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Capitalization:
The Politics of Privatization in Bolivia

In 1993, Bolivia's newly elected government, headed by President Gonzalo Sánchez de Lozada, embarked on the implementation of a radical new reform agenda called the *Plan de Todos* (Plan for Everyone) which included the devolution of state power to local governments, education reform, and a revolutionary program called "capitalization" to privatize the state's largest enterprises.

To many, it is no surprise that Gonzalo Sánchez de Lozada, or "Goni" as he is known to Bolivians, was the driving force behind such a far-reaching reform program. In 1985, under President Victor Paz Estensorro, Bolivia became the first democracy in Latin America to stabilize hyperinflation and implement structural reform. As Minister of Planning under Paz Estensorro, Goni was the chief architect of the radical stabilization and structural reform package, the *Nueva Política Económica (NPE),* which brought the country out of crisis and enabled the achievement of modest economic growth. Yet as much as he was known for being a visionary, Goni was also known for being an obstinate and insatiable micromanager and those who are the closest to him are the first to admit that he is frequently difficult to work with. A process made difficult by labor opposition was exacerbated by the government's inability to implement his proposed reforms quickly.

Although Bolivia achieved successful reforms earlier than other Latin American countries, it lagged behind in its efforts to privatize state owned enterprises. Privatization had been on the agenda of several governments, but political constraints had never allowed any administration to move forward with a program. By the time Goni had begun to develop his *Plan de Todos* in the years prior to his election in 1993, it was clear that a different approach was needed. As with privatization programs in countries throughout Latin America, capitalization was seen as a means

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of reducing the fiscal deficit, improving economic efficiency, and reducing state involvement in running businesses. However, in designing the program, Sánchez de Lozada also sought to address Bolivia's long-standing structural problems of low productivity, scarce investment, a weak capital market, and high levels of poverty and inequity. Because so many Bolivians had been the recipients of the redistributional benefits of state-owned enterprises (in the forms of subsidized prices and employment), Sánchez de Lozada was particularly conscious of equity concerns in designing his program. He also sought to improve upon privatization experiments in other Latin American countries by setting out a strict legal and regulatory framework that would reduce the potential for corruption, reassure investors, and help to ensure that the benefits of the capitalizations would be realized by the Bolivian citizens. Six key sectors of the economy were targeted for capitalization: electricity, telecommunications, hydrocarbons, aviation, railways, and smelters and mining.

The political necessity of showing immediate benefit from the program in a tangible way to the Bolivian people conflicted in many ways with the desire to ensure long term economic gains in the form of increased savings and investment. The pursuit of these seemingly contradictory goals resulted in an innovative approach that differs from traditional privatization in several significant ways. First, the state would not sell the company, but would form a corporation with 50 percent participation of a private investor, or "strategic partner," doubling the company's value and ensuring resources for capital investments. In return for its 50 percent of the shares, the strategic partner would agree to make a quantity of investment into the company equal to the bid within a set time period, and would be given management control of the capitalized firms with 51 percent voting power on the boards of directors. Second, the state's 50 percent share of the company would be held in trust for Bolivian citizens as part of a reformed pension system with individual accounts in which a portion of the shares from the capitalizations are placed. Dividends from the shares are distributed annually to all Bolivian citizens over the age of 65 through a Solidarity Bond (or BONOSOL) payment of about $250. Administrators of the two pension funds fill the remaining 49 percent of seats on the boards of the capitalized companies, representing the interests of the funds and the their beneficiaries.

Background on Bolivia

One of the most underdeveloped countries in Latin America, Bolivia has been plagued with chronic political and economic instability, social fragmentation, and extreme poverty. Although the country won independence from Spain in 1825, it was not until the 1952 *revolución nacional* that a popular government, led by the *Moviemeinto Nacionalista Revolucionario* (MNR), came into power. The revolution, spurred by the prior government's refusal to acknowledge the victory of the MNR in nationally held general elections, signaled the start of a major transformation of the Bolivian economy and political system: voting rights were granted to the entire population; a land reform program redistributed large tracts of land to peasants and small farmers; and the country's largest and most profitable industries—mining, natural gas, electricity, and railroads—many of which were foreign owned, were nationalized. These nationalizations spurred the further development of a strong labor movement that remains a powerful political force in Bolivia today.

After 12 years of democratic governance, the MNR had become a bloated bureaucracy and was troubled by factional infighting. In 1964, a military coup overthrew the government and took power. Political stability eroded even further, and between the years of 1978 and 1982, Bolivia had a total of seven military and one civilian governments. Democracy returned in 1982 with the government of President Hernan Siles Zuazo, but despite initial optimism, the country deteriorated into economic and political chaos. By 1985, Bolivia's economy was in a crisis with annual inflation of 24,000 percent and a budget deficit of 25 percent of GDP. The hyperinflation coincided with several big external shocks that exacerbated Bolivia's troubles: a 50 percent drop in the price of the country's major exports, tin and tungsten, and a 50 percent drop in the price of petroleum.

