Privatization Processes From The Viewpoint of Competition Policy: The Venezuelan Experience 1993 - 1997*

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The purpose of this study is to show the Venezuelan experience in relation to the introduction of competition policy in privatization processes.

In Venezuela, the legal tool that regulates economic freedom is the Law to Promote and Protect the Exercise of Free Competition and within that legal text there are no express guidelines in relation to privatization processes.

However, privatization processes in general, imply changes in market structure, and as a consequence have effects on their functioning. From the view point of competition policies or the provisions that in general terms contain the modern competition legislations, situations that imply changes in market structure must be included in the agendas of the offices for the defense of competition. Within this group of operations that may imply modifications in the market structures are mergers and acquisitions, the creation of holdings of companies, the revision of privatization or commercialization of state-owned corporations and actions begun by antimonopoly agencies to break up monopolies.[1]

This interpretation is important because there are two levels of analysis present when evaluating privatization processes from the perspective of a competition agency. In relation to the enforcement of competition laws, these structural changes are sufficient elements for privatizations to be comprised in the realm of application of those normative frames. On the other hand, a widely debated subject is whether the impact that these processes may have from their design to their implementation from the economic efficiency point of view and the markets affected by them, fall within the field of competition policy.

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* Work prepared for the Seminar about Competition Policies and Economic Reform organized by OECD/CADE/IBRAC to be held in Rio de Janeiro, Brasil. July 10 to 13, 1997

** The opinions expresses this work are the responsibility of the Auhtor and donot necessarily commit the Superintendence for the Promotion and Protection of Free Competiton.

1 See Conrath, Craig. *Practical Handbook of Antimonopoly Law Enforcement for an Economy in Transition*. Washington DC 1995. In this work the author poses the scope of action of the antimonopoly agencies in relation to changes in the market structure. Likewise he emphasizes the need to take each of these types in a separate form.

This last element implies a broader scope of action than the one that would circumscribe the action of competition agencies to the evaluation of structural changes or the determination of possible restrictions to competition. Khemani and Dutz (1994) point out that an adequate competition policy incorporates, on the one hand, government policies that could be applied to improve competition in national and local markets (liberalization of international trade, foreign investment and economic deregulation) and on the other, a competition legislation that foresees the anticompetitive practices of the companies and the unnecessary market intervention of the government.[2]

Thus, the distinction between specific processes of privatization, that would be comprised within the acts of enforcement and privatization policy in a global form that must be considered through the focus of competition advocacy, could be established. This term has been defined by Khemani (1996)[3] as the skill of the competition office to provide advisory services, influence and participate in decision-making to promote a competitive structure of the industry, behavior of the company and the functioning of the market.

In this sense, competent policy has a transversal character because it models all branches of economic activity and at the same time acquires a direct relation with any type of intervention form the Government that could affect the dimensions that have been pointed out in the previous paragraph in relation to structure, behavior and market functioning.[4]

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[2] Khemani, R.S. and Dutz, M. "The instruments of Competition Policy and their relevance for Economic Development", in *Regulatory Policies and Reform in Industrializing Countries.* Claudio R. Fristak, Ed., The World Bank, 1995.

[3] Khemani, Shyam *The Role and Importance of Competition Advocacy in Promoting Competition*. Work prepared for the Conference "Emerging Market Economy Forum on Competition Policy and Enforcement" organized by OECD/World Bank/Government of Argentina, held in Buenos Aires, October 1996.

[4] Some authors like Rodriguez, A.E. and Williams, M (*Economic Liberalization snd Antitrust in Mexico*. Magazine Analisis economico, 1995) have identified competition advocacy or antitrust advocacy mainly in relation with the removal of obstacles to competition introduced by regulations imposed by the Government. This area is an obligatory item in the agenda of competition agencies and has been emphasized at the start of the competition regimes in countries with recent opening processes. (See Jatar, A.J. *Implementing Competition Policy in Recently Liberalized Economies: The Case of Venezuela*. Superintendence for the Promotion and Protection of free competition. Caracas, 1993. In order to apply a system and support the work of competition agencies for the identification and removal of entry barriers or market functioning, intensive work has been performed for the identification of intervention forms and friction associated with them in the work by Curiel, C., Genel, T.Y. Ferrin, J. *Barriers to entry derived from the different forms of Government intervention.*

As Tineo said (1996)[5], competition laws are a new world for countries in transition and their understanding is in the hands of agencies in charge of applying them. This appreciation is true in relation to the knowledge that private and public sectors have about the objectives and scope of competition laws. But it is even more tangible in relation to the handling of efficiency and competition objectives by policy makers. Thus, the idea that institutional development is a necessary but not sufficient element to promote long-term competition objectives.[6] In this sense, fostering and recognizing the need of an antimonopoly policy in society, advocacy for competition is achieved and from those, the necessary institutions may be developed in order to consolidate an open economy.[7]

The elements used in the previous paragraph are worth pointing out. First, long-term consolidation of competition objectives. Second, the understanding of competition policy objectives within the context of achieving a greater contestability in the markets. Regarding this matter, the promotion of contestability goes beyond the removal of entry barries and implies, basically, the establishment of sustainable industrial configurations.[8] This expression, which refers to the promotion of contestability, is used as a synonym of entry barriers reduction. In consequence, it has important implications in the interrelation between competition policies and industrial policies.

Work presented before the Latin American Institute of Social Research. Caracas, May, 1996.

[5] Tineo, Luis. *Policies and Law about Competition in Latin America: From Distributive Regulations to Efficient Regulations.* Work prepared for the Conference "Emerging Market Economy Forum in Competition Policy and Enforcement" organized by OECD/World Bank/Argentine Government held in Buenos Aires, October 1996.

[6] It is possible to go deeper into this interpretation with the work of Douglas North Struturing Institutions for Economic Development. Conference given in the Investment Fund of Venezuela. Caracas, August 3, 1995.

[7] Curiel, L.C. *Elements for the qpplication of competition policies in transition economies*. *The experience of Venezuela*. Work presented in the First Meeting of Competition Policies for Latin America and the Caribbean, held in Caracas, in October 1995. Published in *Revista Venezolana de Analisis de Coyuntura.* Volume II, N° 1. January -June 1996. Caracas.

