relations, Latin American Advisory Council, and a Faculty Fellow at the Yale School of Management. Dr. Molano was a participant and panelist at the Second Conference on "The Economic and Political Challenges of Market Reforms in Latin America", Southern Methodist University, Dallas, Texas, 4 October 1997.

1. Dominique Hachette & Rolf Lüders Schwarzenberg, *El Proceso de Privatization en Chile Desde 1984*, 25 BOLETIN ECONOMICO (1988).
 2. Pan Yotopoulos, *The (Rip) Tide of Privatizations: Lessons From Chile*, 17 WORLD DEV. (1989).
-

In 1984 the military government, bowing to domestic and international political and economic pressure, launched simultaneous programs of re-democratization and more privatizations. The former gradually expanded political participation to other social groups, but with the intent of maintaining the military in control until the end of the century. The latter was designed to remove the more powerful resources, such as the large SOEs, from the hands of future civilian governments.³ This would ensure the preservation of the free-market economic reforms installed after the coup. In August 1987, the Chilean government announced the privatization of CTC, the state-owned telephone company. Six months later, 151 million common "A" shares of CTC stock were sold to the Bond Corporation of Chile, which offered \$114.8 million in cash and debt instruments, thereby giving it full ownership and control of the company. The Bond Corporation was the holding company of Australian financier Alan Bond, a media tycoon.

II. Theoretical Approach.

The theoretical foundation for this study was developed in Molano.⁴ The basic premise is that the initiation and implementation of privatization policies hinge on the ability of the political leaders to control the extensive bargaining process during the divestiture of state-owned companies. This process starts with the initiation of the policy, and follows through the specific formulation of the privatization initiative, and ends with the implementation of the sale. Failure to control the privatization process may expand the conflict beyond the scope of the original participants and result in its failure at any one of the stages. This theoretical framework is loosely based on Schattschneider's⁵ four fold scheme used to analyze the political dynamics involved in the implementation of U.S. economic programs. Schattschneider proposed that the formation of economic policies was somewhat controversial, and that the outcome of every conflict was determined by shifts in the relative balance of power and the inherent balance of power between the central groups. Schattschneider also proposed that the most important role of the politicians was to control the scope of conflicts. He argued that the political actors at the center of any conflict help determine the outcome by controlling the scope of participation. Hence, conflicts were won as a result of the contestants' ability to increase or restrict involvement by external actors or groups. Given the conflictual nature of privatization policies, the Schattschneider framework is quite appropriate.

3. See Philip Brooks & Barbara Stallings, *Political Economy of Economic Adjustment: Chile, 1973-90*, in *POLITICAL AND ECONOMIC INTERACTIONS IN ECONOMIC POLICY REFORM* 78-122 (Robert Bates & Anne Krueger eds., 1993).
4. Walter Molano, *The Political and Economic Factors Affecting the Implementation of Privatization Policies: The Case of Telecommunications*, 7 *BUS. IN THE CONTEMPORARY WORLD* 151-63 (1995); WALTER MOLANO, *THE LOGIC OF PRIVATIZATIONS: THE CASE OF TELECOMMUNICATIONS IN THE SOUTHERN CONE OF LATIN AMERICA* (1997).
5. See ELMER SCHATTSCHNEIDER, *THE SEMISOVEREIGN PEOPLE* (1960).

Several researchers have found conflict to be a central characteristic of privatization policies. An extensive analysis of the phenomenon by Beinen and Waterbury in 1989 found that certain groups were consistently opposed to the policy.⁶ These included labor unions, civil servants, and the military. Indeed, all of these interest groups have derived high rents from their exclusive relationships with state enterprises, especially in the telecommunications sector. Since this analysis narrowly focuses on telecommunications, I include businesses that provide equipment, supplies, and services to the telecommunications state-owned enterprises (SOEs), opposition political parties, and consumers. The study poses three questions on privatization outcomes: Q (1) How does the microeconomic performance of a state-owned telephone company impact the likelihood that a privatization program will be approved?; Q (2) How does the macroeconomic condition of the privatizing country shape its privatization policies? and, Q (3) How does the political environment affect the implementation of privatization policies?

The first question looks for factors that explain how the variance in privatization outcomes is explained by firm-level factors, such as efficiency and performance. The second question looks for explanations of how country-level factors, such as gross domestic product (GDP) or economic growth, fiscal performance, and the level of foreign debt, impact privatization outcomes. The third question asks whether the formulation and initiation of privatization policies depend on the political situation. These questions lead to a case study structure to examine the microeconomic, macroeconomic, and political factors shaping privatization policies. These sections are then followed by a section that employs a quantitative analysis of the three approaches to statistically examine their explanatory power.