Elections were pushed ahead, and the entering Paz Estensorro government instituted radical "shock treatment" in the form of the NPE. The shock treatment brought inflation to three percent within two years, GDP began to grow at a rate of two to three percent per year, and the budget deficit was cut to only three percent of GDP by 1988.

Yet despite the progress achieved through economic reforms and an apparent commitment to democratic government, Bolivia remains one of the poorest countries in the region. Although the fifth largest in size on the continent, Bolivia is landlocked, bordered on the northeast by Brazil, to the south by Paraguay and Argentina, to the southwest by Chile, and to the west by Peru. Seventy percent of the population live below the poverty line, and the GDP is one of the lowest in Latin America. Income distribution is also extremely unequal: the richest 20 percent of the population control 50 percent of the wealth, the poorest quintile, only six percent. By the late 1980s, due in large part to the land reform initiated in the 1950s, most of the country's land was in the hands of rural farmers. Eighty percent of industrial production, however, was still in the hands of the government. Many of the country's largest companies were bankrupt and in desperate need of capital and technology. But the state, struggling to control its fiscal deficit, especially in the aftermath of the 1985 hyperinflation and subsequent countermeasures, was unable to finance needed improvements.

Privatization Under Paz Estensorro (1985-1989)

The MNR government of Paz Estensorro considered privatization to be an integral part of the broader goals of the NPE. The state-owned companies were desperately in need of capital investment and policy makers believed that the economy could be revitalized in part by efficiency gains brought about by privatization. A commission was appointed in 1987 to elaborate on the conceptual and practical objectives of the privatization program. But the MNR had ascended to power through the 1952 revolution which had reclaimed control of the natural resources and industries from foreign ownership. These industries continued to be the pillars of Bolivia's economy and a source of national pride. The return of what was considered to be Bolivia's national patrimony to foreign control was unthinkable for many Bolivians and any suggestion of such was opposed strongly by the powerful labor unions, which also saw state control as a way of ensuring jobs for their members. Advocates of privatization were aware of the controversies surrounding privatization and initially used the term "industrial transition" when discussing privatization, hoping to avoid offending political sensitivities.

Based on privatization experiments throughout the region, five alternatives for the implementation of a privatization program and their relative advantages and disadvantages were proposed by Paz Estensorro's Commission. The first option, that of a direct sale to private owners, would be the most expedient for the government and the most attractive to foreign investors. The state would benefit from a direct infusion of capital, but the commission was concerned about problems in accurately valuing assets so as to attract investors and ensure competitive bidding while guaranteeing an acceptable price for the state. Privatization experiences in other countries had shown that even potentially profitable companies with natural monopolies often were so burdened with debt or so severely undercapitalized that no buyers came forward until prices were drastically lowered.

The second option, which would allow leveraged buy-outs, was considered as a way to encourage domestic entrepreneurs to participate in the privatizations. It was unclear, however, that any domestic firms had the scale and technical capacity to manage any of the public enterprises effectively. Furthermore, the enormous debt burden on the domestic firms had the potential to destabilize the economy and undermine any potential for growth and development from the privatizations.

Debt-for-equity swaps, the third option proposed, would provide a huge incentive for foreign investors. By accepting debt-equity incentives instead of cash, potential investors could theoretically experience huge savings since the quotation of these equities in the secondary market at the time was at an all time low. The Argentine and Brazilian governments had pursued this option as a mean to further entice investors in light of their countries' dismal macroeconomic condition. Both experiences ended disastrously and had led to the requirement of cash receipts in all subsequent privatizations throughout the region.[1]

The leasing of state enterprises to private companies was considered as a fourth option. It was an attractive means to retain the benefits of private management without losing a source of

1 President Carlos Menem had used this approach during Argentina's first round of privatizations in order to show that the revenues from the sale of the public enterprises could reduce the country's foreign debt, but that experiment had ended in disaster when several of the consortia collapsed. In Brazil, President Fernando Collor de Melo turned government domestic debt instruments into privatization currencies, but their status as junk bonds enraged the opposition and later forced his successor, President Itamar Franco, to require mostly cash receipts. These two experiences most likely influenced Peruvian President Alberto Fujimori to insist on cash receipts in Peru's later privatizations.

revenue. It seemed unlikely, however, that the much needed capital improvements would be made under this option since the incentive for such investment was drastically reduced without an ownership stake. Furthermore, the lack of incentives would also likely dilute any efficiency gains to the economy.

Employee stock options, the fifth option, was seen as a potential political maneuver to gain support for the privatizations. This method, however, had caused serious problems in Eastern Europe. The employees had almost immediately sold their stocks to speculators, flooding the market and causing a subsequent crash in stock prices. In Bolivia, a poor county without a strong paper culture, it was feared that the same was likely to occur.

