

Lessons from Privatization

Andjelko S. Lojpur*, Yoji Koyama**

Introduction

After famous “Privatization mania” Central and Eastern European countries as well as Russia found themselves in the middle of much more complex situation than they had expected. It seemed that overcoming communism meant a huge problem for their economies. It turned out that their Governments had many possibilities to do things bad and much less strength to do things right.

Basic hypothesis of the transition process needed a long time to be checked. However, what made the privatization process interesting is not its easiness but its implications. Since the main goal and meanings of economic lives are reflected in the efforts to realize plans as much as possible, we can say that we have had enough time to learn a lesson about privatization.

We are aware that comparative evaluation of facts is always questionable. Here we would like to emphasize some of the main lessons that we learned about privatization. We are aware of the fact that, apart from the elements and arguments that we have learned, there are some other viewpoints that we cannot support.

* Andjelko Lojpur is Associate Professor at Faculty of Economics, University of Montenegro, J. Tomasevic 37, Podgorica, Montenegro. At the same time, he works as a consultant of the Agency of Government of Montenegro for Reconstruction of Economy and Foreign Investments. He has participated in preparation of legislation and methods of privatization process for many important Montenegrin companies. E-mail: andjelko@server1.cis.cg.ac.yu

**Yoji Koyama is currently engaged in the research project “Economic reconstruction, regional cooperation and stabilization of Southeastern Europe”. He is Professor of Russian and East European Economies at Faculty of Economics, Niigata University, Ikarashi, 2-8050, Niigata-shi, 950-2181, Japan. Tel: (+81)-25-262-6555; Fax (+81)-25-262-7665; E-mail: koyama@econ.niigata-u.ac.jp

1. Privatization represents natural basis for market economy

It is obvious that this lesson is not a new point of view concerning privatization. It is rather a lesson which makes braking through the "golden gate of socialism" much easier. If political authorities want to obtain peaceful cooperation among individuals, justice, which they must realize, cannot exist without the recognition of privatization. As John Lock wrote, if there is no ownership there is no justice, and this proposition is as clear as Euclid's theorem (Hayek, 1998, p. 44).

The importance of privatization process can be proved by different characteristics, such as: 1. Overloaded public sector, 2. Strict protection of domestic economy from international competition, 3. Price distinction, 4. High inflation rate deriving from the constant pressure on budget, 5. Unstable and unreal domestic currency exchange rate, 6. Macroeconomic instability, etc.

2. Organizers of privatization process must clearly define strategy and the main goal of privatization

At the beginning of privatization process in Czech Republic, its Prime Minister V. Klaus stressed that comprehension of its processes, goals and strategy were of crucial significance for success of privatization and the whole process of reforms. Main goals of privatization in individual countries in transition are quite similar and as a rule ambitious. Even a superficial analysis shows that they are mainly based on goals which M. Thatcher pointed out in early 1980s, such as: a) providing constant financial influx in budget, b) increasing level of efficiency, c) reducing the level of Government control of market economy, d) change and expansion of ownership structure, e) creating opportunities for competition, and f) development of domestic capital market.

The above-mentioned goals can be fulfilled only if privatization process is successful. However, privatization process is not always successful. Sometimes, it remains only among mentioned goals. This can be easily explained by too much ambition and too many goals, or poor implementation of strategy. In some countries where there were fierce political turbulence (such as Russia and FRYugoslavia) preferential treatment of the solution of ethnic problems and conflicts, have delayed the reform and diminished its effect as a whole.

3. In the first step of transition, privatization is a worthwhile political investment

Political aspect of privatization was emphasized in countries in transition. Therefore, transition of public property into private property was primarily a political goal. Privatization process itself was quite a new process, and consequently reformist politicians called it political investment. Judging from the aforementioned, privatization has assumed a character of "political fashion". This can be explained by the fact that it offers solutions for problems which are confronted not only by Governments of socialist countries but also by Governments of developed European countries and even conservative countries. Therefore, one of the most important characteristics of economic policies in Western European countries in 1980s was privatization. The most important among others is the so-called "demonstration effect", which the privatization program in Great Britain had on its European neighbors. After that, (re) privatization processes have become a part of generally accepted development philosophies of the countries, which aimed to important goals, such as: development, growth, stability, adaptability to needs of market, etc. (Stojanovic, 1992, p. 39).