III. Microeconomic Factors.

CTC was the first provider of telephone services in Chile. The firm was established in Valparaiso in 1880, and by 1881 it had a network of 300 telephones. In 1884, CTC entered into a joint venture with a U.S. partner, the West Coast Telephone Company. Five years later, the Chilean company acquired the West Coast Telephone Company, increasing the firm's total lines to 2,187.⁷ By 1927, CTC had grown to 26,205 lines and was sold to the North American firm, International Telephone and Telegraph (ITT). ITT was a large conglomerate that owned telephone operating companies and equipment manufacturing facilities throughout the world.

The telecommunications industry was under private ownership and was regulated by a specific operating contract between 1880 and 1974. The original concession for CTC provided the telephone operator with a fifty-year license. The company was allowed to charge telephone rates that provided a maximum rate of return of 10 percent. The government, however, exerted some political control. It appointed three of the fifteen company directors, and there were limitations on nationality in that 80 percent of the company staff had to be Chileans.

6. Note that since many cases involve international investment banks, that issue shares on global markets, the transfer date will also be recorded in public documents such as stock prospectus. Also note that the dependent variable in this analysis is the divestiture of state-owned telephone companies.

7. See Jose Richardo Melo, *Panorama de las Telecomunicaciones en Chile* (May 1992) (unpublished paper on file with the author).

The Chilean telecommunication network was centered mainly in the major economic urban centers, and long-distance operations were limited. The long-distance network in Chile consisted of a sole connection between Santiago and the port of Valparaíso. The relatively small size of Chile's population, economy, and telephone network denied the economies of scale needed to proceed with the import-substitution experiments that were implemented by some of the larger Latin American countries. The absence of an expansive long-distance network became painfully apparent during the crisis surrounding a devastating earthquake of 1960. Due to the absence of a telecommunications system, many towns in the southern part of the country were isolated from rescue efforts. Coupled with heightened military tensions with Argentina during the same period, the government finally created a state-owned long-distance company, Entel.

The establishment of Entel in 1964 marked a new trend in government intervention in the telecommunications industry. In 1967, the government announced a national telecommunications policy that increased its control of all network operations through the state development agency, *Corporacion de Fomento de la Produccion* (CORFO). It was authorized to increase its control of CTC by purchasing 49 percent of the firm's stock.⁸ Chilean policy-makers sought to improve the telephone industry's technology base. Chile's rugged terrain and great expanses could be overcome only with technological sophistication, thus encouraging investment in microwave technology as a major format for long-distance communications.⁹ Therefore, the establishment of Entel led to heavy investment in technology and network expansion.

In the late 1960s, the management of CTC perceived a deterioration of relations with the government. With political rhetoric rising and the government increasing its stake in the company, the management decided to decrease its level of investment. By the start of the 1970s, however, the lack of investment halted the firm's rate of growth and its performance began to deteriorate. Finally, in 1970, the Allende government decided to wrest managing control of CTC from ITT. On May 26, 1971, the government informed ITT that it would begin steps to nationalize CTC. This led to the now famous plea from the multinational corporation to the U.S. government and the subsequent alleged involvement by the CIA in toppling the Allende administration.¹⁰ On September 29, 1971, the government formally intervened in the company by appointing an overseer. ITT was offered \$24 million for its assets, which had recently been valued at \$153 million.¹¹ Formal nationalization of the firm, however, never occurred under the Allende government; it came short-

-
8. CORFO had been in existence since the early 1940s, when it was created to foster the development of Chilean productive activities through loans and guarantees to the private sector. In 1970, CORFO held an equity stake in 46 companies; this had increased to 500 companies by 1973, when the socialist government began an expanded program of nationalization. CORFO's acquisitions were usually implemented through the capitalization of government taxes, receivership, or seizing control through nationalization. Ahmed Galal, *Regulation, Commitment and Development of Telecommunications in Chile*, WORLD BANK WORKING PAPER, Apr. 1993.
 9. See Mario Castillo, *Privatizaciones de Empresas Publicas en Chile: El Caso del Sector Telecomunicaciones*, in CEPAL (1993).
 10. A subsequent investigation by a U.S. Senate subcommittee, in March 1973, found that ITT, along with the CIA, played a major role in the destabilization of Chile and the overthrow of the Allende government. See ANTHONY SAMPSON, *THE SOVEREIGN STATE OF ITT* (1973).
 11. See ROBERT SCHOENBERG, GENEEN (1985).
-

ly after the coup. Late in 1973, the operating contract for CTC was revoked by the U.S. supported military government, and in 1974, the military-controlled CORFO acquired the remaining shares from ITT for \$125.2 million.