During this time, the commission also conducted a variety of feasibility studies to determine which industries should be targeted for the first wave of privatizations. Notably, some strategic sectors, such as the airlines, telecommunications, and smelting were marked for the first wave, while mining and hydrocarbon monopolies, where the labor unions were the strongest, were excluded because of perceived high political costs. In the end, these perceived political costs prevented the government from pushing ahead any privatization program at all, despite the commission's efforts. The elections of 1989 loomed ahead, and although the MNR was fairly popular at that time, as was its candidate, Gonzalo Sánchez de Lozada, the race was tight and it was thought that any talk of privatization might seriously threaten the MNR bid to retain the presidency.

As it turned out, the MNR made an even more egregious political error that cost Goni the presidency. Although he won 51 percent of the popular vote, he lost the presidency due to a clause in the Bolivian constitution requiring a second round congressional vote based on proportional representation. The military right and the social democrats, the second and third runners up in the presidential race, formed a coalition that enabled the election of MIR candidate, Jaime Paz Zamora, to the presidency instead of Goni.

Privatization Under President Paz Zamora (1989-1993)

The Paz Zamora government initially touted privatization as one of its top priorities and promised to push ahead with the work of Paz Estensorro's commission. Privatization was seen both as a vehicle for increased investment in the country and as part of the administration's commitment to redefine the role of the state and preserve tax resources for social spending. In 1991, the government announced a decree establishing guidelines for privatization. The guidelines retained much of the same language of the previous commission's recommendations, but specifically targeted 159 state-owned enterprises for privatization. Again, the union-controlled mining and hydrocarbon sectors were conspicuously absent from the list and political pressures continued to constrain the administration in pushing forward with a privatization program. Although a privatization law was actually passed under this administration, it was done under somewhat suspicious circumstances—in the early morning hours and without a quorum—calling its legitimacy into serious question.[2] Several small privatizations were undertaken, but with serious political toll. Strikes and significant opposition from the labor sector quelled Paz Zamora's initial eagerness to proceed quickly with the privatization program.

Sánchez de Lozada Develops His *Plan de Todos*

After his defeat, a disillusioned Sánchez de Lozada fell into a deep depression. Still, determined to find a way to help his country, he formed a think tank, *Fundación Milenio*, devoted to assessing Bolivia's problems and developing a comprehensive program of reform which he could use as a platform for his next presidential bid. Research conducted by the foundation revealed that Bolivia needed to undergo serious changes if it was to experience any further social and economic development. The economy, despite its successful recovery from the crisis in the mid-eighties, was still suffering—exports of raw materials were not bringing in sufficient revenue, the country was overly dependent on foreign assistance, no mechanism for economic sustainability existed (such as a capital market), and the public sector was rife with corruption. Furthermore, most of the country's citizens were excluded from participation in the political system because of race, language, or involvement in economic activity outside the formal economy. The results of the studies convinced Sánchez de Lozada of the need for a dramatic downsizing and decentralization of the state and limiting the role of government to governance, not business.

The issue of privatization was naturally one of many issues considered. In developing ideas for a program for Bolivia, Sánchez de Lozada undertook a variety of public opinion polls and conducted extensive research into privatization experiments in other countries. This process strengthened Goni's resolve that a privatization program for Bolivia needed to be handled differently from the way it had been undertaken elsewhere.

First, Bolivia's economy by this point was relatively stable. Peru, Argentina, and Brazil had initiated privatization as part of their stabilization packages, and the influx of cash from privatizations was desperately needed to finance large fiscal deficits. By the late 1980's, Bolivia's fiscal deficit was under control and the goals of a privatization program were necessarily different Therefore, the methods and strategies would have to reflect those differences.

Second, because efficiency considerations were secondary to the receipt of cash, many privatizations in other Latin American countries had transferred monopolies from the public to the private sector and had strengthened the power of oligopolies without ensuring any consumer or investor protection. Public scrutiny of these transactions and their effects did not occur until well after the privatizations had taken place and the economy had stabilized. In Bolivia, on the other

2 The Supreme Court constantly threatened revocation of the law throughout the duration of the Administration, but it never had the opportunity to go before the court.

hand, consumer and investor protection would have to be offered at the inception of any program, since public scrutiny would be focused on the impact of the privatizations themselves, not their effects as part of a broader economic plan.

Surveys conducted by the foundation revealed that this public scrutiny would be particularly critical. Overwhelmingly, Bolivians were opposed to both the term and concept of "privatization." Although many people objected to the principle of giving up Bolivia's patrimony to foreign ownership, many more objected to privatization because of perceived corruption in government. Bolivians believed that prior privatization experiments in other Latin American countries had yielded little for citizens, while money from the sale of public enterprises had "disappeared into large and corrupt bureaucracies." They were not willing to sell the "jewels of the state" if they could not realize the benefits.

Third, because Sánchez de Lozada was concerned with improving the climate for growth in Bolivia, he needed to be more conscious of the needs and concerns of potential foreign investors. Goni saw such reforms as necessary for a long term growth strategy.