4. Reforms cannot be carried out without democracy

Democracy and new political spirit have dissolved socialism in the best way. Since it is a complex and all-embracing turnaround of the of the whole society, means of transformation must be as important and potent as democracy itself. It is well known that democratic progress represents a necessary guarantee for radical reforms. In this connection, already in the initial phase of the transition the both advocates and opponents of transition process agreed that there would be no room for dispute about the two main goals of reform: market economy and parliamentary democracy (Babic, 1996, p 71). Democratization is not less important than stabilization of society if stable society can not exist without democracy. Experience shows (Romania, Bulgaria, FRY, etc.) that only on this basis it becomes possible to carry out radical changes, avoid retreats and satisfy newly-emerged ambition and taste. More democracy (political justice and civil rights, transparency of market and free market economy) usually means less corruption (for example, Slovenia, Estonia, Hungary, Czech Republic, etc.).

However, free market and democracy sometimes lead to business cycles, crisis and various kind of inefficiency. Market economy might probably lead to corporatism where

a rich minority rules, while democracy might lead to more inequality. There remains a question if those two processes will merge into one, which would make some kind of democratic corporatism. That might be a kind of “substitute” for betrayed hope in socialism.

5. Transition crisis is a normal side effect of privatization

Concerning the main goal of privatization, it is necessary to eliminate an important confusion that has been present for a long time and may have long-term negative consequences. Namely, the main goal of privatization is not and cannot be an increase in efficiency of all companies that perform in the market. The main goal is to increase the efficiency of the most important companies, which would improve the level of efficiency and effectiveness of the economy as a whole. It means something that Schumpeter has defined as “creative destruction” of economy. It has been proved that many companies would not expect an occasion where they would be privatized, and that some of them would not survive the process of privatization nor any “rescuer” would salvage them (Triska, 1977, p. 29). Since earlier experiences are well known, the problem of transitional crisis deserves elucidation taking into consideration the following aspects: 1. Institutional vacuum; 2. Losing capital of the company; 3. Spontaneous privatization; and 4. Survival of companies called “value thieves”.

In the first phase of privatization process, there used to be sometimes a situation of the so-called “privatization agony” in which former state or social companies hesitate to decide a choice either bankruptcy or spontaneous privatization by the existing management structure of the company. Furthermore, the management is not stimulated to connect its interests with the long-term perspective of the company, nor stimulated to use their time and efforts for reconstruction of the company. Therefore, the most probable logical consequence of that behavior is paralysis of decision making process. In public companies, the existing management and workers have a very strong motive to “decapitalize” the company where they work. In other words, they are motivated to draw as much wealth as possible from the company for themselves. They have a little or almost no motive to increase the value of the company by investments, productivity increase, and restriction of salaries and employment. Because they have premonition that there is little chance left for them to take part in prosperity of the company. At the same time, a majority of managers does not want to decrease supplementary benefit because they are afraid of losing sympathy of workers who elected them. “Spontaneous privatization” represents an extreme

example. It means that managers in countries in transition, encouraged by laws which have given them new power, have literally usurped companies from the country. Furthermore, they have "borrowed" as much and long as possible. One can easily conclude that spontaneous privatization leads to corruption. In the course of privatization public property was usurped by politicians or managers.

Another phenomenon called "value thieves" companies has further complicated the privatization process and made crisis more serious in the transition period. Namely, many companies in the countries of Eastern Europe have performed in a way that cost of input was higher than value of output. Such a behavior was possible only in a special mechanism in which, for example, thanks to low costs of oil and gas many Soviet companies used to sell their products not only in the Soviet Union but also in other Eastern European countries. After such a special mechanism has disappeared, even if the companies cut salaries and number of employees they can not gain profit.