The firm continued to operate relatively free of political manipulation even after its acquisition by the military. ITT was paid a generous fee to manage the firm until new Chilean managers could be trained. Although CTC was now owned by the government, the company remained subject to private-sector accounting and reporting rules.¹² In the late 1970s, however, the government began some political manipulation by integrating the tariffs of Entel and CTC. Since both companies were owned by CORFO, the state was able to set up a cross-subsidization scheme similar to that in the United States, whereby long-distance rates subsidized local urban services.¹³

IV. Macroeconomic Factors.

The years leading up to the military intervention witnessed the creation of a massive macroeconomic disequilibrium in Chile. The Unidad Popular (UP) government, headed by Salvador Allende, aggressively expanded the state sector. Unfortunately, the expansion exceeded the capacity of the economy and the government. The expansion program was led by CORFO, a national development organization that was designed to provide long-term financing, guarantees, and consulting services to Chilean firms. At the instigation of UP party militants, CORFO developed a policy of nationalization. By 1970, the state agency held an equity stake in forty-six companies, mostly as a result of converting public loans into shares. Between 1970 and 1973, the number of firms under CORFO control climbed to 500. This followed the takeover of 259 companies and the acquisition of another 204, including 19 commercial banks, increasing the government's ownership five fold.

The Allende government attempted to finance the expansion of the public sector by raising new taxes, but it could not get political support from the Congress.¹⁴ Hence, it resorted to using Central Bank reserves to finance its economic programs. The burgeoning public-sector deficit was also financed through monetary expansion and foreign loans. Soon the public deficit exploded to 24.7 percent of GDP and inflation grew to 487 percent year-on-year.¹⁵ The administration tried to protect domestic industries and halt the economic crisis by erecting high import barriers, price and exchange controls. Unfortunately, these measures resulted only in the breakdown of pricing structures and market mechanisms. Thus, there ensued a massive decline in growth, a dramatic reduction in investment, and a liquidation of foreign reserves as capital fled the country.

By 1973, the economic problems had come to a head. The efficient administration of SOEs collapsed, and much of the productive system fell into disorder. Although Chilean SOEs were once very well managed, most of the original managers had been ousted or had fled the country. Many firms stopped preparing annual reports, and payrolls became highly politicized. By the end of the Allende administration, approximately 85 percent of the

12. Hachette & Schwarzenberg, *supra* note 1.

13. Castillo, *supra* note 9.

14. Hachette & Schwarzenberg, *supra* note 1.

15. Carlos Budnevich, *Implicancias Financieras de las Privatizaciones en Chile*, in CIEPLAN (1993).

financial and mining sectors, 40 percent of the industrial sector, and 55 percent of the agricultural sector were in the hands of the government.¹⁶

In 1973, the new military administration attempted to reverse the situation by enforcing a series of proactive measures to reduce the level of government spending and stabilize the economy. Under the leadership of the finance minister and a University of Chicago economist, Sergio de Castro, the new government removed price controls and demobilized labor unions.¹⁷ Although the administration sought to stabilize the economy, it maintained reasonable anti-inflation goals while focusing on the development of the external sector and market-oriented strategies.¹⁸ The new measures, however, produced a severe recession in 1975, and the economy contracted by 12.9 percent. Fortunately, the period of adjustment was over within a year, and the economy quickly rebounded. Between 1976 and 1981, the Chilean economy grew 7.1 percent.

The new economic regime forced state-owned enterprises to rationalize their business practices. The government no longer assumed company liabilities and cost overruns. Hence, each SOE was required to operate as if it were a private firm. This required SOEs to balance their books and practice self-financing. Between 1973 and 1978, the government took the new measures one step further by initiating a profound privatization program that transferred 500 firms to the private sector. Not only did this eliminate over one-third of the fiscal deficit, it also added over \$1 billion to the state coffers.¹⁹

While the government thoroughly liberalized the economy, it failed to introduce important regulations and safeguards to monitor the newly expanded private sector. One area that was radically deregulated, but also grossly under-monitored, was banking.²⁰ With domestic interest rates soaring due to tight monetarist policies, and the currency showing increasing signs of overvaluation, Chilean banks obtained cheap capital by borrowing abroad.²¹ Hence, they were able to finance a wave of highly leveraged acquisitions by the banks. But the period of high international liquidity and low international interest rates ended with the Mexican debt crisis, and soon many Chilean financial institutions were in trouble.