Fourth, examination of the mass privatizations in the former Soviet bloc countries of Poland, Czechoslovakia, and East Germany illuminated another set of potential problems related to the distribution of benefits from privatizations. Many of these programs, which involved massive transfers of public property with shares distributed among the populations through voucher programs, ended in catastrophe. Employees of the firms, needing cash, flooded the market with their shares, causing stock prices to fall dramatically. Often, newly privatized companies were closed down almost immediately after their purchase, with the state having received little money for their sale.

Although the research conducted through the foundation confirmed that Bolivia had to take a unique approach to privatization, the idea for capitalization came from another source entirely. According to Goni, the seeds of the idea were actually planted when, as Minister of Planning, he visited his family's farm. Curious about the effects of agrarian reform on the rural population he struck up a conversation with a local peasant:

> "I said, 'How was land reform for you?' and he said, 'Well, land reform gave me the land, but it didn't give me either the money or technology to really make that land productive, so I had three options: One, I could sell it, but even if I spend the money wisely on the health and education of my family, at the end I will have no money and I will have no land. Two, I could go and borrow the money. But if you borrow money, especially from money lenders, there are three things that grow while you sleep: one is crops; the other is children; and the other is interest.

> So I will be again a *peon*, a peasant slave if I do this. So what I do is I invite in my godfather, who lives in the town, and he puts up the money for fertilizer and seed and I put up the land. We work it together. If we have a good year we divide the profits and we do very well. If we have a bad year than we only have to recuperate our investment.'"

Capitalization in the *Plan de Todos*

Capitalization, designed around the fundamental idea of adding value through partnership and incorporating the lessons learned through study at Fundación Mileno, became one of the planks of Sánchez de Lozada's 1993 presidential election campaign platform which he called the *Plan de Todos*. The *Plan de Todos* also included a radical plan for political decentralization called "popular participation" and an education reform program designed to enable all Bolivian citizens, despite racial and linguistic differences, to receive an education. Goni believed strongly in the necessary interconnectedness of economic and social reform, and his plan was carefully designed to push the country's development forward on both fronts.

On June 6, 1993, Sánchez de Lozada and his *Plan de Todos* won 36 percent of the popular vote, and his party gained control of two thirds of the Senate. He was elected into the presidency with a clear majority in the second round congressional vote. The new President immediately appointed a National Secretary of Capitalization charged with designing the process through the creation of a legal framework. The design process included a survey to assess public opinion about capitalization. The results of the survey were startlingly clear: No one understood what capitalization meant. This meant that Goni's administration still had a lot of flexibility in designing the program, but it also implied that there was significant confusion among government officials and potential investors. It was clear that a public relations program had to be developed quickly to explain capitalization to the public, government officials, and potential investors. The need for better public relations was punctuated when only 20 days into the new administration, on August 25, 1993, the powerful *Central Obrera Boliviana* (COB) staged a 24 hour work stoppage protesting the *Plan de Todos* and its main element, capitalization.

Drafting a Legal Framework

After examining the failures of the early privatizations in Chile and Argentina, it was clear to Sánchez de Lozada that a legal framework had to be put into place prior to any capitalizations. The Chileans and the Argentines had believed that a legal and regulatory framework might hinder the process of privatization by deterring investors, but Goni believed that the quality of bidders would likely depend on the transparency of the process. In Peru, President Alberto Fujimori had established a framework prior to privatizing but the law was broad, and left too much room for interpretation. For the process to be attractive to investors and supported internally, thought Goni, the rules of the game had to be set in clear terms. At team comprised of Bolivia's top lawyers and businessmen was assembled to craft a law that was precise yet flexible enough to be applicable to all sectors.

The drafting of the law exposed several problems with the initial plan. First, Sánchez de Lozada's government realized that private investors were uncomfortable with the 51/49 split of shares, even though they liked other aspects of capitalization. In a traditional privatization, an investor would need to fund the purchase of the company before it could make subsequent investments in capital improvements. With capitalization, by contrast, the investors' purchase price would go directly into improving the existing capacity of the company. But with only 49 percent of the shares, strategic partners would not have management control over the company and could not have final say over the use of their invested funds. In November 1993, the president announced that the shares would be split 50/50, and the strategic investor would have 51 percent voting control on the board of directors of the capitalized firm. Not surprisingly, this caused an outcry by many Bolivians who felt that relinquishing state's control, in effect, equaled the loss of the country's most valuable industrial assets.

The process of drafting the law brought to light another unresolved question: what to do with the state's shares in the capitalized company? The president knew that he wanted to distribute them in some way to the Bolivian people, but a feasible method for doing so had yet to be determined. Based on his understanding of experiences in Eastern Europe, he had seen that a mass distribution of shares through tradable stock was not viable. Yet he had also realized that lumping shares into a large social investment fund ran counter to his vision of reducing government and of providing an equal benefit to all Bolivians. There seemed to be few alternatives.