[8] Tavares de Araujo, J. *Contestability and Economic Integration in the Western Hemisphere*. OAS Trade Unit, November, 1995. The concept of sustainable market structures was introduced by Baumol Panzar and Willig in their *work Contestable Markets and the Theory of Industry Structure*. Harcourt Brace Jovanovich, Inc. 1982. A sustainable market structure is the best to produce the basket of assets considering the available technologies and scale dimensions.

We have to stop here to examine this relation, since many times the effects of privatization on market structures can be incorporated to the elements related to the formulation of industrial policies. Although privatizations involve, at least in theory, very precise objectives to leave to the private sector the provision of private goods, the implications of the manner in which these processes have been implemented in industrialized as well as developing countries, makes it necessary to study them under the point of view of the effects in market structure and is why we establish the connection of how to tackle the discussion between industrial policy and competition policy.

From the viewpoint of industrial policy, to search for sustainable configurations or efficient industrial systems, has very important effects on well being. If the industrial configuration is sustainable, the government and society at large do not have to spend any resources to assure the protection of that industry. It has a natural protection in itself. The rest of the world cannot come in simply because they are the most efficient and produce the best products given the existing restrictions.[9]

These objectives, although intrinsic to the design of privatization processes, are not expressly undertaken by the legal framework accompanying these processes nor attended by privatizing organisms, if the idea is to guarantee economic efficiency. Thus the objective shared by industrial and competition policies in relation to market structure must be completed with transparency objectives and consumer welfare which are directly included within the scope of interpretation of competition policies.

In this way, the concepts mentioned have important implications to understanding the role that competition agencies must fulfill in privatization processes. It is not only to watch that no structural changes are produced in the market that could favor monopolist functioning but to avoid within the privatization process those elements that could hinder the transparency or the efficiency in this reassignment of properties.

Another aspect that we must consider in relation to general guidelines that support, at least in theory, the actions of the antimonopoly offices in these processes, reverts to deregulation processes.[10] Even though

[9] This reflection is taken from the presentation of José Tavares de Araujo about *The relation between Competition Policies and Industrial Policies in the Second Meeting of Competition Policies* for Latin .America and the Caribbean, held in Caracas, November 1996.

[10] This interrelation is presented with more detail in the work by Guasch, J. L. and Spiller, P. *Unraveling the Regulatory Comindrum: Concepts, Issues and the Latin Amenrican History*. Library of Congress Cataloging-in-Publication - Data. September 1994.

necessary reforms of the regulatory framework are undertaken by different government instances, the association between deregulation and competition invites competition agencies to enter the field of debate. However, here again we have the problem of legitimization that may displace the criteria arising from those agencies. This trend may grow stronger if there are sectarian regulating agencies, because the technicalities developed by them not always take into account the structure of markets nor the objectives of promoting contestability and competition.

Another area of general reflection and not less important, if we are to consider the strong fiscal incentives implied to complete the transfer of certain activities from the public sector to the private, is the encouragement of investments flow. Competition laws have arisen in most Latin-American countries as support tools for the opening processes and liberalization of the economy. A crucial point related to the impact of the adoption of these control schemes to regulate the actions of economic agents are the control systems of the structuring forms that companies may present according to those norms, in relation to the fact that the legal defense systems of competition contain prohibitions in matters of economic concentration and vertical arrangements that the companies may adopt.

In this way the scope of the contracts that could be signed within the framework of an economy subject to competition rules, is being regulated and has important implications in the way of doing business. However, the adoption of regulatory schemes does not constitute any guarantee about the degree of economic freedom that does exist. In fact, the interrelation of the Government with economic agents and the permanence of rentseeking behaviors generate innovations in the way of obtaining favors from the regulations, but do not end with juridical insecurity or other regulatory problems that private agents must face.

Trying to observe beyond the relation between competition policy and some foreseeable behaviors of companies there are some areas of enforcement of competition laws that may affect investments. This is the case of economic concentration regulations, joint ventures, cooperation agreements, vertical restrictions, accessory clauses to the sale contracts of companies, trademarks, goodwill and other types of assets. However, when speaking about privatizations, all these elements must be evaluated jointly and the differentiation of objectives corresponding to competition policies is not very clear.

Once we have a general idea of the interpretation of the role of competition agencies we can present the Venezuelan experience in the application of those concepts. For this we have organized the presentation in the following way: First, an explanatory section of the different areas

undertaken by the Superintendence for the Promotion and Protection of free Competition. Second, the legal framework related to privatizations policy. Third, a short summary of all processes where the Superintendence has participated. Fourth, a detailed explanation of the privatization of companies that constitute the Aluminum Production Complex, property of the Venezuelan Corporation of Guyana (CVG). Fifth, a series of conclusions and recommendations for public policy from the viewpoint of competition advocacy.

Evaluation of privatization processes from the viewpoint of competition legislation

Actions of the Superintendence for the Promotion and Protection of Free Competition in relation to the privatization processes consider two fundamental areas: the sale of corporations and the privatization of sectors of public utility.

The sale of corporations

This has been the most commonly used modality by the National Government in the privatization program. Within these sale processes, we can distinguish three areas of activity corresponding to very well-differentiated phases in the privatization process. Although these are different phases, this difference is established by reasons of context: previous evaluation of the scheme to group corporations in the case of privatization of holdings property of the Government; the study of possible restrictive effects generated in the sale processes, as a function of the applicants in each process; and the revision of buying and selling contracts and other commitments undertaken as a consequence of the sale of the corporations.

There is another segment worth considering: corporations property of the Government are sold according to the norms and guidelines of privatization policy. However, after the crisis of the Venezuelan financial sector from 1994, an important number of these corporations became property of the Deposits Guarantee Fund (FOGADE). This organization has put several corporations up for sale and the processes, although regulated by different legal structures from the ones that regulate the actions of the privatizing entity (Venezuelan Investment Fund) have been treated by this Superintendence under the same criteria as the first ones mentioned.

The process of auctioning corporations

The first stage is the valuation of potential buyers that participate in the bidding process, in order to determine if the economic concentration derived from the sale of public corporations could generate or strengthen dominant positions or could generate restrictive effects on free competition.