In 1982, the banking sector plunged the country into another economic crisis as loan portfolios fell apart. The world recession of 1982 exacerbated the situation by depressing commodity prices, particularly of copper, and pushing more Chilean firms into financial ruin. Many entrepreneur groups that had bought privatized assets during the 1970s at very cheap prices fell into bankruptcy. The newly privatized firms were unable to service their dollar-based obligations as interest rates climbed. They also lacked the expertise and capital to withstand the economic downturn. Faced with poorly performing loans at

16. William Glade, *Privatization in Rent-Seeking Societies*, 17 *WORLD DEV.* 673-82 (1989).

17. A group of ten Chicago-trained economists implemented the economic programs. They met weekly and eventually produced a several-hundred-page report, nicknamed *el ladrillo* (the brick), that underlined the new economic plan.

18. See A. R. M. Ritter, *Development Strategy and Structural Adjustment in Chile, 1973-1990*, 15 *CANADIAN J. OF LATIN AMERICAN AND CARIBBEAN STU.* 159-75 (1990).

19. Hachette & Schwarzenberg, *supra* note 1.

20. PHILIP BROCK, *IF TEXAS WERE CHILE: A PRIMER ON BANKING REFORM* (1992).

21. To break inflationary expectations, the government even allowed the currency to overvalue for a time. See Hachette & Schwarzenberg, *supra* note 1.

home, Chile could not turn to the international market for more capital because of the growing international debt crisis. Hence, the country fell into a recession worse than the 1973 economic crisis, and by the end of 1982, the economy had contracted by 14.3 percent.²² On January 13, 1983, eight private banks representing 60 percent of the financial system collapsed and were intervened. The government was also forced to renationalize many of the companies that had recently been privatized.²³

Chile finally emerged from the economic crisis during 1984 and 1985. The military government recommenced the process of privatization and divested its portfolio of recently acquired companies.²⁴ The economy, however, continued to suffer from high levels of unemployment and relatively low levels of investment. Most of these problems were attributed to the macroeconomic distortions created by the large SOEs. Therefore, the government decided to commence another round of privatizations by selling twenty-nine of the larger strategic firms.²⁵ The new program sought to improve the economic structure by further opening the economy and spurring higher levels of investment.

The privatization initiative was also designed to help reduce the fiscal deficit. During the years leading up to the privatization of CTC, the telephone company posted profits each year except 1982 and 1985.²⁶ Nonetheless, the Chilean public sector was bloated and inefficient. By selling the large SOEs to foreign investors, the government hoped to increase the level of foreign investment, improve overall efficiency and productivity, and increase the level of economic activity, thereby raising government revenues.²⁷ Hence, fiscal pressures played an important part in the government's decision to privatize the telephone company.²⁸

Foreign debt was another important macroeconomic factor. The military government in the 1970s made steady progress in reducing the foreign debt obligations that had accumulated under earlier governments, but the banking and economic crises of the early 1980s erased all of the gains. When the government took control of bankrupt firms during the 1982 crisis, it had to assume responsibility for most foreign credits. Hence, between 1980 and 1983, Chile's foreign debt exploded 50 percent, from \$12 billion to \$18 billion.²⁹ Given its foreign debt burden of 121 percent of GDP in 1983, Chile could no longer afford to

22. See Carlos Pietrobelli, *Trade Liberalization and Industrial Response: The Case of Chile (1974-1987)* (paper presented at the LASA Conference, March 1994).

23. Yotopoulos, *supra* note 2.

24. Castillo, *supra* note 9.

25. Hachette & Schwarzenberg, *supra* note 1.

26. In 1982 and 1985, CTC posted moderate losses due to changes in the exchange rate and technical problems. The latter resulted from low levels of capital investment and modernization of equipment.

27. Mario Marcel, *Privatizacion y Finanzas Publicas: El Caso de Chile, 1985-1988*, in COLECCION ESTUDIOS CIEPLAN 5-60 (1989).

28. It is important to note that CORFO was planning a fourth round of privatizations that would have involved politically sensitive companies such as CODELCO, the mining copper monopoly, and ENAMI, the state-owned copper smelter. This would have been implemented in the early 1990s, had the military government won a plebiscite to continue in power.