At the time that the law was being drafted, advisors in other sectors of the government were examining the possibility of reforming Bolivia's pension system, a pay-as-you-go system that was suffering from major deficits due to a shortage of payers into the system and a longer-than-expected life span of retirees. The administration was also concerned that the system only covered 11 percent of Bolivians—those working in the formal economy who contributed to their pension funds through their paychecks. Some of the president's advisors suggested that there might be a way to link reform of the pension system to the distribution of shares from the capitalized firms. A pension system of individual accounts could be created into which the dividends from the shares of the capitalized firms could be distributed. Not only would that ensure benefits for all Bolivian citizens, but it would provide a pension for all individuals, whether or not they participated in the formal economy.

Sánchez de Lozada required 57 drafts of the 10 page general law governing capitalization before he was satisfied. The law was finally approved nine months after he took office, on March 21, 1994. The law established a seven step process for capitalizations:

*First, the book value of the capitalized company would be determined in accordance with nationally and internationally accepted accounting and auditing standards.

*Second, the company would be converted into a mixed capital corporation (MCC) made up of the state's shares and those of workers who accepted a state invitation to purchase shares at book value.

*Third, the mixed capital corporation would issue new shares which would then be offered to potential strategic partners through a system of international public bidding.

*Fourth, after a pre-selection process, the bidder with the best financial offer would be awarded the share issue worth 50 percent of the capitalized company.

*Fifth, the successful bidder, after paying the cash amount of its bid, would receive the share certificates.

*Sixth, the shares owned by the State would be transferred to the fiduciary under trusteeship of Cititrust Limited until the pension fund administrators began operating. The pension funds would then be responsible for managing the shares and distributing the benefits.

*The final transfer of the state's shares to the fiduciary would complete the capitalization process and the capitalized partnership would be transformed into a corporation managed by the strategic partner.

Regulatory Reform

In addition to the basic capitalization law, the administration drafted laws governing the capitalization of each of the six designated sectors, as well as laws creating two new regulatory agencies. One agency, SIRESE, was established to regulate and ensure compliance with the general and sectoral laws governing capitalized companies, and a second, SIREFE, was established to regulate the new financial structure created by the capitalization process. Although the agencies were endowed with the power to create regulation and investigate compliance, they would not have enforcement power. All disputes that could not be settled through negotiations with SIRESE or SIREFE would require a court order to be enforced. This distinction has severely impaired the agencies' abilities to carry out their mandates. Nonetheless, the creation of the regulatory agencies signaled a fundamental redefinition of roles within the government. Regulatory power had previously been held in the legislative and executive branches, where political pressures incompatible with regulatory needs frequently hampered effective regulation. The new system, despite its flaws, represented a marked improvement in designing fairer regulation.

Pension Reform and the BONOSOL

A pension reform law allowed for the creation of a new pension system based on individual savings accounts to be managed by two separate funds, the administrators of which were to be selected through a competitive bidding process based on the lowest overhead cost. Fund administrators would sit on the boards of the capitalized firms representing the interests of their beneficiaries — both as consumers and as share holders. A distribution of the benefits from the shares would be deposited into the individual accounts of every Bolivian citizen over the age of 21 as of December 31, 1995 by means of a "Solidarity Bonus," or BONOSOL. The BONOSOL, worth approximately $250, would be distributed on an annual basis to Bolivians over the age of 65 as part of their pension. All citizens would also be encouraged to make individual contributions to their accounts.

The BONOSOL quickly became the most hotly debated aspect of capitalization. Goni's supporters pointed out that the BONOSOL enabled all Bolivian citizens to benefit directly from the capitalization of the state-owned enterprises. The pairing of the BONOSOL with a reformed pension system that included members of both the formal and informal economies furthered Sánchez de Lozada's larger goals of expanding political and social access to a greater number of Bolivian citizens. Moreover, the supporters pointed out that the BONOSOL would also provide the older generation, typically no longer participating in revenue generating activities, a way to contribute to their families' incomes. Critics countered that the money was much more desperately needed to fund social sector projects in infrastructure, health, and education. In fact, well after the implementation of the capitalization program, a debate waged about whether or not the money held within the pension funds should be used for social investment. In a final effort to gain popular support for the BONOSOL and the MNR, Sánchez de Lozada made the first distribution of shares two months before the 1997 election.

Promotion of the Program

In the meantime, a team responsible for the domestic and international promotion of the capitalization program was assembled. According to one team member, the objective on the national front, was "the removal of internal barriers to the capitalization process." Specifically, that meant helping workers in the companies slated for capitalization to understand the process, negotiating with opposition parties, civic groups and labor organizations, and assessing and attempting to address the needs of the users and the public in general. This was no small job, and the team was ill-equipped to handle massive strikes and strong labor opposition, especially in the mining sector, nor was it particularly effective at crafting responses to negative public opinion. On April 18, 1995, the government declared a state of siege in response to over a month of paralyzing general wage strikes and militant action by the COB protesting the planned capitalizations. Over 400 union leaders were arrested, though were later released. The siege lasted for six months before it was lifted on October 15. On November 6, 1995, the COB initiated another strike, again protesting increasing prices, the pension reform, and the impending capitalizations of the oil industry, the railways, and the government's smelting company. Despite lengthy negotiations and a series of accords signed between the government and the labor unions, the team was never able to effectively counter the strong labor opposition on a mass scale.