6. Successful reform needs a State with market economy

It becomes necessary to open a dialogue on the subject between State and market. Of course, the ruling group, who came to power owing to victorious "revolution", has at their disposal various mechanisms to maintain the arrangement for a long time. We can make a conclusion: after collapse of the "self-managed State", salvation should be sought in a "State with market economy". However, market economy does not mean completely autonomous performance of economic subjects¹. Market is not self-determined regulator of economic life. At this point, we would like to point out Professor Bajec's observation concerning the role of State in transition process. Namely, both liberal and State-controlled concepts of privatization strategy demand a "strong State" (Bajec, 1996, p. 264).

In connection with the role of State and Government it is necessary to warn that there are some theses completely opposite to neo-liberal understanding of economy. One of those theses is that the role of Government especially in post-communist period should be increased. G. Kolodko² stresses, "One Government can be successful or not, but it cannot

¹ In order to understand our economic reality, it is important to point out opinions of two famous authors. In 50's P. Drucker warned that "markets are not given from heaven, nor they are self-made economic entities". P.A. Samuelson says that "Market is not a system of chaos and anarchy; it is regular and complete system. It should successfully work."

² Prime Minister Deputy of Poland and Minister of Finance from 1994-1997.

stand apart from economy". Focusing on mistakes made due to wrong management of transition process in post-communist countries and consequences of bad management of crisis in some countries of East Asia, he concludes with following message: "Market makes more mistakes than State". At the same time, it turned out that too much control of many countries in the process of transition became a fine basis for the spread of corruption.

7. Economic structure is not the same at the beginning and the end of transition process.

From this point of view, privatization strategy, as a rule, means important changes in the old economic structure. Without those changes in the structure of national economy, privatization and restructuring would not be necessary, because companies behaved "optimally" in the framework of centrally planned economy. Therefore, the situation at the beginning of privatization process will not be the same as that at the end of the process. The new situation is to be objectively formed, often regardless of the intention of organizers of privatization process.

As for economic structure, we have to take into account that a main role in the future economic growth will be played no longer by privatized former public companies, but by newly-created private companies. Emergence and advancement of private sector have many advantages such as additional private investment, savings, innovations, a wider scope of supply of goods and services, an increase in productivity and competitiveness, etc.

If the above mentioned demands are not fulfilled in time, "introduction" of privatization in the existing economic structure will remind us of a patient with a wrongly treated bone fracture. Reformers face the following dilemma: either break the bone again and then treat it in a proper way, which is quite painful experience, or leave it as it is and try to teach a patient how to walk with an almost fractured bone, which is quite impossible to do.

8. The most important thing is to find the best (suitable) method of privatization

However, experience shows that ideal method of privatization does not exist. Every company has its specific elements, and every country has its unique economic structure, culture, tradition, etc. Therefore, privatization is implemented, taking into consideration

all unique elements and specific limitations.

Analyzed privatization programs include many different methods and variants. Having in mind the above-mentioned lessons, privatization of big state and social companies can be carried out by adoption of one of or a combination of the following methods :

- Public stock offer ;
- Selling stock to individuals or companies ;
- Free distribution of stock to employees ;
- Free distribution of stock (vouchers) to citizens ;
- Free distribution of stock to institutions ;
- Compensation to former owners (restitution) ;
- Management buy-out and other forms of privatization.

9. Privatization process should be fair

Request to follow the principle of fairness is connected with a possibility of promotion of the privatization process. However, while its influence was expressed in terms of speed, it has much smaller impact on the final result of the privatization process as a whole, including privatization by distribution of vouchers.

Already after the first step of the privatization process, it became obvious that a social stratification should be inevitable. In the privatization process it should be "decided" who would become richer and who would live a painstaking life.

However, fair privatization is not always understood in a proper way. J. Kornai stressed in his book that it would be extremely stupid to enable whomever, regardless of managers or ordinary workers, to become shareholders at a small expenses (Kornai, 1992). This idea is connected with a presupposition that social wealth should be distributed among all citizens on the basis of civil rights. Kornai says, "The point is not in distribution of property, but to hand over it to hands of really better owner. The precondition for it is the expansion and strengthening of true entrepreneurship". We do not know if Kornai, at the moment of writing this book, had in mind distribution of vouchers, but it is obvious that the author does not support free distribution of property if the principle is misused for political purpose. Therefore, the proclaimed fairness assures citizens support to privatization process, but it is obvious that this is not exactly what citizens expected concerning the above mentioned historically proven consequences.