29. Interestingly, many Latin American countries accumulated their foreign debt burdens due to the overexpansion of the public sectors, whereas Chile accumulated its debt due to the unregulated and uncontrolled expansion of the private sector.

assume any more obligations to expand and modernize state-owned companies. With a relatively low domestic savings rate of 8 percent, the country remained highly dependent on foreign financing.³⁰ Hence, the country was forced to stop expanding its industrial base, modernizing its infrastructure, and expanding the economy. Instead, it was forced to grow at a more optimal and slower rate.³¹ Hence, Chile experienced another period of structural adjustment and privatization. Marcel³² argued that indeed the third round of privatizations was driven by the need to access new sources of capital and to create new mechanisms for the conversion of external debt. Therefore, it is clear that Chilean privatization of the telephone company was strongly affected by the country's high level of foreign debt.³³

In order to maximize the amount of debt that would be used for the privatization program, the government developed a series of debt-equity swap programs. Chapters XVIII and XIX of the Compendium of Rules on Foreign Exchange set the rules for debt-equity conversions. The program had two intentions. The first was to increase foreign investment in Chile, and the second was to increase the repatriation of flight capital that had left during the banking crisis. Chapter XIX applied only to foreign investors or Chileans living abroad. Such investors were allowed to acquire Chilean debt (which was trading at 60 percent of face value) and then exchange it for equity in state firms that were being privatized. While they could redeem for it 85 percent of face value, the investment had to remain in the country for ten years and dividends could not leave the country until the fifth year. Furthermore, all transactions had to be approved by the Central Bank. Chapter XVIII, also known as Annex 4, also was used to capitalize the privatized firms, but it applied only to Chileans living in Chile. Thus, the privatization program allowed Chile to drastically reduce its debt obligation in nominal and real terms.

V. Political Factors.

Since the sale of CTC occurred almost thirteen years after the military takeover of Chile, it is necessary to understand the events that occurred between 1970 and 1973 in order to grasp the political forces that shaped the privatization process. The breakdown of the civilian political institutions during that time period transcends a struggle between the Chilean political left and right. Instead, it was rooted in an inherent flaw that existed within the country's political structure. The Chilean political system developed a long tradition of relative equilibrium between the presidency and the legislature.³⁴ The system

30. Felipe Larrain, *The Economic Challenges of Democratic Development*, in *THE STRUGGLE FOR DEMOCRACY IN CHILE, 1982-1990* (Paul W. Drake et al eds., 1992).

31. Ricardo French-Davis, *El Conflicto Entre La Dueda y El Crecimiento en Chile*, in *COLECCION ESTUDIOS CIEPLAN* 61, 61-89 (1989).

32. Marcel, *supra* note 27.

33. It is important to note that Glade, *supra* note 16, argues that Chile was the only major Latin American privatization program that was not debt-related. He bases this observation on the fact that Chile did not have the state-led expansion programs seen in the other countries. Nonetheless, as we have pointed out earlier, the increased debt burden on the public sector, due to the failure of the banking system, was one of the principal drivers behind the Chilean privatization program.

34. See generally TIMOTHY SCULLY, *RETHINKING THE CENTER: PARTY POLITICS IN 19TH AND 20TH CENTURY CHILE* (1992).

worked well most of the time but broke down when the two institutions came to an impasse. The absence of a third and viable political institution to mediate between the executive branch and the Congress led to the political breakdown of the early 1970s. Although the courts attempted to serve as mediator, they had neither the resources nor the will to broker the crisis, and the military eventually was forced to intervene in order to prevent a full-scale civil war. Therefore, it is important to take a deeper look at the political events surrounding this breakdown and the impact it would have on Chile's future political economy.

In 1970, Salvador Allende Gossens was elected president with 36.6 percent of the vote. Jorge Alessandri, a free-market advocate from the National Party, received 35.2 percent of the vote, and the centrist Christian Democrat candidate, Radomiro Tomic, came in third with 28.1 percent of the vote. Since no single candidate received the 50 percent +1 majority needed to win the election, the Chilean Constitution mandated that the Congress decide between the two top candidates.

The Congress, however, was controlled by the Christian Democrats, who held two-thirds of the seats. But although Allende was from the Unidad Popular party, a coalition of socialist and Marxist groups, the Christian Democrats allowed him to assume the presidency. In return, they received a set of guarantees and concessions that Allende would not change the country's fundamental political institutions. Nonetheless, the more Marxist elements of Unidad Popular disregarded the agreement and immediately began implementing aggressive changes in the country's social, economic, and political structures, and groups of workers appropriated factories, businesses, and farms. In 1972, the national courts attempted in vain to reverse many of these illegal seizures by interpreting existing laws and defining property rights. Faced with the strong possibility of a civil war, largely fueled by threats from Marxist elements to arm peasants and workers, the military decided to intervene, and assumed control on September 11, 1973.