In the end, however, the team was effective in communicating with workers in the companies to be capitalized. The promotion team developed a variety of materials to use in direct talks and information sessions with the workers and put together a package of share offers whereby the workers could purchase shares in the capitalized firms at book value for one year before the company was fully capitalized. After capitalization, workers who had purchased shares in the first round could purchase more shares at the original price. A full 95 percent of workers were convinced to buy shares in the new companies.

On the international front, the promotion team had two main objectives: to project an image that Bolivia was serious in its intentions to establish a professional and transparent process; and to secure the support and confidence of the international lending community as a way of gaining both legitimacy and financial assistance for the program. In the pursuit of these objectives, the team was faced with two challenges: first, how to explain capitalization as distinct from traditional privatization, and second, how to make Bolivia appear a more attractive place for foreign investors.

In fact, Sánchez de Lozada had already undertaken quite a bit in terms of improving the business climate for potential investors. He had established a regulatory framework before undertaking the privatizations themselves to help increase investor confidence that the rules of the game would stay constant. He had also loosened restrictions on foreign ownership, allowing investors to invest in any sector without limitation of ownership rights. Special privileges for local entrepreneurs were eliminated, and foreign and domestic investors were provided equal treatment before the law. Sánchez de Lozada had also re-negotiated Bolivia's external debt in an effort to improve the country's risk rating and he strove to maintain good relationships with its creditors throughout the process.

In presenting capitalization as an opportunity for potential investors, the promotion team took to the road and enlisted the international press both for news coverage and advertisement. Bolivian capitalization was widely billed in the press around the world and various informational seminars and workshops were held to inform and attract investors throughout the United States and Europe. These seminars were designed not only for the government promotion of the capitalization program, but also as a means of gauging investor interest and perspectives on each sector.

The Process of Capitalization Begins

According to the original time table, all capitalizations were to have been completed by June 1995, and the stock transferred into the new pension funds by the end of the year. By that time however, the process was just beginning. The administration had been severely weakened by strong labor opposition, the Mexican peso crisis, and Goni's own tendency to get bogged down in details, delaying passage of the laws governing the process that would enable the program's launch. In May, 1995, the first company slated for capitalization, ENDE, was split and its components put up for bidding.

ENDE

Always cognizant of the importance of managing the perceptions of potential investors, Sánchez de Lozada was careful in defining the sequence in which the publicly-owned enterprises would be offered up for capitalization. He had originally designated ENTEL, the communications monopoly, to be the first of the six companies to be capitalized. However, difficulty with the local telephone cooperatives and the strong opposition of unions convinced the administration to move forward instead with ENDE, the state-owned electricity company that controlled two thirds of the generation, distribution, and transmission of power in Bolivia. The primary goals in the capitalization of the electricity sector were: to remove the Bolivian government from electricity production and commercial activities; to attract private investment for the expansion of the generation capacity of the sector; and to create conditions for the efficient and competitive development of firms within the sector.

The administration knew that as the first example of capitalization, the process for ENDE had to be flawless and the result financially viable. Goni not only had to ensure that investors saw a successful process, but the public who had voted for the MNR and the *Plan de Todos*, but had yet to witness any benefit of capitalization, also had to be convinced. In preparing the new sectoral law for electricity, analysts and consultants looked to past experiences in other Latin American countries. According to the General Superintendent of SIRESE, Claude Bessé, the question was always the same, "what did they do wrong?" They saw that in Chile and Argentina, the publicly held electricity monopolies had been converted through privatization to little more than privately held electricity monopolies. To avoid this, they split up ENDE into three separate generation companies and one company for transmission. The capitalization began with the three power generators.

Like all of the capitalizations that followed it, the process of the capitalization of ENDE proceeded according to the guidelines set out in the capitalization law. First, potential investors were invited to a presentation in Bolivia during which they could present their credentials for pre-selection. The invitation was published in the international press, and the event was broadcast live on Bolivian television and radio. After one week, a commission made up of investment bankers, strategic and legal analysts, the Minister of Capitalization, and the Secretary of Capitalization for Energy announced which candidates had pre-qualified, and closed the list of bidders. Thirty one potential investors had pre-qualified. Over the next several months, potential investors were given access to all available information—technical, labor related, and legal—about the companies. Only seven of the original thirty one submitted bids. Live cameras covered the opening of the sealed bids and the announcement of the winner after the bids had been thoroughly evaluated by the cabinet and the president. The largest bid for the thermal electric generator, Guaracachi de Santa Cruz, was from Energy Initiatives who committed to invest $47.13 million; Corani, a hydroelectric plant near Cochabamba, was awarded to Dominion Resources for $58.8 million in new investment; and Valle Hermoso, another thermal plant, received a high bid of $33.9 million from Constellation Energy. All bids were well over the declared book value of the companies and the process was declared a success.