10. Privatization speed is in proportion with the complexity of the process

There is no ideal variant in a choice of the speed of privatization, and consequently the problem which should be adopted, fast privatization ("big bangers") or slow privatization (gradualist) is reduced to a choice of the "optimal" speed of privatization (Babic, 1996, p. 70; Lojpur, 1999, pp. 84-88). Experience so far shows that gradualists are correct when they say that fast privatization is a highly risky, but they are not correct when they say that slower privatization is less risky. We should conclude with an advice that do not waste time, but do not go too fast if you want things to go in the right direction.

"Step-by-step" concept, which pays more attention to specific characteristics of every economy, turned out to be more acceptable than the often one-sided argument for installation of capitalism by order of the State. As its good example we can mention the case of Slovenia, where in an almost whole process of transition competed each other two opposing concepts: "shock" therapy vs. gradual approach. This process is known as the most successful in Eastern Europe (Mencinger, 1997, p. 26). There was a compromise encompassing features of the both methods of privatization: a predominantly distributed voucher privatization from the first, and decentralized and gradual approach from the second³.

Finally, privatization speed is connected with phenomenon of corruption. In some countries, where fast privatization was carried out quickly and successfully and the State and political managers team was dismantled, the spread of corruption has been prevented. In other countries, where such a reform was non-existent, privatization has transformed itself from medicine into another very serious cause of illness for an already ill society.

11. Mass-voucher-privatization (MVP) is a mental experiment created by socialists

MVP is based on the principle of fairness in the process of distribution of wealth and possibility of participation of the widest strata of citizen in the process. Experience so far shows that MVP resulted in an insufficient or a low level of success. Because this method cannot guarantee new capital, business administration, necessary skills and inflow of funds. Since the beginning of privatization process countries in transition, including for example Russia, has been facing the following problems: (1) in partly privatized companies there still remains state capital together with private capital; (2) a considerable part of economy,

³ For Slovene experience see Koyama (2001a).

which forms infrastructure sector (transport, energy, telecommunication), has not and could not been privatized by this method ; (3) financial sector (banks and insurance companies) has remained completely out of the transition process, etc.

Finally, no matter how MVP sounds simple and attractive, experience shows that it is one of the most controversial methods of privatization in countries in transition. Even if MVP is technically successful, its consequences will not show any fruits for a month or maybe a few years. Some of its consequences are : bankruptcy, closing of factories, lost employments etc. It should also be mentioned that politicians like this method very much because it makes them closer to all citizens and gives them opportunity to avoid responsibility.

12. There is a very close connection between privatization and corruption

We can rephrase this thesis into another expression, for example : Corruption grows during the process of privatization. Anyway, after almost ten years of experience in countries in transition, few people will be surprised by the conclusion that privatization and corruption are closely connected. When this phenomenon becomes a subject of discussion, it can be often heard that, thanks to a "good-friend-method", corruption has reached an endemic level in countries in transition. New businessmen are considered clever and successful, but not so "moral". If the next step, which lead to creation of a new system, is identified with a rotten egg in citizen's consciousness, it will undermine stability and credibility of the transition process.

Advocates of transition believe that burden of transition can not be equally shared and that social stratification of citizen is inevitable. In parallel with the evolution of transition process the social inequality is growing, and in some countries (for example, Russia) it is threatening to force a great number of people out of their existence. It is a remnant of the former "nomenklatura" that has first succeeded in sneaking into the "institutional vacuum" immediately at the beginning of the transition. There are various speculators who took part in illegal outflow of the state property into hands of a small number of people. The so-called "spontaneous privatization" inevitably leads as a consequence to social stratification, increase in poverty, and growing inequality in distribution of national income. However, in spite of a high level of positive correlation between privatization and corruption, it would be wrong to say that corruption spreads due to or exclusively due to privatization.

Unreliable public institutions, ill-functioning legal system, non-existing civil society in

many countries in transition (for example, Uzbekistan, FRY, Byelorussia, Bosnia and Herzegovina, Azerbaijan, etc.) remain to be origins of corruption. Fee paid to officials for a "well-done business" is very high (sometimes it reaches 4% of the company's incomes). In contrast to this case, however, experience shows that Poland, Slovenia, Czech Republic and Lithuania have the lowest rate of corruption.