It is important to note that once in power, the new military government did not side with any of the competing factions. It immediately dismantled Chile's democratic institutions and vested all political power under a single authoritarian commander, General Augusto Pinochet.³⁵ It dismissed the Congress, outlawed political parties, and stripped labor unions of their bargaining and organizational rights. Many civil rights were restricted, including freedom of speech, press, and assembly.³⁶ Furthermore, the military jailed and exiled thousands of people. It also prosecuted dissidents, killing several thousand in the process. The military's actions were so extreme that it became alienated from the business community. The military government then began a process of reversing many of the programs implemented by Unidad Popular.³⁷ Instead of returning economic control to the traditional business forces that had opposed President Allende, the new government

35. GENARO ARRIAGADA, *PINOCHET: THE POLITICS OF POWER* (1988).

36. Stallings & Brock, *supra* note 3.

37. Larrain, *supra* note 30.

came to rely on a cadre of U.S.-trained economists from the Catholic University of Santiago, known as the Chicago Boys.³⁸

Giraldo³⁹ has argued that the Chicago Boys were determined to reverse many of the redistribution policies that had been implemented since the mid-1930s. They shared with the military a contempt for political parties, politicians, and interest groups. They also shared disdain for the narrow economic interest groups that had precipitated the political and economic crises. Indeed, both groups held in common a perception that interest groups in general prevented the implementation of policies that would benefit the country as a whole. Therefore, the only way to implement the changes needed to rescue Chile was through a benign dictatorship that would solve the collective action problem. Indeed, Silva⁴⁰ argued that the Chicago Boys and the military were convinced that the only way to transform Chile's economic model was through a complete centralization of power. Therefore, Chile's new rulers were faced with a complex proposition that would take a long time to implement.

In 1976, the military rulers appointed a Council of State to reshape Chile's political institutions, including the drafting of a new constitution. In 1980, a new constitution was voted into place. At the same time, General Pinochet was given an eight-year term that would expire in 1989. With the clock counting down to a return to a democratic environment, the country's rulers decided that they had to move fast to lock in the economic policies imposed since the coup. The centerpiece of this initiative would be the privatization of the remaining state-owned companies. Although there were some important macro-economic considerations driving the privatization program, the political factors were probably more important.⁴¹ Unwilling to turn over a vast public sector to a future government of unknown political persuasion, the government decided to divest it. To further ensure that these assets remained within the private sector, the government designed a privatization program to give foreign bidders a comparative advantage.⁴²

-
38. In 1955, USAID, a U.S. development agency, launched a program to train top Latin American students in the rigors of classical economics. The agency approached the Catholic University, a highly conservative institution, and set up a program in which five students would receive scholarships each year. By the mid-1980s, the program had trained 150 Chileans. Most of the graduates returned to Chile and taught at the university or entered government. The graduates also formed CIEPLAN, a neoliberal economic think tank.
 39. Jean Giraldo, *Development and Democracy in Chile: Finance Minister Alejandro Foxley and the Concentration Project for the '90s* (paper presented at the Latin American Studies Ass'n Conference, Mar. 10-12, 1994).
 40. Eduardo Silva, *The Political Economy of Chile's Rigme Transition: From Radical to Pragmatic Neo-Liberal Policies*, in *THE STRUGGLE FOR DEMOCRACY IN CHILE, 1982-1990* (Paul W. Drake et al eds., 1992).
 41. Schneider in 1992 argued that privatization in the United Kingdom and Chile was driven more by ideological factors than by economic ones—that is initiatives designed to reduce or eradicate the power of the left.
 42. The military rulers had already witnessed firsthand how fiercely foreign owners would defend their property rights; for example, ITT spent over a million dollars to destabilize the Allende government. See Schoenberg, *supra* note 11.
-

As part of the foreign-debt restructuring program, the Chilean government decided to allow foreigners to purchase shares in Chilean privatization programs through debt-equity swaps. In 1985, the Central Bank introduced several mechanisms to convert foreign debt into equity. One such mechanism, known as Chapter XIX, allowed creditors to convert Chilean foreign debt into equity shares in privatized firms. Another mechanism, called Chapter XVIII, allowed private agents to purchase Chilean debt on the secondary market and use it to pay for equity stakes in privatized companies.⁴³ Since most Latin American debt was trading on the international markets at a deep discount, foreigners were able to buy privatized Chilean assets at very low prices. The program allowed Chile to retire about \$4 billion (almost 25 percent) of its total debt obligations and also provided a lucrative incentive for foreigners to establish large stakes in Chilean firms.⁴⁴ In order to lock in the investments for a long period of time, Chilean foreign investment Rule DL600 forced investors to maintain their holdings for a minimum of three years.⁴⁵