Once the sale has been approved by the Congress of the Republic, the next step is to proceed to the adjudication through bids or public offers.[11]

The Superintendence has been requested to evaluate the possible effects on the market in terms of competition that could arise from the acquisition of pre-qualified corporations. The effects on competition are evaluated in terms of the relevant markets in which the company to be sold participates, and where the potential buyer is a competitor or potential competitor at present, also taking into account the market structure and nature and magnitude of the entry barriers.

Since the eventual purchase of a corporation by another one performing the same activity constitutes an economic concentration[12] the reports for the analysis of effects on free competition produced by an operation of this type[13] follow the methodology established by this Superintendence. At this point it is necessary to define the interpretation of the Superintendence to determine the effects of the sale of state-owned corporations in the case of horizontal, vertical or conglomerate operations, in relation to potential competition and according to the objectives of promoting the contestability of markets and the constitution of sustainable market structures.

The methodology used comprises the determination of relevant markets, the study of entry barriers, market structure and degree of concentration and finally evaluation of the efficiency arguments should it be

[11] The last one has been the mechanism used until now in most privatization processes. In this sense, transparency is one of the elements considered within the Guidelines For the Execution of the Privatization contained in the *General guidelines of the privatization policy*, prepared by the Venezuelan Investment Fund in August, 1990. In this sense the text of this document:

> "The information about all aspects of the process must be available to the interested and the general public. Likewise, the bidding and public offer of shares as sales mechanism shall have priority".

[12] In Venezuela, the regime for the evaluation of economic concentration operations is regulated by Ordinance N°2 of the Law to Promote and Protect the Exercise of Free Competition, published in Official Gazette N° 35,963 dated May 21, 1996.

[13] See Superintendence for the Promotion and Protection of Free Competition. *General Evaluating Guidelines for Economic Concentration Operations.* Caracas, May, 1994. A detailed analysis of the elements of the methodology and procedures that constitute the control regime of concentrations in Venezuela can be found in Curiel L., *The experience in the application of the merger regime in Venezuela, 1993-1996*. Work prepared for the Conference: "Emerging market economy Forum on Competition Policy and Enforcement" organized by OECD / World Bank / the Argentine Government, held in Buenos Aires, October, 1996.

necessary to weigh the restrictive effects over competition against the benefits generated by the operation.

Analysis of integration schemes

In cases in which a group of companies is for sale, such as holdings of basic corporations such as the steel and aluminum complexes, the Superintendence has participated in the phase prior to the sale.

In these cases, the companies to be sold were already under the concept of "persons related among themselves" according to the definitions of article 15 of the Law to Promote and Protect the Exercise of Free Competition.[14] However, the organisms in charge of completing the privatization process must decide, before the announcement of mechanisms and conditions of sale, the integration scheme under which the corporations shall be sold, whether as a block or separately.

In these two cases, steel and aluminum, the corporations of the holding were integrated vertically. The scheme basically implied the adoption of structures that could correspond to vertical concentration operations. In this way the Superintendence determines the relevant markets involved in the concentration operations and then evaluates possible anticompetitive effects the different integrations may produce.

It is important to point out that in the integration schemes analysis, the idea is to formulate recommendations in order to guarantee that the sale of vertically integrated structures does not imply the formation of dominant positions transferred to the private sector and also avoid the creation of entry barriers affecting the potential competition or compromising the formation of efficient structures.

In relation to the analysis of the integration of corporations within the same holding and participating in the same relevant markets, other

[14] Article 15 of the Law establishes:

"The following shall be considered "Persons related among themselves":

1° Persons that have participation of fifty percent (50%) or more of the capital of the other or exercise control over it in any other way;

2° Persons whose capital is owned in fifty percent (50%) or more by the persons indicated in the previous paragraph or are subject to control by them; and

3° Persons that in some way are under the control of the persons previously indicated.

Sole Paragraph: It is understood as control the possibility that a person has to exercise a decisive influence over the activities of some of the subjects under this Law, whether through the exercise of property rights or the use of all or part of the assets or through the exercise of rights or contracts that allow the influence over the composition of deliberations or decisions or activities."

elements must be considered such as scale economies and the effects on related markets, by applying the methodology used for horizontal concentrations. On the other hand, the legislation does not consider that this type of concentration must be evaluated under the viewpoint of concentrations control, therefore we emphasize that the office formulates merely preventive recommendations.

Next, we present some theoretical aspects considered in the evaluation of efficiencies and the possible anticompetitive effects that could arise from a vertical integration[15].

One of the main reasons companies try to integrate into a single economic unit the different phases of production and/or commercialization, is the search for efficiency.

This can be manifested in many forms, such as an improvement in the flow of information, improvement in negotiations for the purchase and sale of raw material or final products, savings in distribution costs, improvements in the handling of inventories, scope of scale economies in management and the elimination of distortions coming from failure in the markets.

Another factor that could foster vertical mergers comes from the creation or reinforcement of the "power of the horizontal market". For this reason, competition offices closely monitor vertical mergers. In this context we are referring not only to economic concentration operations in their true sense but also to the effects on the market derived from different forms of integration.

Although there is an intense discussion at theoretical levels on the anticompetitive effects associated with vertical mergers, from this point on, the restrictive consequences of such operations are considered a genuine possibility. Therefore, the criteria adopted is to offset these consequences in terms of the net benefits obtained from the efficient distribution of the resources in the economy. In evaluating the impacts of vertical integration, we can distinguish two big blocks of effects: damage to competitors and damage to competition. In fact, the consequences integrations may have over

[15] To complement some of these elements, the following sources could be consulted: Fisher, A.A. and R. Sciacca. *An Economic Analysis of Vertical Merger Enforcement Policy*; Lande, R. Efficiency Analysis in Merger Anlysis (look for complete reference); Conrath,C. *Pratical Handbook of Antimonopoly Law Enforcement for an Economy in Transition*. Washington D.C. 1995.
This summary has been extracted from: Superintendence for the Promotion and Protection of Free Competition: Special report about the integration scheme to be adopted in the sale of the aluminum production complex of the Venezuelan Corporation of Guyana. Caracas, February 21, 1996.

competitors are analysed in terms of the decrease of competition versus efficiency criteria which may compensate for this decrease.