ENTEL

Bolivia's long distance telecommunications monopoly was the next company put up on the block for capitalization. The principal objectives of the capitalization of ENTEL were: to double the national telephone density rate, in both urban and rural areas; to modernize and expand the telephone network and available services to meet market demand; and to establish better quality infrastructure for further opening of the Bolivian telecommunications market.

Before capitalization, the Bolivian telecommunications sector was characterized by some of the poorest performance indicators in the world. With only three telephone lines per 100 people, a 43 percent level of digitalization of lines, 0.2 pay phones per 1,000 Bolivians, and 0.52 cellular telephones for every 1,000 people in 1994, Bolivia was at or near the bottom of all these categories when compared to other Latin American countries. The basic access network in urban areas was operated by 19 regional cooperatives and private telephone companies, while the national transmission network was controlled by ENTEL, which operated both domestic and international long distance services as a monopoly, in addition to owning the access network in most rural areas of the country. Phone services were heavily concentrated in urban areas. There were numerous problems in the sector: low productivity at both ENTEL and the cooperatives; poor quality of service; and high levels of corruption within the cooperatives.

Although the administration had initially wanted to package local service and long distance service together, the regional cooperatives, despite intense and lengthy negotiations, remained unwilling to relinquish control. Nonetheless, the offer from the Italian company, STET, of

$610 million for ENTEL, was much higher than Bolivia had expected to receive (the declared book value of ENTEL was only $130 million), although not unusual compared with other bids for telecommunications companies in the region. STET was anxious to establish a presence in the southern cone and offered a massive expansion of ENTEL's services promising more lines, lower rates, and affordable cellular service.

LAB

The capitalizations of the next two state owned enterprises, Lloyd Aéreo Boliviano (LAB) and the two western rail lines controlled by ENFE, did not follow the successful pattern of their predecessors. The major objectives of the capitalization of LAB were: to expand routes and modernize the fleet; to improve services and prepare LAB for competition in the long term; to find a strategic partner who would create economies of scale for LAB's operations; and to eliminate political and union interference in the administration of the airline. In addition to capital outlay, the government considered contributions by a strategic partner in terms of hangars, airplanes and equipment to be acceptable and valuable. LAB had been seriously considered for privatization by prior administrations and several major airlines had even approached the government with inquiries about the potential sale of LAB. By the time it was offered as part of the capitalization program, however, interest had waned, due in large part to the large number of domestic flights that had been taken over by Aero Sur, an airline based in Santa Cruz. Bolivia received only one bid for the LAB, from the Brazilian airline, VASP. A year after control of LAB had been transferred into private hands, punctuality of flights had improved, but the service on board had deteriorated significantly in large part due to worker resentment of capitalization.

ENFE

The capitalization of the two western railway lines run by ENFE was even more problematic. The principal objectives of the capitalization of the Bolivian railroad were: to maximize private investment; to reduce the government's participation in the railroad sector; to promote and develop railroad transport; and to eliminate political interference in the railroad's operations. Rife with corruption and burdened with over US $70 million in debt, its revenue hampered by large subsidies granted to agricultural exporters, ENFE was widely known to be one of the most inefficient and worst-run enterprises in the Bolivian government. For the purposes of capitalization, ENFE was separated into two companies—ENFE Andina which served the altiplano in western Bolivia, and ENFE Oriental in the lowlands in eastern Bolivia. The capitalization of both portions of ENFE attracted only one bidder, a Chilean railroad operator, Cruz Blanca, who offered to invest US $25.8 million in return for the eastern company, and only US $13 million, half of the company's book value, for ENFE Andina.

After a special meeting of the cabinet, and much deliberation, Sánchez de Lozada decided to accept both offers from Cruz Blanca, in spite of the low offer. The public outrage was immediate and surprisingly vehement, evoking much nationalism and resentment toward Chile and the sale of Bolivian patrimony "to the enemy." Cruz Blanca signed a 40 year concession agreement for the operation of the railroad.

YPFB

The problematic capitalizations of LAB and ENFE fueled the fire of the opponents fighting against the capitalization of the company holding Bolivia's most highly valued national resources—oil and gas. The proposed capitalization of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) was by far the most contentious of all of the capitalizations thus far. Goni's prediction at the beginning of his administration that the capitalization of YPFB would be the "mother of all battles" was confirmed. Pride over YPFB was deeply rooted in Bolivian history, dating back to the nationalization of the company from the "gringo" owned firm, Standard Oil, and a war with Paraguay in which 55,000 Bolivians died to protect the land and oil fields that they considered part of their national patrimony.