The privatization of CTC was a clear example of the advantage that was given to foreign owners. In 1986, CORFO announced that it would sell 51 percent of the telephone company. The next year, the government sold 6.4 percent of the shares, to workers and 7.6 percent to Chilean pension funds. In 1988, CORFO invited domestic and foreign investors to bid for at least 30 percent of the shares with two conditions: (1) the bidders had to commit themselves to subscribe for new shares so that their final stake would reach at least 45 percent; and (2) the winner had to buy over ten million B shares of CTC.⁴⁶ In two weeks, Alan Bond, an Australian financier and speculator, offered \$114.8 million for 50.1 percent of the shares (see Table 1). Surprisingly, Bond had no experience in the telecommunications industry. The remaining shares were then sold on the international capital markets in the form of American Depository Receipts (ADRs) and Global Depository Receipts (GDRs). Some of the remaining shares were later sold to Chileans through the popular privatization program, whereby the government subsidized the sale of small quantities of company shares to individual investors. Overall, the privatization program prevented the centralization of power in any single domestic group(s) and thus reduced the chances of creating powerful interest groups.⁴⁷

43. See Larrain, *supra* note 30.

44. The decision to provide incentives to foreigners could also have stemmed from the experiences gained from the earlier privatization program. The government sold off large sections of the firms nationalized by the Allende government, thereby creating large and powerful domestic conglomerates. By the end of 1978, 5 conglomerates owned 53 percent of total assets of Chile's 250 largest firms, but many of these firms failed during the economic crisis of 1982. See Pietrobelli, *supra* note 22. In an effort to avoid repeating the mistake of concentrating too much economic power, the government may have opted to sell the companies abroad.

45. Raul Sáez, *Las Privatizaciones de Empresas en Chile*, in CIEPLAN (1992).

46. The only difference between the two types of shares is that owners of B shares can vote for the company's board of directors.

47. It is interesting to note that most of the other privatization programs in the Southern Cone were mindful of giving too much power to foreign owners and thus gave preference to local ownership.

Table 1
CTC Ownership Structure, 1987-1990

	1987	1988	1989	1990
CORFO	75.0	14.2	2.9	0.1
<u>Private/Domestic</u>				
Pension Funds	7.6	7.7	11.6	11.6
CTC Employees	6.4	4.3	3.2	3.2
Other	10.2	23.5	31.9	25.8
Total	24.2	35.5	46.7	40.6
<u>Foreign</u>				
Bond Corp.	0.0	50.1	49.2	0.0
Telefónica	0.0	0.0	0.0	43.4
ADRs	0.0	0.0	0.0	14.9
Other	0.8	0.2	1.2	1.0
Total	0.8	50.3	50.4	59.4

Source: CTC, 1990.

VI. Conclusion.

This paper examined the privatization of Chile's state-owned telephone companies. The divestiture was somewhat unique in Latin America, since the government sold the long distance and local operations as separate companies. Although the sale of the two assets helped promote competition and efficiency, it was also done because the two operations developed separately.

This study found that of the three driving factors, microeconomic, macroeconomic and political forces, Chile's privatization program was driven by the latter two. First, a substantial disequilibrium in the fiscal accounts was a major impetus to sell the companies. A lack of investment capital and the distortions created by the large state-owned companies, forced the military government to pursue the privatization initiative. Second, political factors were important in the implementation of the plan. The centralization of power in the military leadership prevented the type of conflicts generated in other countries that tried to sell their telephone companies. Nevertheless, the Chilean case underscores the fact that ideology has little to do with the privatization process. In the Chilean case, the telephone company entered into government control during the military government. Furthermore, the military government sold off assets only when macroeconomic conditions warranted, otherwise, as in the case of the mining and oil industries, the assets remained under government control.