In these cases, effects on the market from a vertical integration may manifest themselves in three ways: 1) the increment of monopoly power of the corporation on the input and product market; 2) increase of entry barriers and 3) a greater possibility of oligopoly coordination.

In those cases where situations that can compromise the dynamics of competition in the markets have been detected, an analysis of efficiencies gained should be made. They must be considered in terms of improvement in production, distribution, innovation or commercialization which could occur if the concentration operation or the integration process was verified. In any case it is an extreme criteria in which the debate is over which could be the most damaging effect on society: to allow the concentration operation knowing it is anticompetitive or foster the creation of a series of efficiencies or benefits that otherwise would not happen[16]. The idea is the protection of competition and the mechanism of assignment of resources and not the protection of competitors.

Study of sale contracts

The experience of the Superintendence has been that part of the privatization process refers to the discussion and approval by Congress of the buying and selling contracts of corporations and, in some cases, the supply contracts with corporations that would lose the status of related persons once the sale process is perfected.

Commitment clauses that could be introduced in the contracts could affect the dynamics of competition and even modify market structures by erecting barries to potential competors. The most evident of these considerations is the demand made to the Government by industries downstream of the holding on sale. In many cases, these industrial sectors have enjoyed preferential treatment in prices, guaranteed supplies or provisions. There are actions by pressure groups that try to maintain these benefits through the establishment of provisions assuring protected prices or commitment for supplies.

However, when the relevant markets are international in geographical terms, one of the elements that determines the lack of risks to competition in the sale of block of corporations is, precisely, the possibility of competition with foreign buyers or suppliers. Thus, the establishment of formulas as the ones previously stated would imply that the relevant market

[16] This extreme treatment is interpreted as recorded in Resolution SPPLC/0036-94 dated August 10, 1994, where the analysis criteria of economic concentration operations under the argument of imminent bankruptcy are developed.

where the corporations would operate after the sale, would be more restricted than the market originally defined. So, the analysis of more restricted markets would imply that integration schemes could restrict competition.

It is exactly because of these implications that the Superintendence participates in the evaluation of contracts. Another variable that should be considered is that in the case of basic industries there are supply contracts for certain key raw materials such as the case of electricity and gas. In these cases it is necessary to monitor that the commitments [*assumidos sean realistas a la dinámica de las empresas en venta, de forma que no se levantes barrieras a la entrada de nuevos*].

An element strongly linked to privatization processes in public utility sectors is the revision of regulations of the sector. It is of great importance to obtain the participation of competition agencies since, it is not only a matter of observing the regulatory schemes, but evaluating that entry barriers are not generated or the degree of contestability of the markets is not compromised. Thus the importance of introducing the idea that regulatory schemes must apply studies and models about the structure and dynamic of the markets in order to achieve a design of market structure as close as possible to the characteristics that would make them sustainable.[17]

Another element the Superintendence considers must be monitored in the design of regulatory schemes, specially in sectors where the dynamics of technological change makes the adoption of flexible and modern schemes obligatory because technological development will be faster than the process of industrial development implicit in those regulations. This difference in development speed of those two areas requires a very specific analysis regarding the scope of this work, however it is important to be aware of problems involved in the achievement of competition objectives in sectors subject to regulation.

This approach is fundamental since the intervention of the competition offices in the deregulation processes tries to assure long-term objectives. We cannot think the approach is merely technical or that market structures shall achieve efficiency in the long term without taking into account institutional elements, since the phase difference in institutional development could imply, at a certain time, the adoption of schemes and reforms to avoid

[17] In 1996, the technical team of the Superintendence prepared some reports about the regulatory frame under discussion for the electrical sector. At present, the discussions about the Draft of the Law for the Electrical Sector and the reform to the Telecommunications Law and in both cases the work of the office Telecommunications*: A comparative Analysis of Five Country Studies*. Annual Conference on Development Economies. The World Bank, Washington D.C., May 1993.

the implicit risk of lack of action and response capacity by regulating organizations.

Privatizations in relation to investment and concentrations control

An important consideration in order to discuss the influence of competition legislation on investment flow, is the structural form corporations may adopt in order to preserve the possibility of conforming structures in a position of dominance. The net present value of future income estimated by an entrepreneur is clearly related to the possibility of enjoying a comfortable position in the market. This position, technically called market position may be reinforced through the acquisition of brands, specific assets and even competing corporations.

This clearly shows that in the domestic markets level or at the multinational level, market structure may, at once constitute an attraction (when acquiring a monopoly or similar, there is a flow of resources with less risk) or discouragement for investments due to entry barriers as understood within industrial economy developments in advantages of cost, scale economies and scope, the difficulty to have access to the consumer and juridical security. This attraction, is considered by the competition laws whether they are produced by endogenous measures of investment agents. The scheme of incentives is regulated through prohibitions on change of structure and contracting forms or integrations contrary to public interest from the point of view of competition.

But these endogenous decision-making processes can be present in the negotiations of commercial integration agreements, in privatization processes, deregulation of special sectors specially public utilities and reforms in the size of the Government that accompany the strengthening and expansion of concessions regimes.

Participation of The Superintendence in Privatization Processes

Table 1 presents all cases of evaluation in privatization processes where the Superintendence has participated. It shows the cases, dates of reports, the organization in charge of the sale of the companies and the mode of participation of the Superintendence according to the criteria previously stated.