YPFB unions were among the strongest in the country and were vociferously, and sometimes violently, opposed to the capitalization program. Massive strikes and demonstrations took place throughout Bolivia in the months leading up to the sale, and discussion of the capitalization dominated Bolivian news. Social unrest escalated to new levels—street protests, general strikes, explosions, and outbreaks of rioting and looting became common. Chilean firms were targeted, especially the offices of ENFE's new strategic partner, Cruz Blanca. In March, 1996, the army was called in to guard the oil fields in response to an indefinite strike called by the Bolivian Workers Confederation. The army itself was unhappy about the capitalization process, however, in particular the sale of ENFE to the Chilean firm, and a group of retired army generals and admirals issued a communiqué several weeks later vowing to defend Bolivia's geopolitical interests. Polls showed that up to eighty percent of Bolivians opposed the sale and opposition in the legislature almost jeopardized the entire capitalization.

The administration pushed forward nonetheless. The objectives of the capitalization of the Bolivian oil and gas industry were: to attract investment capital; to significantly develop production capacity; to attract modern technology; to increase competition in the industry; to create greater value for Bolivian oil resources; to implement adequate environmental risk management practices; and to successfully conclude the Natural Gas Project with Brazil. Before capitalization, YPFB had operated the hydrocarbon industry as a monopoly within Bolivia, controlling exploration, production, transport, processing, and distribution. In the mid-1980's, after the collapse of tin prices threatened Bolivian reliance upon the mining industry, the oil industry began to figure more prominently. By the early 1990's, YPFB was the most important industry in the country and a significant source of the government's fiscal revenue—YPFB's operations accounted for thirty-five percent of Bolivia's state revenue in 1994. Yet as YPFB's sale commitments increased, investments fell—the company had to borrow US$104 million in 1994 to meet expenses. YPFB needed greater capital infusions, but the Bolivian government was unable to finance investments. This situation was compounded by an agreement reached with Brazil to initially supply Sâo Paulo with 8 million cubic meters of natural gas per day, worth about US$100 million annually, about ten percent of Bolivia's total exports in 1995. With Brazilian plans in the works for the construction of gas-fired power plants, that demand could potentially reach 30 million cubic meters a day, and provide an even greater boost to the Bolivian economy. Such an agreement required the construction of a US$2 billion gas pipeline between Bolivia and Brazil. Suggestion of transferring the benefits of the pipeline into foreign hands was adamantly opposed, but Sánchez de Lozada knew that the company would be unable to finance the project without investment from a strategic partner.

Like the case of ENDE, to ensure that the entire YPFB monopoly was not transferred into private hands, the company was dismantled into four separate parts. The state retained ownership of the extraction branch of the industry, which had the strongest labor union. The remaining three parts—two exploration companies and one transportation company—were capitalized. The capitalization of three upstream components of YPFB took place in December 1996 and brought in a total of US $835 million. A consortium made up of the US-based Enron Corporation and the Anglo-Dutch conglomerate Royal Dutch/Shell won the transport concession for US $264 million including an agreement to invest in the completion of the pipeline. An Argentine consortium won one exploration and production concession for US $265 million, while the other exploration and production concession was capitalized by US-based Amoco Corporation for US $307 million. Although the process was completed, the public had never been mollified, and angry protesters filled the streets of La Paz on the day that the capitalization of YPFB was finalized.

Vinto (EMV)

The final state-owned enterprise slated for capitalization, Empresa Metalúrgica Vinto, a smelting company for tin, never made it to the first stage in the process. The original goals for Vinto's capitalization were: to develop an internationally competitive mining industry with modern technology and administrative efficiency; and to increase the productivity of mineral and metal production in Bolivia. Striking workers protesting lay-offs and deeply opposed to the company's capitalization had paralyzed the firm's operations. After the fight over YPFB, the government had run out of steam. Furthermore, it seemed unlikely that foreign investors would come forward with an offer to take over such a hostile and malfunctioning company. With the elections looming in the not too distant future, Sánchez de Lozada decided not to pursue capitalization in the case of Vinto.

The Final Results

Overall, the capitalizations brought almost $1.7 billion in direct investments into the country, more than twice the amount of direct foreign investment Bolivian had attracted in the previous fifteen years. The growth rate of the economy doubled to between four and five percent in the years 1995 through 1997, and observers were certain that it would continue upward as the full effects of the investments in the capitalized firms begin to be felt.

The MNR did not fare as well. In the 1997 elections, Sánchez de Lozada's party lost in a landslide and his popularity rating was one of the lowest ever seen in the country's history. Goni had won the presidency on a platform of reform and had fulfilled his campaign promises, almost fully implementing one of the broadest and radical reform packages in Latin America, if not the world. The irony registered with Goni, and he once quipped "how funny it is that it was just as I was completing my final reforms that my opinion polls reached zero."