13. Privatization process should be carried out before economic restructuring

Since public companies are obsolete, inefficient and have surplus of labor, they need complete restructuring. Experience shows that it would be better to entrust new owners to make this decision than to let other persons do. In countries in transition a majority of public companies needs complete restructuring. However, this raises questions about availability of resources and justifiability of their participation in the restructuring prior to the privatization process. Besides, the dilemma-privatization first or restructuring first-can not be solved if restructuring cost is not taken into consideration. It is also necessary to take into consideration "post-privatization process", especially the so-called secondary reconstruction of ownership.

14. Transparency of privatization is necessary in order to convince citizens that the process is fair.⁴

Transparency means that citizens have access to all necessary information about the privatization process. In other words, it means that all potential investors have access to the same information about privatization process and the way of its realization. One of the most important reasons why most of Governments assure transparency of privatization process is to get public support for their program. Full transparency is not easy to achieve. Because various social interest groups live in different ways, and for most of Governments it remains only their wish. This can be explained by the fact that transparency is not connected with individual privatization methods and techniques. The lack of transparency is sometimes ascribed to the fact that people do not understand methods and practices of the privatization. At the same time, opposition parties also complain that there are no

⁴ See : Building Transparency into the Privatization Process, by Adam Smith Institute, Economic Reform Today, 1/1998.

access and inspection concerning the operation of privatization funds. Low level of transparency might arouse a suspicion about individual transactions, and it might open a space for political conflicts in Parliament and criticism, and thereby create an atmosphere which would discourage investors. All these might endanger the normal privatization process.

15. The final lesson : find appropriate method of development

After one decade of different experience, we can conclude that transition means "forced" reform. Privatization as the essence of reform, from legal or historical aspect, represents one stage of evolution. Regarding everything that has been promised and done in most countries in transition, it is obvious that privatization process is still far from its perfect end. Namely, with the exception of Slovenia, slightly Hungary, Czech Republic and, maybe, Poland, countries in transition have not properly carried out privatization process. Nevertheless, "satisfaction" scale is less important for this analysis. Lessons are more important for finalization of privatization practice. They can be of special importance in countries where privatization has not justified their historical mission yet.

Perhaps, for organizers of privatization process we can recommend the following message as synthetic lessons: Governments should resolutely carry out privatization. At the same time, every country should be regarded as a specific entity, which needs its own development pattern. However, specific characteristics and a request for finding its "original" way should not be an alibi for unrealistic prolongation of privatization process, wandering, etc. That would increase the cost of transition. Partial reform, which could lead to neither stabilization of economy and social trends, nor long-term positive effects, would simply satisfy the leading political structure. This has happened exactly in Serbia and Montenegro⁵. It would lead to negative consequences unless they decide to properly carry out their reforms.

Literature :

- Anderson, E.R (1994) Voucher Funds in The Transition Economies ; the Czech and Slovak Examples, Investment Funds as Intermediaries of Privatization, CEEP, Ljubljana.
- Babic, B (1996) *Way to Transition*, Prometej, Beograd.
- Bajec, J (1998) Economic Role of Country in Transition and Public Election Problems in New

⁵ For FR Yugoslavia see Koyama (2001b).