Table 1
Operations evaluated by the Superintendence

DATE	CASE EVALUATED	ORGANIZATION IN CHARGE	MODALITY OF EVALUATION
10/22/93	Special report on the possible participation of Venezuelan airlines in the privatization process of AEROPOSTAL	FIV	Auction of companies
5/26/95	Special report on the participation of prequalified companies in the bidding process of INDULAC	FIV	Bidding
2/21/96	Special report on the integration scheme to be adopted in the sale of the aluminum-producing complex of the Venezuelan Corporation of Guyana.	FIV	Evaluation of integration schemes. Examination of contracts.
4/14/96	Special report on the participation in a public auction by FOGADE for 85% of the corporate capital of Telecommunicaciones Bantel, C.A	FOGADE	Auction process
4/23/06	Special report on the prequalification of companies in the process of auctioning operational assets of AEROPOSTAL	Tenth Civil, Mercantile and Transit Court of First Instance of the Judicial Circumscription of the Metropolitan Area[18]	Auction of assets
6/11/96	Special report on the auction process for 74 agencies of Banco Latino	FOGADE / Board of Financial Emergency	Auction of Assets
8/6/96	Special report on the participation in a public auction by FOGADE for ninety five percent (95,6%) of the corporate capital of Seguros Nuevo Mundo S.A.	FOGADE	Auction of companies
11/7/96	Special report on the participation in a public auction by FOGADE for ninety eight percent (98,8%) of the corporate capital of Seguros Banvalor C.A.	FOGADE	Auction of companies
11/13/96	Special report on the participation in a public auction by FOGADE for ninety seven percent (97,05%) of the corporate capital of Seguros Profesional C.A.	FOGADE	Auction of companies
11/29/96	Special report on the participation in a public auction by FOGADE for ONE HUNDRED percent (100%) of the corporate capital of Aluminio de Carabobo S.A. ALUCASA	FOGADE	Auction of companies

[18] In this case the participation of the Superintendence was requested to integrate the Commission for the prequalification of parties interested in the acquisition of assets belonging to AEROPOSTAL. In this case the Liquidators in the bankruptcy process of the Mercantile Corporation asked the Court, according to article 975 of the Commercial Code judicial authorization to sell operational assets of the failed corporation.

12/16/96	Special report on the participation in a public auction by FOGADE for ninety nine percent (99,92%) of the corporate capital of "Custodia y Translado de Valores C.A."	FOGADE	Auction of companies
5/26/97	Special report on the auction process of the agencies of Banco Latino	FOGADE	Auction of assets
5/97	Special report on the integration scheme to be adopted in the sale of the steel-producing complex of the Venezuelan Corporation of Guyana (in process)	FIV	Evaluation of integration schemes. Examination of contracts.

Table 2
Relevant markets evaluated in the different privatization processes

CASES	**RELEVANT MARKETS AFFECTED**
Privatization of Linea Aeropostal Venezolana, C.A. AEROPOSTAL	Air transportation services for passengers by national airlines between ports of origin and destinations located in Venezuela.
Bidding process of Industria Láctea Venezolana C.A. INDULAC	Powdered milk at national level. Condensed milk at national level. Long-lasting milk at national level. Ultra-pasteurized juices in the national territory.
Integration scheme to be adopted in the sale of the aluminum-producing complex of the Venezuelan Corporation of Guyana	Trihydrated bauxite or similar that can be processed with the same technology, extracted by existing operators within the international field. Alumina produced by existing plants in the international field. Carbon anodes produced in the country. Primary aluminum in an international.
Public Auction of the Company Telecommunicaciones Bantel C.A.	Transmission of information through private networks in Venezuela.
Auction of operational assets of Aeropostal	Passenger air transportation services rendered by national airlines in the territory of the Republic.
Public auction of the corporate capital of Seguros Nuevo Mundo S.A.	Each of the markets of products constituted by the different insurance branches where Seguros Nuevo Mundo participated in the Venezuelan market.
Public auction of the corporate capital of Seguros Banvalor C.A.	Each of the markets of products constituted by the different insurance branches where Seguros Banvalor, C.A. participated in the Venezuelan market.
Public auction of the corporate capital of Seguros Profesional C.A.	Each of the markets of products constituted by different insurance branches where Seguros Profesional, C.A. participated in the Venezuelan market.
Public Auction by FOGADE of the capital stock of the company "Custodia y Translado de Valores C.A."	Service of transportation and custody of securities in the Venezuelan market.
Public Auction of part of the capital stock of Aluminio de Carabobo, S.A. ALUCASA	All rolled aluminum products (manufactured by any of the aluminum-rolling plants) in an international context.

Case analysis: sale of the aluminum-producing complex belonging to the Venezuelan corporation of Guyana

In general terms, the juridical elements that regulate the privatization process in Venezuela are the Privatization Law, the Law of the Venezuelan Investment Fund. The analysis of the case corresponds to the sale of the companies that constitute the aluminum-producing complex property of the Venezuelan Corporation of Guyana. The analysis will be performed according to the juridical instruments regulating this process in particular, fundamentally considering the aspects related to competition policy. Thus we will address only the juridical provisions that refer to decisions about participation schemes and the sale processes themselves.[19]

Description of the process

The participation of the Superintendence in the process was requested by the Venezuelan Investment Fund (FIV) and the Office of Strategic Associations Coordination of the Venezuelan Corporation of Guyana, in order to evaluate the different integration schemes that could possibly be formed prior to the privatization process of the companies mentioned.

For all effects of this study, a scheme is presented that represent finished products of each company to be sold as well as their shareholding structure (See table 3). This last element is presented because by knowing the number of shares CVG holds we can determine whether these are persons related among themselves under the terms of article 15 of the Law to Promote and Protect the Exercise of Free Competition. It is relevant in order to identify the type of operation that the Superintendence shall evaluate considering the constitution of integration processes.

Table 3
Corporations that constitute the aluminum-producing complex

CORPORATION	PRODUCT	SHAREHOLDERS
BAUXILUM	Extraction and processing of Bauxite	CVG 91.32%; CVG Ferrominera 7.78%; Alusuisse 0.90%
ALCASA	Primary aluminum	CVG 83.9%; Reynolds International 7.3%; CVG Electrificación del Caroní 6.8%; CVG Ferrominera del Orinoco 1.8%
VENALUM	Primary aluminum	CGV 77.13%; CVG Edelca 3.59%; Japanese Consortium 18.32% and Marubeni Corporation 0.96%
CARBONARCA	Carbon anodes	CVG Venalum 45%; CVG Bauxilum 45%; CVG 10%.

[19] Hereinafter we shall present elements extracted from the Special Report about the integration scheme to be adopted in the sale of the aluminum-producing complex of the Venezuelan Corporation of Guyana.Caracas, February 21, 1996.