Bibliography

- Alan Angell, *Unions and Workers in Chile During the 1980s*, in *THE STRUGGLE FOR DEMOCRACY IN CHILE, 1982-1990* (Paul W. Drake et al eds., 1992).
- GENARO ARRIAGADA, PINOCHET: THE POLITICS OF POWER (1988).
- Henry Beinen and John Waterbury, *The Political Economy of Privatization in Developing Countries*, *WORLD DEV.* 617-32 (1989).
- PHILIP BROCK, IF TEXAS WERE CHILE: A PRIMER ON BANKING REFORM (1992).
- Carlos Budnevich, *Implicancias Financieras de las Privatizaciones en Chile*, in *CIEPLAN* (1993).
- Mario Castillo, *Privatizaciones de Empresas Publicas en Chile: El Caso del Sector Telecomunicaciones*, in *CEPAL* (1993).
- CTC, *STATISTICAL YEARBOOK OF DEVELOPMENT IN TELECOMMUNICATIONS, 1960-1989* (1990).
- EIU, *CHILE: CONTRY PROFILE* (1987).
- Ricardo French-Davis, *El Conflicto Entre La Dueda y El Crecimiento en Chile*, in *COLECCION ESTUDIOS CIEPLAN* 61, 61-89 (1989).
- JEFFREY FRIEDEN, DEBT, DEVELOPMENT, AND DEMOCRACY: MODERN POLITICAL ECONOMY AND LATIN AMERICA, 1965-1985 (1991).
- Ahmed Galal, *Regulation, Commitment and Development of Telecommunications in Chile*, *WORLD BANK WORKING PAPER*, Apr. 1993.
- Jean Giraldo, *Development and Democracy in Chile: Finance Minister Alejandro Foxley and the Concentration Project for the '90s* (paper presented at the Latin American Studies Ass'n Conference, Mar. 10-12, 1994).
- William Glade, *Privatization in Rent-Seeking Societies*, 17 *WORLD DEV.* 673-82 (1989).
- Dominique Hachette & Rolf Lüders Schwarzenberg, *El Proceso de Privatization en Chile Desde 1984*, 25 *BOLETIN ECONOMICO* (1988).
- GARY KING, ROBERT KEOHANE & SIDNEY VERBA, *DESIGNING SOCIAL INQUIRY: SCIENTIFIC INFERENCE IN QUALITATIVE RESEARCH* (1994).
- Felipe Larrain, *The Economic Challenges of Democratic Development*, in *THE STRUGGLE FOR DEMOCRACY IN CHILE, 1982-1990* (Paul W. Drake et al eds., 1992).
- Mario Marcel, *Privatacion y Finanzas Publicas: El Caso de Chile, 1985-1988*, in *COLECCION ESTUDIOS CIEPLAN* 5-60 (1989).
- Jose Richardo Melo, *Panorama de las Telecomunicaciones en Chile* (May 1992) (unpublished paper on file with the author).
- Walter Molano, *The Political and Economic Factors Affecting the Implementation of Privatization Policies: The Case of Telecommunications*, 7 *BUS. IN THE CONTEMPORARY WORLD* 151-63 (1995).
- WALTER MOLANO, *THE LOGIC OF PRIVATIZATIONS: THE CASE OF TELECOMMUNICATIONS IN THE SOUTHERN CONE OF LATIN AMERICA* (1997).
- Carlos Pietrobelli, *Trade Liberalization and Industrial Response: The Case of Chile* (1974 1987) (paper presented at the LASA Conference, March 1994).
- A. R. M. Ritter, *Development Strategy and Structural Adjustment in Chile, 1973-1990*, 15 *CANADIAN J. OF LATIN AMERICAN AND CARIBBEAN STU.* 159-75 (1990).
- Jaime Ruiz-Tagle, *Trade Unionism and the State Under the Chilean Military Regime*, in *LABOR AUTONOMY AND THE STATE IN LATIN AMERICA* (Edward C. Edpstein ed., 1989).
- ANTHONY SAMPSON, *THE SOVEREIGN STATE OF ITT* (1973).
- Raul Seaz, *Las Privatizaciones de Empresas en Chile*, in *CIEPLAN* (1992).

ELMER SCHATTSCHNEIDER, *THE SEMISOVEREIGN PEOPLE* (1960).

ROBERT SCHOENBERG, *GENEEN* (1985).

TIMOTHY SCULLY, *RETHINKING THE CENTER: PARTY POLITICS IN 19TH AND 20TH CENTURY CHILE* (1992).

Eduardo Silva, *The Political Economy of Chile's Rigme Trasition: From Radical to Pragmatic Neo-Liberal Policies*, in *THE STRUGGLE FOR DEMOCRACY IN CHILE, 1982-1990* (Paul W. Drake et al eds., 1992).

Barbara Stallings & Philip Brooks, *Political Economy of Economic Adjustment: Chile, 1973-90*, in *POLITICAL AND ECONOMIC INTERACTIONS IN ECONOMIC POLICY REFORM* 78-122 (Robert Bates & Anne Krueger eds., 1993).

WORLD BANK, *WORLD DEBT TABLES* (1992).

Pan Yotopoulos, *The (Rip) Tide of Privatizations: Lessons From Chile*, 17 *WORLD DEV.* (1989).