- Democracies, *Economic Review*, Beograd, July-September, 1998.
- Berg, A. and Berg, E (1997) Methods of Privatization, *Journal of International Affairs*, School of International and Public Affairs, Columbia University, vol 50/No. winter 1997.
- Csaki, G. and Macher, A (1998) The Ten Years of Hungarian Privatization, Budapest, June, 1998.
- Hayek, F (1998) The Fatal Conceit, The Errors of Socialism, CID, Podgorica.
- Jezek, T.: The Czechoslovak Experience with Privatization, *Journal of International Affairs*, School of International and Public Affairs, Columbia University, vol 50/No.
- Kolodko, G (1998) Irrelevancy of Economical Neo-liberalism, *Transition*, No 9, June 1998, translated in magazine: *Ekonomika*, Beograd, br.11-12: 1998.
- Kornai, J (1992) *Way to Free Economy*, Institute of Economics, Beograd.
- Koyama, Y (2001a) Economic Restructuring and Thorough Internationalization in Slovenia: A Small Country's Strategy for Survival and Development, *Working Paper* No.29, Faculty of Economics, Niigata University.
- Koyama, Y (2001b) The Transition to a Market Economy in the Successor Countries of the Former Yugoslavia: Comparison between the Northern Republics and Southern Republics, *Abstract of the VI ICCEES World Congress*, Tampere, 2000, pp. 228-229: The full paper appeared in the *Journal of Economics of Niigata University*, No. 70, 2001, pp. 15-54
- Lojpur A. and Dragasevic M., Jankovic B (1999) Understanding Privatization, *Official Gazette of the Republic of Montenegro*, Podgorica.
- Mencinger J (1997) Privatization in Slovenia: Self-management Continuation, *Business Policy*, Beograd, novembar, 1997.
- Pirie M (1998) Policymaking and Privatization: Ten Lessons from Experience, *Economic Reform Today*, 1/1998.
- Stojanovic I. et. al. (1992) *Comparative Policies of Economy*, Ekonomika, Beograd.
- Triska D (1997) Privatization, Reconstruction of ownership and Competition, Case Study: Czech Republic, *Business Policy*, Beograd, November, 1997.
- Wright V (1994) *Privatization in Western Europe, Pressures, Problems and Paradoxes*; Pinter Publishers, London.

[要 旨]

民営化の教訓

アンジェルコ・ロイプール, 小山 洋司

中東欧諸国ならびにロシアでは民営化が実施された。民営化過程の組織者としての政府はその戦略と主要な目標を明確に定義しなければならない。民営化の主要な目標は、市場で活動するすべての企業の効率性を向上させることではない。それは不可能だ。主要な目標は、その国の経済の効率性と有効性を高めるような最も重要な企業の効率を高めることであり、シュンペーターの言う「創造的破壊」と関連している。経済成長の主要な担い手は、民営化されたかつての公企業ではなく、新たに創設される民間企業であろう。私的セクターの出現と躍進により、移行過程の最後には、経済構造は変革されている。

民営化の理想的な方法は存在しない。どの企業も特殊であり、どの国にも独特な経済構造や文化、伝統、等があるので、実際には多くの特殊な制約を尊重しながら、民営化は実施される。さまざまな方法のうち、一つ、もしくはいくつかの組み合わせが採用される。

民営化の過程は公正でなければならない。だが、公正さはしばしば誤解される。公正さの原則により、ディレクターであれ、普通の労働者であれ、誰もが安く株主になれるとしたら、馬鹿げたことだ。コルナイも述べているように、「大事なことは、財産を分配することにあるのではなく、それをよりよい所有者の手に渡すことである。そのための前提条件は、本物の民間の企業家的イニシアティブを拡大し、強めることである」。

民営化の速度の選択（「ショック療法」対「漸進的民営化」）では、理想的なヴァリエントは存在しない。大衆的なバウチャー民営化は、富の分配過程における公正の原則に基づいているが、これまでの経験では、十分成功したとは言えない。この方法は、新たな資本、経営管理、必要な技術および資金の流入を保証できないからだ。

移行諸国の10年間の経験は、民営化と汚職とは密接に関連しているを示している。「制度的真空」にこっそり忍び込むのに成功したのは、かつての「ノメンクラトゥーラ」の残りであった。「自発的民営化」により、彼らは、少数者の手中への国家の財産の流出に関与した。だが、もっぱら民営化のせいで汚職が増大したと言うとしたら、間違いであろう。公共機関が信頼できず、司法制度がきちんと機能せず、市民社会が構築されない多くの移行諸国では、民営化は依然として汚職の源泉である。他方、ポーランド、スロヴェニア、ハンガリー、チェコ、およびリトアニアでは腐敗度は低い。民営化の過程の透明性を確保することは、大衆の支持を得るために必要である。

総合的教訓として次のようなことが言える。政府は断固として民営化を実施しなければならない。同時に、どの国にも特殊な問題があり、固有の発展パターンを見出す必要がある。だが、このことは、民営化の引き延ばしの口実にされるべきではない。