Juridical Framework

The juridical instruments that regulate the privatization process in Venezuela and that constitute the juridical framework of the privatization process of the aluminum sector corporations, Bauxilum, Alcasa, Venalum and Carbonarca, are the Privatization Law, the Venezuelan Investment Fund Law, the Organic Statute for the Development of Guyana, the Mines Law and the Law for the Promotion and Protection for the Exercise of Free Competition.

The Privatization Law as provided for in Article 1 as the object of "regulating the process derived from the policy of Privatization assets and services of the public sector.....". In order to begin a Privatization process, it is necessary to have a privatization policy ,which according to article 5 of the Law must be prepared by the Venezuelan Investment Fund and approved by the President of the Republic in the Council of Ministers. Once the approval of the Privatization policy by the President is published in the Official Gazette, it is necessary to obtain the authorization of the Permanent Finance Committees in the Senate and the Chamber of Representatives to execute the Privatization process.

In this way, the President gathered with the Council of Ministers approved on March 22, 1991 the document: *General Guidelines for the Process of Privatization of assets and Government-owned corporations*. Also on December 8, 1994, the President of the Republic approved the beginning of the privatization process of the companies of the CVG. Finally the Permanent Finance Committees of the Senate and Chamber of Representatives authorized execution of Privatization of the aluminum companies on March 15, 1995.

Following is an analysis of each of the laws that constitute the regulatory framework in the privatization process of the aluminum companies. We will then proceed to link them to the articles of the Law for the Promotion and Protection of the Exercise of free Competition, in order to establish how the Privatization processes are related to the objectives of said law and how the Superintendence becomes the technical organization in charge of analysis that shall determine feasibility of the processes considering the objectives that legally must pursue the Privatization policy.

Decree N° 676

Beginning the review of the juridical instruments that constitute the juridical framework of the privatization process we find Decree 676 dated June 21, 1985 proclaiming the reform of the Organic Statute for the Development of Guyana and empowers the Venezuelan Corporation of Guyana (CVG) and Government-owned corporations to begin the sale of their shares and allow the entry of private capital.

Mining Law

Within the activities performed by the companies in the aluminum sector is the extraction of bauxite, used as the main component for the manufacture of alumina. In this sense, according to the established in the Mining Law, everything related to mineral reserves located in the national territory has been declared "of public utility", which means that in order for a company to develop activities in the sector, it must have a concession granted by the Government.

Once a corporation has obtained a concession right, there is a possibility of renewal and extension. Likewise the law foresees the transfer of the concession, in the cases where the concession granted shall not perform the exploitation activities, which could happen if the assets are bought by another company that will become the concessionaire. Bauxilum presently handles the concession for the extraction of bauxite. At the time of assigning the shares to new owners, the concession for the exploitation of bauxite will also be assigned.

Privatization Law

Article 6 of the Privatization Law establishes the objectives which must be fulfilled by the privatization policy:

"Article 6: The objectives of the privatization policy are:

1. Free competition and the development of the competitive capability of the companies.
2. Democratization and broadening of the regime of property of capital-producing assets and shareholding.
3. Incentives for the constitution of new forms of entrepreneurial organizations, cooperatives, community, co-management or self-management, and
4. The modernization of the activity, service, technological transfer and supply of equipment, goods or services that have a favorable impact on the efficiency of production and administration".

All of these objectives are strongly related to the policy for the Promotion and Protection of the Free Exercise of Competition to obtain efficiency from the privatization process for the benefit of producers and consumers that, according to our criteria, could not be obtained if the national Government were to discriminate the results for the benefit of others, such as privatize to solve budgetary problems.

The Privatization Law states in its article 7 an order for the Venezuelan Investment Fund to prevent that the transfer of Government assets generate a concentration of companies or groups of companies that could incur

in monopolistic or oligopolistic behavior that could restrict, hinder, misrepresent or limit the enjoyment of economic freedom and free competition in the following way:

> "Article 7: The Venezuelan Investment Fund shall prevent the concentration of assets, shares, concessions for public services that are or have been object of privatization actions in companies, group of companies or companies with the same interests or that *may incur in monopolist or oligopolistic behaviors that perform maneuvers that could, restrict, hinder, misrepresent or limit the enjoyment of economic freedom and fee competition*. The violation of these provisions shall cause of absolute nullity of the bidding process or the placement processes in the capital market." (Italics placed by the Superintendence).

Thus the mentioned article becomes a preventive norm, because it justifies the impediment of creating structures, whether through concentrations, conglomerates, associations or any other type of integration between companies that facilitates the existence of monopolistic practices.

To strengthen the previous statement, the legislator in the same article 7 punishes with absolute nullity the bidding process or the placement in the capital market that violate the preventive norm in said article of the Law.

Thus, FIV as executive arm of the privatization policy, has been charged by the Law itself to avoid concentration of companies, assets, shares or concessions of public services that are or could be transferred by privatization to companies with the same interests or related among themselves or that without being related may perform monopolist practices.

The Superintendence considers that article 7 of the Privatization Law commits the FIV to prevent that privatization processes create structures, through concentrations, conglomerates, associations or any other type of integration among companies, that may facilitate monopolistic or oligopolistic practices with damaging effects on the markets related with these processes.

Venezuelan Investment Fund Law

The Law that regulates the functioning of the Venezuelan Investment Fund states its functions in Article 9 as follows:

The Venezuelan Investment Fund is in charge of:

1) Executing the privatization policy and for that purpose the assets, companies or activities involved shall be transferred to the Venezuelan Investment Fund through the modality most convenient for each case;

2) Executing the restructuring of companies and public entities and propose the modification of regulatory frames that govern at present the different economic activities taken over directly or indirectly by the Government, *as well as the elimination of monopolies exercised by the Government* and the granting of concessions for public services or the amendment of norms in force by the corresponding party;
3) Financing the restructuring processes of public entities; and
4) Administering the Social Investment Fund that shall be constituted with the resources assigned according to the Law to regulate the privatization operations".

Number 2 of Article 9 states that it is the faculty of the FIV to restructure corporations and public entities and in order to comply with that commitment it has the power to propose the modification of the regulatory frame that governs at present the economic activities of the Government. In this sense, the objective of the FIV is to restructure public corporations and eliminate Government monopolies.

At the time of the beginning of privatization processes, the FIV has the opportunity to comply with Article 7 of the Privatization Law and Article 9 of the FIV Law, since it has assure that the transfer of assets, services or concessions in the public sector do not affect free competition.

From all the preceding considerations, it is clear that the FIV, as executive arm of the privatization processes, has the faculties to assure the protection of free competition in the Venezuelan market and these powers can be translated in real commands that the Fund must fulfill, but it has the autonomy to chose how so.

Law to Promote and Protect the Exercise of free Competition

Article 1 of the Law reads:

> "Article 1: This law has the object of promoting and protecting the exercise of free competition and efficiency for the benefit of the producers and consumers and to prohibit monopolistic and oligopolistic practices and behaviors and other means that could prevent, restrict, misrepresent or limit the enjoyment of economic freedom."

This article consecrates the object protected by the law, "free competition", thus it can be observed that it is directly related to articles 6 and 7 of the Privatization Law, since they coincide in protection free competition

against any practice or structure functioning in any way which could restrict, misrepresent or limit it.

Article 29 of the same law establishes:

> "Article 29: The Superintendence shall be in charge of the vigilance and control of practices that may prevent or restrict free competition. It shall have among others, the following attributes:
>
> (.....) 3 - *Determine the existence or not of forbidden practices and behaviors*, and take the necessary measures to stop them or to impose the sanctions foreseen herein. (....)" (Italics by the Superintendence).

The Law, expressly granting the faculty to determine the existence or not of forbidden practices or restrictions on competition, to the Superintendence, at the same time grants it the character of technical body specifically in charge of performing investigations to determine when and where the behavior that affects the object protected and free competition, are being carried out.

Thus, the Law grants the Superintendence the technical concepts needed when competition is affected and grants it ample and sufficient powers to guarantee that said process is fast and efficient.

From the analysis of the mentioned articles we infer that the fundamental legislation of the privatization process, Privatization Law and the Law to Promote and Protect the Exercise of Free Competition coincide in considering that free competition represents not only a clear objective pursued by those processes but also that it must be protected from any situation or practice that in any way could lead to its restriction.

In this sense, the role of the Superintendence within privatization processes is extremely important since it is the technical entity legally empowered to support the decisions of the FIV as the executive arm of the process.

Economic Analysis

This analysis is based on the evaluation of privatization schemes of the aluminum-producing industrial complex under the point of view of integration or economic concentration, since they could lead to an increase of power of the market and consequently to restriction of free competition in the markets involved.

Within the group schemes we identify two types of integration or concentration: vertical and horizontal. Economic vertical integration refers to

the type of operations involving corporations that operate in markets where the predominance is supply - demand. Such is the case of the Bauxite Operator, Aluminum operator and the plant producing carbon anodes, (Carbonarca) and the reducers such as Alcasa and Venalum; and economic horizontal integration, where corporations object of the operation participate in the same market, as is the case of the two reducers, Alcasa and Venalum.

The consequences of vertical integration depend on the characteristics of the relevant markets involved since this is the effects on competition can be determined.

Thus, we are going to present the relevant markets identified based on the methodology used by the Superintendence.[20]

1 - Relevant market constituted by trihydrated bauxite or similar, that could be processed with the same technology, extracted by existing operators, within an international scope.

- Trihydrated bauxite is an indispensable and irreplaceable material for the production of alumina.
- The exploitation of bauxite is performed only under the concessions regime and the time for granting those concessions is fairly long.
- The alumina refinery imported in the recent past, bauxite from the mines of Trombetas, Chimery and Gove supplying up to 100% of the bauxite requirements of the operator.
- The alumina operator may obtain bauxite from those mines, with similar characteristics to the one extracted in Los Pijiguaos, at better prices.
- The country does not have any duties or tax regime forbidding the importation of bauxite.

2 - Relevant market constituted by alumina produced by existing plants within the international context.

- Alumina is used in the production of aluminum by the aluminum-reducing plants, and is an irreplaceable and indispensable material.
- The aluminum-producing process requires specific machinery and equipment, besides a high degree of expertise by the workers. Thus, it is not possible to expect that because there is an increase in prices there will

[20] The methodology followed by the Superintendence to determine relevant markets incorporates criteria presented in *General Guidelines of EvaIuation of Operations of Economic Concentration* (Caracas, May 1994) and later methodological revisions that have been incorporated as a result of the experience from case studies. Likewise, criteria present in the jurisprudence of other countries and the publication of the Bureau of Competition Policy of Canada: *Merger Enforcement Guidelines.* Information Bulletin N° 5, April 1991.

be new entries into the market through the reorientation of production lines of the present participants in the other markets.
- The installation of a new alumina-producing plant is subject to bauxite availability and requires a high level of investment. Thus it not possible to expect new entries in the market because of an increase in alumina prices.
- The price differential between internally produced alumina and the prices in foreign markets with more competitive costs, are small enough that a hypothetical increase in the internal prices of alumina could be annulled by the possibility of the entry of alumina coming from producers located in other geographical zones.

3 - Relevant market constituted by the carbon anodes produced in the country
- Carbon anodes require a specific process in order to be used in aluminum reduction, determining then that there are no products with similar characteristics that could be considered as substitutes.
- The only possibility of substitution by the anode consumers would be represented by their capacity, through internal production and baking, to satisfy their requirements of the product. However, none of the local reducers owns a carbon plant with enough production capacity and with production costs which are comparatively advantageous.
- The only possibility of a new anode producer coming into the market would be through the installation of a new “maquila” and baking furnaces.
- There are potential foreign suppliers, however transportation costs make importation very costly.

4 - Primary aluminum relevant market in an international context.
- The aluminum transformation industry can only process primary aluminum.
- There is an alternative market of recycled aluminum.
- The production assets used in aluminum manufacturing are specific for the process.
- Transportation costs are not very significant in relative terms.
- There are no government obstacles for the importation of aluminum.
- The imports of the metal may discipline the behavior of internal prices.

The relevant market was defined as the international primary aluminum market.

Effects of integrations

From the determination of the four relevant markets involved in the privatization process of aluminum producing corporations, we went to consider the possible existence of anticompetitive effects generated from the group of corporations.

l. Vertical integration between the bauxite operator and the alumina refinery does not generate restrictive effects on free competition in the markets involved.

This conclusion was reached, basically from the possibility that the international market, through imports and exports could discipline any price increase and/or any other restrictive practice on competition. Besides, there are no elements that could be classified as limiting free access to the alumina or bauxite markets.

2. The group between the bauxite/alumina - Aluminum reducers does not generate elements that could damage free competition. This is the result of the existence of international relevant markets for alumina as well as aluminum and the lack of entry barries in the markets. In these markets any deficiency in demand or offer of these products can be corrected through imports in the case of aluminum producers or exports for the alumina refiners. Thus, the international market shall discipline any anticompetitive behavior.

3. Vertical integration between the aluminum reducers and the carbon anodes producer (Carbonorca) does not generate anticompetitive effects. Although it is true that the integration between reducers and anode-producers generates elements that could be considered limiting to the entry of new participants in both relevant markets, since the only producer of anodes will be in the hands of the main consumers, it would limit the availability of the raw material to new entries. In the long term, the efficiency criteria indicate that the entry of new reducing plants would be made under the vertical integration scheme.

4. Horizontal integration between Alcasa and Venalum does not create or strengthen a dominant position in the relevant market of primary aluminum nor does it generate limitations to the entry or exit from the relevant market.

The participation of Alcasa and Venalum in international relevant markets permits that imports discipline any anticompetitive behavior of the concentrated Alcasa an Venalum. For this reason horizontal integration in this case does not generate a dominant position or favor the occurrence of collusive or oligopolistic practices.

It has been concluded that neither of the integration schemes that could be adopted could generate any situation catalogued as contrary to the Law to Promote and Protect the Exercise of Free Competition.

Some elements of the Political Economy of Privatization

A brief examination of the successful possibilities of implementing competition policies verifies that most costs occur in the political arena, basically interest groups that lose negotiation space before the Government and are submitted under frame laws more than particular regulations whose scope and content could be molded with bureaucracies. In this context the costs in that public arena are produced due to the character of *frame law* that has been pointed out.

However, there must be an awareness that the cost arising from bureaucracy is associated with the transverse character of competition policy[21], and as long as there is a persistence of sectors under special regulations, the privatizations processes and deregulations are connected with the consolidation of competition spaces that theoretically are recognized but imply a cost for those other sectors within bureaucracy.[22]

The Sale of the aluminum-producing industries has been a subject of great importance in public discussions in Venezuela, because representatives of the industrial sector of primary aluminum-processing oppose the terms under which the sale of these companies has been foreseen by the FIV.

In that respect, when the Superintendence presented its report, there were some reactions because of the arguments against incorporating clauses of preferential treatment in prices or supply obligations in the text of the sale contracts. This indication has been made because it is precisely the

[21] This focus was developed by Curiel, C. In her work *Design of an advocacy competition model in the context of implementation of Competition policies in Latin America*. Work published for the United Nations Conference about Trade and Development. October 1996.

[22] The criteria to identify implementation costs correspond to Grindle, M.L and Thomas, J. *Public choices and policy change: the political economy of reform in developing countries*. The John Hopkins University Press. Baltimore 1991. According to these actors, the initiative of a policy reform may alter or reverse at any stage of the cycle by the pressures and reactions of the opposition, thus the possibilities of success depend in large part on the reactions generated towards it. To evaluate those possible reactions, there are two scenarios of response to change of policies: the political arena and the arena within bureaucracy. In relation to this scenario, when trying to incorporate competition criteria and concepts in the sphere of special regulatory agencies a reaction not evident to the general public is generated which can create friction within the bureaucracy itself. Also in relation to this point, applied specifically to the case of privatizations, a revision of the work of Findlay, R "The new political economy: its explanatory power for LDCs".
Politics and Policy-making in Developing Countries. International Center for Economic growth. San Francisco, 1991.

international dimension of the geographical market of primary aluminum production the argument that supports the lack of anticompetitive effects in the horizontal integration of Alcasa and Venalum.

However, the lack of commercial or preferential protections for the national downstream industry implies establishment of international prices or close to international for the national industry, unable to compete under those conditions.

Later in that debate, other points of the privatization process were discussed by the national industrialists. This time, the discussions were centered on the conditions under which criteria for the requirements the industries must fulfill to prequalify was established.

On March 25, 1997, representatives of the Venezuelan Association of the Aluminum industry (AVIAL) presented a document to the Superintendence requesting the start of a sanctioning procedure against the privatizing agents of FIV and the Venezuelan Corporation of Guyana (CVG) for actions that contradict the Law to Promote and Protect the Exercise of Free Competition, establishing norms and conditions for the privatization process that create entry barriers to public bidding and hinder the possibility of Venezuelan industrialist to participate and compete under equal conditions with foreign companies in the privatization of the aluminum sector.

The general conditions for prequalification of companies with the right to participate in the privatization, object of the demand, were established in an ad published in the written media on July 28, 1996 publicly notifying the opening of a "Registry of Interested Parties". Likewise the Technical Committees for Privatization of the Aluminum Sector complemented the general conditions through a document identified as "Norms and Conditions of the Prequalification process".

In Resolution N° SPPLC/0009/-97 of May 15, 1997 the Superintendence denied the opening of that procedure against the privatizing entities that reads as follows:

From the previously stated, the Superintendence DECIDES:

1. That the opening of such procedures considered in the Law of Promotion and Protection for the Exercise of Free Competition does not proceed.

a) Against the Venezuelan Investment Fund (FIV) because it is not subject to the application of the Law for establishing conditions or requirements for prequalification in the privatization of the aluminum sector.
b) Against the Venezuelan Corporation of Guyana (CVG) because it is not yet subject to the application of the Law, since it does not execute the privatization process.

Thus there is no reason for the sanctioning procedure according to the established in article 32 of the Law to Promote and Protect the Free Exercise of Competition AND IT IS SO DECIDED.

2. That the FIV, upon establishing prequalification criteria for investors interested in the acquisition of the industrial complex producer of aluminum, would not be incurring in any violation of the Law to Promote and Protect the Free Exercise of Competition.

AND IT IS SO DECIDED.